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Emerging ESG-Driven Models of Shareholder Collaborative Engagement

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Peter O. Mülbert
University of Mainz and ECGI
Alexander Sajnovits
University of Mainz

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Abstract

The received view of shareholder engagement from a micro perspective holds that the difficulties of collective action and the resultant rational apathy on the part of shareholders discourage effective (collaborative) engagement. In theory, recent fundamental transitions in ownership structures - in particular, the increasing concentration of investment capital within active and passive funds - should not alter shareholders' rational incentives to remain passive, particularly because funds compete with each other in offering the lowest fees, and any engagement at the level of a single portfolio company entails increased costs. Free rider problems also contribute to shareholder passivity. In practice, however, shareholder involvement has increased in recent years in spite of these disincentives. This development is attributed to four main factors: (i) the "Big Three" of the investment fund industry are often too big to remain passive, (ii) institutional investors increasingly use proxy advisors, (iii) political pressure and stewardship considerations spur on proactive shareholder involvement, and (iv) institutional investors, in particular hedge funds, collaborate with each other ("wolf pack" activism) or institutional investors follow the lead of activist hedge funds. The emergence of ESG investing has the potential to be a game changer. Increasing demand for ESG-compliant investments from millennials, the potential reduction of systemic risk across portfolios, and the opportunities for higher fees - at least during the transition period - constitute incentives for (formerly passive) institutional investors to adopt an active engagement approach, in particular by way of collaboration. We look at new forms of collaboration which are currently emerging: (i) among the Big Three, (ii) between hedge and impact funds (wolf pack activism?), (iii) between nonactivist institutional investors and (iv) on new institutionalized platforms (Climate Action 100+; PRI). We explore potential legal risks associated with and obstacles to these (new) forms of collaboration (acting in concert, insider trading rules, antitrust law) and suggest ways of bolstering opportunities for future collaboration.

Keywords: ESG, shareholder engagement, collaborative engagement, collective action, institutional investors, stewardship, environmental social governance

Peter O. Mülbert
University of Mainz and ECGI

Alexander Sajnovits
University of Mainz

Emerging ESG-Driven Models of Shareholder Collaborative Engagement

– Increased Involvement of Activist Investors; Reliance on Coordinating Entities to Facilitate Collaborative Endeavours; Building Coalitions around ESG-Oriented Initiatives –

Peter O. Mülbert[*] and *Alexander Sajnovits*[**]

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[*] Prof. Dr. iur., Chair of Private Law, Commercial and Business Law, Banking Law, Faculty of Law and Economics and Director of the Center for German and International Law of Financial Services, University of Mainz, Germany.

[**] Dr. iur., M.Sc. (Oxford), Assistant Professor and Post-Doctoral Fellow (*Akademischer Rat* and *Habilitand*), Chair of Private Law, Commercial and Business Law, Banking Law, Faculty of Law and Economics, University of Mainz, Germany.

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least during the transition period – constitute incentives for (formerly passive) institutional investors to adopt an active engagement approach, in particular by way of collaboration. We look at new forms of collaboration which are currently emerging: (i) among the Big Three, (ii) between hedge and impact funds (wolf pack activism?), (iii) between non-activist institutional investors and (iv) on new institutionalized platforms (Climate Action 100+; PRI). We explore potential legal risks associated with and obstacles to these (new) forms of collaboration (acting in concert, insider trading rules, antitrust law) and suggest ways of bolstering opportunities for future collaboration.

I. Introduction

The received view of shareholder engagement from a micro perspective holds that the difficulties of collective action and the resultant rational apathy on the part of shareholders discourage effective (collaborative) engagement. In theory, recent fundamental transitions in ownership structures – in particular, the increasing concentration of investment capital within active and passive funds – should not alter shareholders' rational incentives to remain passive, particularly because funds compete with each other in offering the lowest fees, and any engagement at the level of a single portfolio company brings with it increased costs. Free rider problems also contribute to shareholder passivity.

In practice, however, shareholder involvement has increased in recent years in spite of these disincentives. This development is traditionally attributed to four main factors: (i) the "Big Three" of the investment fund industry are often too big to remain passive, (ii) institutional investors increasingly use proxy advisors, (iii) political pressure and stewardship considerations spur on proactive shareholder involvement, and (iv) institutional investors, in particular hedge funds, collaborate with each other ("wolf pack" activism) or institutional investors follow the lead of activist hedge funds.

In this paper, we further explore collaborative shareholder engagement as a way of overcoming collective action problems and high engagement costs. Considering the disincentives for shareholder engagement, collaboration between shareholders indeed is, on a theoretical level, a way to overcome, or at least mitigate, some of these disincentives. This is because: (i) voting rights and the associated informal influence can be bundled through collaborative interaction, (ii) collaboration may mitigate the free rider problem, (iii) collaboration can reduce information costs by sharing resources, skills, and expertise among collaborators, and (iv) collaboration contributes to risk sharing among the participants in the collaboration.

Collaboration is defined by the Oxford Dictionary as "the act of working with another person or group of people to create or produce something". In this article, we also

understand collaboration as an active form of cooperation between various people/institutions. Therefore, we distinguish collaborative behaviour from mere (coincidentally) simultaneous behaviour as well as from imitative behaviour without active cooperation or any kind of consultation between the parties. The intensity of the collaboration, i.e., whether it is formalized, institutionalized, or merely informal, however, is immaterial, which is why we also analyse informal, non-binding exchanges of information between persons, or non-binding participation in certain platforms, are also the subject of our analysis.[1]

Given that we are concerned with collaborative engagement pertaining to listed public companies, we focus on collaboration among institutional investors. Institutional investors are not only theoretically best placed to overcome the obstacles to effective collaboration, but this way of collaborative engagement between institutional investors is also increasingly common in practice.[2] In this regard, the focus has traditionally been on wolf packs, as well as on the interaction of large, diversified funds and/or their owners, with hedge funds. Since collaborative ES(G) engagement is becoming increasingly important, it will be a particular focus of our paper.[3] Section II. gives an overview of ownership structures in several jurisdictions (II.1.), which are of considerable importance for the prospects of collaborative engagement, and the main actors in shareholder collaborative engagement (II.2.). Section III. expands on the traditional micro picture of shareholder collaborative engagement. Here, we evaluate the (dis-)incentives for shareholder engagement in general (III.1.), describe the reasons traditionally put forward for why shareholder engagement still takes place despite these disincentives (III.2.), and take a closer look at collaborative engagement in particular (III.3.). In Section IV., we introduce the nascent ES(G)-era as a potential game changer with regard to shareholder collaborative engagement, and raise the question of whether increasing interest in E and S issues, in particular, might serve as an additional incentive to institutional investors to collaborate. Section V. presents several forms and strategies of collaboration that were already present in past decades – wolf packs and coalitions between non-activist investors and hedge fonds in particular – and new ES(G)-driven approaches. Section VI. discusses potential legal

[1] Cf. *Dimson/Karakas/Li*, The Review of Financial Studies 28 (2015), 3225, 3231 (distinguish between hard and soft forms of collaboration). For a different view, see *Fisch/Sepe*, Texas Law Review 98 (2020), 863, 865 with fn. 7 (excluding mere exchanges of information).
[2] See V.1. below.
[3] See V.2. below. This article does not deal with the collaborative engagement of retail investors, which has have higher obstacles to overcome, although new forms of coordination have come into focus, collectively labelled as “swarm trading”, which, while it may well bring about influential activism in the future, is currently still in its infancy. See *Sajnovits*, in Köhler/Korch, Schwärme im Recht, 2022 (forthcoming); *Fisch*, GameStop and the Reemergence of the Retail Investor, ECGI Law Working Paper No. 637/2022, p. 36 (to be published in Boston University Law Review 102 (2022)), available at <https://papers.ssrn.com/sol3/papers.cfm?abstract_id=4049896>.

barriers to collaboration. The article concludes with a brief outlook as to what the future may hold in this regard (VII.).

II. Ownership Structure of and Primary Actors in Shareholder Collaborative Engagement

1. Ownership structure

Collaborative engagement by institutional investors is particularly facilitated by profound changes in the ownership structures of publicly traded corporations in numerous jurisdictions. While the "Berle-Means corporation", with its widely dispersed shareholders, has long been the paradigm of U.S. corporate law.[4] The U.S. has experienced an increasing concentration of share ownership among institutional investors since the 1980s at the latest[5], a development that began much earlier in the UK.[6] Conversely, the concentrated ownership structures of numerous continental European countries have been broken up in recent decades, and institutional investors have increasingly gained in importance in these countries.[7] As a consequence, institutional shareholdings are now the dominant form of equity ownership worldwide; according to OECD calculations, institutional investors currently hold approximately 43% of the global market capitalization of listed stock corporations.[8]

Nevertheless, significant differences remain, which also have a considerable impact on the importance and market power of institutional investors, as well as the prospects for collaborative engagement on the part of the latter.[9] In the U.S. for example, institutional investors are by far the most important investor group, owning at least 68% of all listed stock corporations.[10] This dominance does not exist in other markets. For example, while the share of listed stock corporations held by institutional investors in the UK is still high at 60%, it is already significantly lower in other European and in Asian countries, namely 36% in Denmark; 35% in Belgium; 31% in Finland; 30% in Germany and in Japan; 29% in Italy; 27% in France; and as low as 16% in Greece and 11% in China.[11] In addition to the actual shareholdings of institutional investors in listed companies, the degree of ownership concentration is of particular relevance as regards the potential influence of, and, thus, also the effectiveness of, any collaborative

[4] *Christie*, University of California Davis Law Review 55 (2021), 875, 898.
[5] *Rock*, in: Gordon/Ringe, Oxford Handbook of Corporate Law and Governance, 2017, p. 363; *Christie*, University of California Davis Law Review 55 (2021), 875, 898; *Cheffins/Armour*, Journal of Corporation Law 37 (2011), 51, 87.
[6] See already *Davies*, Brooklyn Law Review 57 (1991), 129.
[7] *Gillan/Starks*, Journal of Applied Finance Fall/Winter 2003, 4; *Barca/Becht* (ed.), The Control of Corporate Europe, 2001.
[8] OECD, Corporate Governance Factbook 2021, 2021, p. 21.
[9] Cf. *Bowley/Hill*, Stewardship and Collective Action: The Australian Experience, ECGI Law Working Paper No. 491/2020, p. 4.
[10] OECD, Corporate Governance Factbook 2021, 2021, p. 21.
[11] OECD, Corporate Governance Factbook 2021, 2021, p. 21.

engagement among such investors. In Germany, for example, the three largest shareholders together hold more than 50% of the shares in 59% of all listed companies; in Italy, this can be said of 69% of all listed companies.[12] Nevertheless, particularly in the case of large stock corporations (blue chips), ownership structures have become much more open in recent years/decades, with institutional investors playing a dominant role even in markets which are still generally characterized by a high degree of ownership concentration, such as in Germany[13] or Italy. For example, institutional investors held 68.1% of the DAX30 (now DAX40) companies in 2020,[14] and were also the major shareholders of 41% of the companies listed on the FTSE MIB.[15]

2. The main actors

When considering the collaborative engagement of institutional investors, it is important to identify the main actors for whom collaborative engagement is a feasible option, at least in theory; their – quite different – incentives and disincentives to engage are considered in the next section (III.1.). Here, we distinguish between traditional actors (II.3.a)), such as owners and managers of active and passive diversified funds, value hedge funds, and investor associations and initiatives, on the one hand, and actors specializing specifically in ES(G)-driven engagement, on the other (II.3.b)). The latter category includes, in addition to owners and managers of diversified funds, so-called impact funds, i.e., hedge funds specializing in ESG-driven investment, and emerging platform operators and intermediaries.

a) Traditional actors

(i) Owners and managers of diversified funds: Traditional players in the collaborative shareholder engagement game are the owners and the managers of broadly diversified passive and active funds (in particular, mutual funds and pension funds in the US and UCITS funds in the EU), and more recently, some large family offices.

Passive funds, in particular so-called *index funds*, have massively gained in importance in recent years[16], at least in a number of important markets such as the US and the UK.[17] The investment strategy of an index fund is to replicate a specific index/benchmark. The composition of the fund – i.e., the selection of the individual

[12] OECD, Corporate Governance Factbook 2021, 2021, p. 21.
[13] *Ringe*, European Business Organization Law Review 22 (2021), 87, 96.
[14] HIS Markit, Who owns the German DAX?, 8th ed. 2021, available at: https://www.dirk.org/wp-content/uploads/2021/06/DAX-Study-2020-Investoren-der-Deutschland-AG-8_0.pdf.
[15] https://www.consob.it/documents/46180/46181/rcg2020.pdf/023c1d9b-ac8b-49a8-b650-3a4ca2aca53a.
[16] *Barzuza/Curtis/Webber*, Southern California Law Review 93 (2020), 1243,1253; *Enriques/Romano*, University of Illinois Law Review 2019, 223, 234.
[17] *Christie*, University of California Davis Law Review 55 (2021), 875, 888; *Enriques/Romano*, Rewriting Corporate Law for an Interconnected World, ECGI Law Working paper No. 572/2021, p. 2. The situation is different in Italy, for example, where passive funds account for a share of just 0.05%. In Germany, too, the share is still only 11%, although significant growth is being observed here.

stock corporations, as well as their share in the total invested assets – is solely influenced by the composition and weighting of the companies represented in the index in question. Active stock picking by the fund manager does not occur. The fund can only dispose of individual stocks if their weighting in the index changes or the stock is removed from the index. This means that such funds, specifically ar institutional owners or their managers, cannot actively make an exit decision.[18] A feature of the market for passive funds which is of particular interest is the fact that it is dominated by the so-called Big Three – BlackRock, Vanguard and State Street –, at least as far as index funds are concerned.[19] These three institutional investors manage approximately 80% of the assets invested in index funds and together hold approximately 25% of the shares of all S&P 500 companies.[20]

Active diversified funds, on the other hand, are generally active in stock picking, albeit to a completely different extent than hedge funds due to their broad diversification requirements (e.g. Art. 52 of the UCITS-Directive). Active funds can, at least in theory, actively make an exit decision at the outset if they are not satisfied with the performance or diversification effect of individual portfolio companies. The Big Three also play a significant role in this market.[21]

(ii) Value hedge funds: The hedge funds we refer to here as value hedge funds – that is, hedge funds whose main objective is to increase shareholder value, whether in the short, medium, or long term –[22] are key figures in traditional shareholder (collaborative) engagement/activism.[23] Hedge funds are much less diversified, and retail investors typically cannot invest in them; as a result, hedge funds are subject to significantly less stringent regulation than mutual funds or UCITS funds in both the US and the EU.

(iv) Investor associations and initiatives: Another group of traditional actors enabling shareholder collaboration and collaborative engagement are investor associations and initiatives.[24] The Council of Institutional Investors or the Investor Stewardship Group in the US, the Institutional Investors' Forum in the UK, Assogestioni in Italy, and the Bund Institutioneller Investoren in Germany, come to mind here.

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[18] Cf. *Christie*, University of California Davis Law Review 55 (2021), 875, 902.
[19] *Bebchuk/Hirst*, Columbia Law Review 119 (2019), 2029, 2033; *Christie*, University of California Davis Law Review 55 (2021), 875, 878.
[20] *Christie*, University of California Davis Law Review 55 (2021), 875, 879; *Barzuza/Curtis/Webber*, Southern California Law Review 93 (2020), 1243, 1246; *Bebchuk/Hirst*, Columbia Law Review 119 (2019), 2029, 2033.
[21] *Coates*, The Future of Corporate Governance Part I: The Problem of the Twelve, Harvard Law School Discussion Paper No. 1001, 2019, available at: http://www.law.harvard.edu/programs/olin_center/papers/pdf/Coates_1001.pdf.
[22] Cf. *Barko/Cremers/Renneboog*, Shareholder Engagement on Environmental, Social, and Governance Performance, ECGI Finance Working Paper No. 509/2017, p. 4.
[23] Cf. *Dimson/Karakaş/Li*, Coordinated Engagements, ECGI Finance Working Paper No. 721/2021, p. 4.
[24] *Doidge/Dyck/Mahmudi/Virani*, Review of Finance 2019, 893, 894; *Balp/Strampelli*, Ohio State Business Law Journal 14 (2020), 135, 141.

b) Specialist ESG actors

Traditional players are also active as regards ESG engagement (see V.2. below). In particular, institutional investors have started to set up dedicated ESG funds on a large scale, taking ESG concerns into account in their investment decisions, albeit to varying degrees. In addition, the Big Three, in particular, have been very media savvy in demonstrating their commitment to ESG, especially with regard to climate change mitigation. For example, in January 2022 and 2021, Blackrock addressed open letters to both the CEOs of the companies in which it invests (2022)[25] and its investor clients (2021)[26], announcing that it would be taking greater account of ESG criteria when selecting investment securities in the future.[27] In addition, we have seen evidence of genuine shareholder activism which provides for not only an influential role of ESG considerations in investment decision-making, but also the involvement of shareholders actively seeking to improve the ESG profile of a company or their whole portfolio.[28]

Lately, even some players whose activities are solely driven by their ESG engagement have established themselves in the market or are in the process of doing so. Chief among these are operators of platforms for organizing (coordinated) shareholder engagement in the ESG context, such as Climate Action 100+, a campaign currently supported by over 500 institutional investors worldwide.

III. Shareholder Collaborative Engagement: The Traditional Micro-Picture

1. (Dis-)Incentives for shareholder engagement

US corporate law scholars have traditionally taken the view that a widely dispersed retail shareholder base is incapable of effectively monitoring management.[29] Shareholders have been characterized as "rationally apathetic"[30], with collective action problems, and excessive coordination costs discouraging them from taking a more active supervisory role.[31] More specifically, a theoretical argument holds that retail investors are unable to adequately inform themselves about their own voting behaviour (high information costs) or to coordinate their voting behaviour with other shareholders

[25] Available at: https://www.blackrock.com/corporate/investor-relations/larry-fink-ceo-letter.
[26] Available at: https://www.blackrock.com/corporate/investor-relations/blackrock-client-letter.
[27] See *Attracta Mooney/Billy Nauman*, "Larry Fink rules on the best global standards for climate risk reporting", in: Financial Times, 20 January 2020, available at: https://www.ft.com/content/fc51227b-9d64-4e5a-b1e2-f6c07f4caa58.
[28] Cf. *Christie*, University of California Davis Law Review 55 (2021), 875, 918.
[29] *Rock*, in: Gordon/Ringe, Oxford Handbook of Corporate Law and Governance, 2017, p. 363, 374.
[30] *Kraakman/Armour/Davies/Enriques et al.*, The Anatomy of Corporate Law, 3rd ed. 2017, Chap. 2.1, p. 30; *Christie*, University of California Davis Law Review 55 (2021), 875, 898 with fn. 121; *Clark*, Corporate Law, 1986, p. 390 et seqq.; *Black*, Michigan Law Review 89 (1990), 520, 527.
[31] *Christie*, University of California Davis Law Review 55 (2021), 875, 898; *Enriques/Romano*, University of Illinois Law Review 2019, 223, 232; *Bowley/Hill*, Stewardship and Collective Action: The Australian Experience, ECGI Law Working Paper No. 491/2020, p. 13; see already *Rock*, Georgetown Law Journal 79 (1991), 445.

(collective action problems). This is a necessary tactic given that, individually, they cannot exert sufficient influence to have a lasting impact on management. Moreover, the costs of ensuring that a shareholder is provided with the necessary information are far too high for each individual investor in relation to the size of their shareholding. Thus, each individual shareholder rationally opts to rely on other shareholders to perform the monitoring function and bear the associated costs, in the hope that they will themselves nonetheless benefit from their engagement (free rider problem).[32]

The concentration of share ownership among institutional investors, which was at first seen by optimists as a way of overcoming collective action problems,[33] did not initially prove in practice to pave the way for increased effective shareholder participation. With regard to owners and managers of active funds, the standard explanation is that of "rational reticence" of this type of investor.[34] The business model of broadly diversified funds is based on achieving good performance relative to other funds at the lowest possible cost.[35] However, exercising informed voting power in an individual company, and thus contributing to the enhancement of that individual company's performance, would entail the incurrence of significant costs by such funds and/or their managers.[36] On the other hand, given the broad diversification of these types of funds, increasing the performance of a single portfolio company would have a very limited impact on the performance of the fund as a whole.[37] In addition, the benefits of the improvement in performance would accrue not only to the fund taking action in a given case, but also to all other funds which have invested in the company in question but have not themselves incurred costs for such engagement (again, the free rider problem). Furthermore, the individual fund manager's remuneration will depend solely on the relative performance of the fund, which will not be improved at all by their engagement, given that this will also benefit other competing funds.[38]

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[32] *Enriques/Romano*, University of Illinois Law Review 2019, 223, 232.
[33] *Gilson/Kraakman*, Stanford Law Review 43 (1991), 863; cf. also *Rock*, in: Gordon/Ringe, Oxford Handbook of Corporate Law and Governance, 2017, p. 363, 374.
[34] *Gilson/Gordon*, Columbia Law Review 113 (2013), 863; cf. *Barzuza/Curtis/Webber*, Southern California Law Review 93 (2020), 1243, 1256 et seq.; *Enriques/Romano,* University of Illinois Law Review 2019, 223, 232 et seqq.; already early on: *Coffee*, Columbia Law Review 91 (1991), 1278, 1318 et seqq.; *Fisch*, Ohio State Law Journal 55 (1994), 1009. At the beginning of the rapidly growing concentration of equity ownership among institutional investors in the U.S., the "inadequate incentives hypothesis" was accompanied by the "excessive regulation hypothesis" established in particular by Mark Roe and Bernard Black, which attributed the lack of commitment of institutional investors to constraining regulatory provisions. For an overview, see *Rock*, in: Gordon/Ringe, Oxford Handbook of Corporate Law and Governance, 2017, p. 363. In more detail: *Black*, Michigan Law Review 89 (1990), 520; *Roe*, Strong Managers, Weak Owners, 1996.
[35] *Gilson/Gordon*, Columbia Law Review 113 (2013), 863, 889 et seqq.; *Christie*, University of California Davis Law Review 55 (2021), 875, 898.
[36] *Gilson/Gordon*, Columbia Law Review 113 (2013), 863, 889.
[37] *Gilson/Gordon*, Columbia Law Review 113 (2013), 863, 889.
[38] *Gilson/Gordon*, Columbia Law Review 113 (2013), 863, 895.

Consequently, exit will generally be the preferred approach for actively managed funds or their managers, as the case may be.[39] The incentives to engage are minimal even in the case of interventions with portfolio-wide effects – such as governance initiatives which institutional investors believe should improve the performance of all or a large share of the portfolio companies. This is because, these would also benefit competitors who do not share in the associated costs and, therefore, would not have the effect of improving the relative performance of the fund.[40]

With regard to *passive funds*, especially index funds, the debate has seen the emergence of highly opposing schools of thought.[41] On the one hand, it is argued that the owners and managers of index funds theoretically have a very obvious interest in influencing the performance of portfolio companies, given that they do not have the exit option available to active funds.[42] In order to be able to improve their own performance – also in competition with actively managed funds –, they should therefore be incentivized to consider certain forms of engagement, in particular engagement having portfolio-wide effects.[43]

On the other hand, *Lucian Bebchuk* and *Scott Hirst*, in particular, argue that index funds are exceptionally cost-averse and suffer from exactly the same problems as actively managed funds with respect to the free rider problem and conflicts of interest resulting from the remuneration of fund managers being linked to relative performance.[44] This is because index funds, in particular, invest in exactly the same portfolio companies as their peers,[45] and would thus benefit to exactly the same extent from any costly investment in "voice," without themselves having to bear any of the associated costs.[46] There would, therefore, be no competitive advantage to be gained from any such engagement, even though this might be in the interest of the ultimate beneficial owners.[47] In this respect, reference is made to empirical studies which show that index funds and their managers very rarely vote contrary to management and never or almost never put forward shareholder proposals.[48]

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[39] Cf. *Balp/Strampelli*, Ohio State Business Law Journal 14 (2020), 135, 144.
[40] Cf. *Balp/Strampelli*, Ohio State Business Law Journal 14 (2020), 135, 144.
[41] See, e.g., *Bebchuk/Hirst*, Columbia Law Review 119 (2019), 2029; *Bebchuk/Hirst*, Boston University Law Review 99 (2019), 722 on the one side and *Fisch/Hamdani/Solomon,* University of Pennsylvania Law Review 168 (2019), 17, 27 et seqq. on the other side.
[42] *Fisch/Hamdani/Solomon,* University of Pennsylvania Law Review 168 (2019), 17, 27 et seqq.; cf. *Christie*, University of California Davis Law Review 55 (2021), 875, 902 with further references in fn. 136.
[43] *Fisch/Hamdani/Solomon,* University of Pennsylvania Law Review 168 (2019), 17, 27 et seqq. providing a highly nuanced theoretical framework.
[44] *Bebchuk/Hirst*, Columbia Law Review 119 (2019), 2029, 2050 et seqq.
[45] *Christie,* University of California Davis Law Review 55 (2021), 875, 906: "essentially commodities".
[46] *Barzuza/Curtis/Webber*, Southern California Law Review 93 (2020), 1243, 1246.
[47] *Barzuza/Curtis/Webber*, Southern California Law Review 93 (2020), 1243, 1246.
[48] *Bebchuk/Hirst*, Columbia Law Review 119 (2019), 2029, 2040.

The incentives for *(value) hedge funds*, conversely, differ significantly.[49] Value hedge funds typically acquire a significant stake in a single company in the belief that they will be able to actively exert influence – i.e., by influencing the corporate structure or strategy, or often by replacing the current management – to bring about an increase in the share price within a relatively short period of time.[50] Therefore, they have a clear interest in being informed and in influencing the company by exercising their participation rights or the resultant power of influence.[51] This interest is also reflected in the remuneration of the fund managers, which is typically a high percentage share of any increase in returns, to the extent that this surpasses the performance of the market as a whole.[52]

2. Traditional reasons for shareholder engagement

In practice, shareholder involvement has increased in recent years in spite of the disincentives described in the foregoing. This development is typically attributed to four factors: (i) the "Big Three" of the investment fund industry are often too big to remain passive because of political and public pressure, (ii) stewardship considerations spur proactive shareholder involvement, (iii) institutional investors increasingly use proxy advisors, and (iv) institutional investors, in particular hedge funds, collaborate ("wolf pack" activism) or follow the lead of other institutional investors, particularly activist hedge funds.[53]

(i) Too big to be passive: some of the fund managers – especially the Big Three – are classified as too big to be passive.[54] This point of view relates to the public and political pressure exerted on large fund managers to actually exercise their voting rights and not to merely follow management or the recommendations of proxy advisors.[55] From the perspective of fund managers, reputational considerations, in particular, will drive them to actively exercise their voting rights or influence.[56]

(ii) Stewardship: Political and public pressure is not limited to the Big Three. Lawmakers and regulators all over the world increasingly intervene to guide the voting behaviour of institutional investors with a clear or even exclusive focus on listed

[49] *Kahan/Rock*, University of Pennsylvania Law Review 155 (2007), 1021, 1062 et seqq.; *Enriques/Romano*, Rewriting Corporate Law for an Interconnected World, ECGI Law Working paper No. 572/2021, p. 19.
[50] *Barko/Cremers/Renneboog*, Journal of Business Ethics 2021, 4; *Barzuza/Curtis/Webber*, Southern California Law Review 93 (2020), 1243, 1256 et seq.
[51] *Kahan/Rock*, University of Pennsylvania Law Review 155 (2007), 1021, 1069 et seqq.
[52] *Enriques/Romano*, Rewriting Corporate Law for an Interconnected World, ECGI Law Working paper No. 572/2021, p. 19 et seq.
[53] *Enriques/Romano,* University of Illinois Law Review 2019, 223, 235; *Gillan/Starks*, Journal of Financial Economics 57 (2000), 275, 277; *McCahery/Sautner/Starks*, Journal of Finance 71 (2016), 2905, 2913.
[54] *Enriques/Romano,* University of Illinois Law Review 2019, 223, 235 et seq.
[55] *Enriques/Romano,* University of Illinois Law Review 2019, 223, 236; *Choi/Fisch/Kahan*, Harvard Business Law Review 35 (2013), 61 et seqq.
[56] *Balp/Strampelli*, Ohio State Business Law Journal 14 (2020), 135, 153.

companies, particularly in terms of disclosure requirements. This trend can be observed in numerous jurisdictions, especially in the UK and the EU, under the heading of *stewardship*.[57]

(iii) Proxy advisors: The notably growing importance of proxy advisors has contributed further to a substantial reduction in information costs and consequently facilitated shareholder engagement.[58] The reliance on proxy advisors relieves institutional investors of the cost of obtaining information on their own initiative. Proxy advisors act as information intermediaries and sell their voting recommendations for a comparatively low fee. Smaller institutional investors, in particular, have strong incentives to follow the recommendations of proxy advisors,[59] which of course poses additional problems in itself.[60] However, over the past decade, we have seen less direct reliance on proxy advisors, but instead, asset managers pouring resources into inhouse stewardship departments.

(iv) Collaboration: Forms of collaboration, especially among hedge funds and between institutional investors and hedge funds, are the fourth key factor in overcoming the disincentives described above. We will turn to this aspect in greater detail in the following.

3. Collaborative engagement, in particular

Collaboration among shareholders is, at least in theory, an appropriate way to overcome or at least mitigate some of the disincentives to shareholder engagement described above[61].[62]

(i) First of all, voting rights and the associated informal influence over a company can be bundled through collaborative interaction, thus creating greater potential for the exercise of influence than in the case of an investor acting individually.[63] In fact, several empirical studies showed that collaborative engagement is in any case more

[57] *Balp/Strampelli*, Ohio State Business Law Journal 14 (2020), 135, 159; *Hill*, Good Activists/Bad Activists: The Rise of International Stewardship Codes, ECGI Law Working Paper No. 368/2017.
[58] *Enriques/Romano,* University of Illinois Law Review 2019, 223, 236; see also Touch, Boston University Law Review 99 (2019), 1459 (lack of institutional investor coordination led to the importance of proxy advisors).
[59] *Enriques/Romano,* University of Illinois Law Review 2019, 223, 237.
[60] See, e.g., *Spatt*, Review of Corporate Finance Studies 10 (2021), 136.
[61] See III.1. above.
[62] *Bowley/Hill*, Stewardship and Collective Action: The Australian Experience, ECGI Law Working Paper No. 491/2020, p. 3, 13; *Balp/Strampelli*, Ohio State Business Law Journal 14 (2020), 135, 166; *Christie*, University of California Davis Law Review 55 (2021), 875, 907; *Condon*, Washington Law Review 95 (2020), 1, 61.
[63] *Dimson/Karakaş/Li*, Coordinated Engagements, ECGI Finance Working Paper No. 721/2021, p. 2, 9 et seq.; *Balp/Strampelli*, Ohio State Business Law Journal 14 (2020), 135, 139, 185.

successful with regard to the enforcement of demands and usually also receives broader support from investors not directly involved in the collaboration.[64]

(ii) Second, collaboration may at least mitigate the free rider problem since all investors participating in the collaboration are eliminated as potential free riders.[65] This reduces the *ex-ante* disincentives of those investors who have an interest in collaborative engagement.

(iii) Third, the costs of obtaining information may be lower than in the case of individual engagements, with collaborators being able to share resources, skills and expertise.[66] Furthermore, the expertise of the group as a whole may exceed the expertise of the individual members of the group, which may also increase the overall efficiency of the engagement.[67] The aspect of resource pooling, in particular, has been intensely researched in organizational economics, for example, where it is discussed under the heading of "collaborative advantages".[68] In theory, the reduction in information costs increases the net return of each individual investor involved in the collaborative engagement.[69] This may contribute to the pursuit of certain forms of engagement which are beneficial from the perspective of all shareholders, with the benefits to individual investors exceeding the total cost of the engagement.

(iv) Finally, collaboration contributes to risk sharing among the collaborators.[70] For example, an individual investor may be deterred from engaging because of conflicts of interest, such as concerns about jeopardizing other business relationships with the target or its peers, and broader collaboration with other institutional investors could reduce this risk.[71]

Despite this potential mitigation of collective action problems and a reduction or sharing of information costs through collaborative action, the disincentives to engagement, especially among large, broadly diversified active and passive fund managers, still work against – even collaborative – engagement.[72]

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[64] *Balp/Strampelli*, Ohio State Business Law Journal 14 (2020), 135, 139 with further references to empirical studies. See *Gillan/Starks*, Journal of Financial Economics 57 (2000), 275; *Dimson/Karakas/Li*, The Review of Financial Studies 28 (2015), 3225; *Kedia/Starks/Wang*, Review of Corporate Finance Studies 10 (2021), 1; *Doidge/Dyck/Mahmudi/Virani*, Review of Finance 2019, 893, 894.
[65] *Balp/Strampelli*, Ohio State Business Law Journal 14 (2020), 135, 166.
[66] *Dimson/Karakaş/Li*, Coordinated Engagements, ECGI Finance Working Paper No. 721/2021, p. 2.
[67] *Dimson/Karakaş/Li*, Coordinated Engagements, ECGI Finance Working Paper No. 721/2021, pp. 2, 9 et seq.; *Balp/Strampelli*, Ohio State Business Law Journal 14 (2020), 135, 191.
[68] *Dimson/Karakaş/Li*, Coordinated Engagements, ECGI Finance Working Paper No. 721/2021, p. 9; *Huxham/Macdonald*, Management Decision 30 (1992), 50.
[69] *Balp/Strampelli*, Ohio State Business Law Journal 14 (2020), 135, 186.
[70] *Dimson/Karakaş/Li*, Coordinated Engagements, ECGI Finance Working Paper No. 721/2021, p. 10.
[71] *Dimson/Karakaş/Li*, Coordinated Engagements, ECGI Finance Working Paper No. 721/2021, p. 9.
[72] See *Christie*, University of California Davis Law Review 55 (2021), 875, 907.

From an economic perspective, the first thing to note in this respect is that collaboration only eliminates the free rider problem among the collaborating investors, but not for the group of collaborators vis-a-vis other investors.[73] The costs of collaboration and engagement are borne by a (potentially small) group while other investors equally benefit from the engagement of that group.[74] This can provide an incentive not to participate in the collaboration in the first place.

In addition, there is an economic – and potentially also a cultural – barrier to collaboration, especially between directly competing institutional investors. It is not obvious that such investors should talk to their competitors about how to proceed, with regard to individual portfolio companies, without any clearly measurable prospects of a financial benefit resulting from their efforts. In addition, many investors or their management personnel may have a cultural reservation about working with competitors (they don't want to play in the same sandbox). Admittedly, this problem is less pronounced in the case of investors with very different business models, such as hedge funds and index funds, who primarily compete with each other to achieve a better reputation in the market, better performance, and possibly lower costs.[75]

Moreover, collaborative engagement is time-consuming and cost-intensive, albeit less expensive than engagement on a stand-alone basis.[76] The time-consuming nature of collaborative engagements, compared to engagements on a stand-alone basis, is a particularly striking impediment in cases where the engagement strategy involves time-pressing issues,[77] as they may occur, for example, in connection with acquisitions of shareholdings resulting in the exceeding of notification thresholds.

The costs of every engagement will, by necessity, be lower than the profitability of such an engagement. These costs must be taken into account in the total costs of the engagement, and these costs must not only exceed the expected benefits of the collaborative engagement, but also meet investors' threshold expectations as to returns (cost-benefit analysis). Particularly in the case of large, diversified funds, it must be borne in mind that even if collaboration lowers the costs of the engagement and increases the chances of its success, the advantages of firm-specific engagement will rarely outweigh the costs involved, given that the disincentives described in the foregoing will continue to have an effect. This may be different in the case of portfolio-wide initiatives. In both cases, still, remuneration incentives of the fund managers will

[73] *Dimson/Karakaş/Li*, Coordinated Engagements, ECGI Finance Working Paper No. 721/2021, p. 10.
[74] *Ringe*, Investor-led Sustainability in Corporate Governance, ECGI Law Working Paper No. 615/2021, p. 33.
[75] *Dimson/Karakaş/Li*, Coordinated Engagements, ECGI Finance Working Paper No. 721/2021, p. 10.
[76] *Dimson/Karakaş/Li*, Coordinated Engagements, ECGI Finance Working Paper No. 721/2021, p. 10; *Ringe*, Investor-led Sustainability in Corporate Governance, ECGI Law Working Paper No. 615/2021, p. 33.
[77] *Dimson/Karakaş/Li*, Coordinated Engagements, ECGI Finance Working Paper No. 721/2021, p. 10

also work to the detriment of an engagement, and the collaboration itself does not alter this.[78]

IV. ESG as a "game changer"?

Environmental, social, and governance-compliant investing ("ESG investing") has emerged as a major social topic in recent years,[79] with an almost exclusive focus on environmental and social aspects. Given that G-aspects were already a major issue in the 1990s, the "G" in ESG – the modern "G", so to say – often relates to governmental features that facilitate or even support the implementation of the "E" and "S" aspects. Put differently, in contrast to the traditional G-features, for example independent outside directors, these modern G-features are not primarily designed with a view to improving a company's economic performance, but to support the introduction and effectiveness of the "E" and "S" features.[80]

While ESG investments to date represent only a small portion of the overall assets under management worldwide, and an even smaller portion of the total assets invested,[81] the sector is experiencing *considerable* growth. This development has been driven, in particular, by increasing demand. Key market observers expect that there will be a (re)allocation of capital on a massive scale to ESG-compliant investments[82] in the near future as the result of fundamental social change, and regulatory measures are being, and will continue to be, introduced at the national, supranational and international level to further bolster this development.[83]

More specifically, shareholder engagement and collaborative shareholder engagement in favour of environmental and social (E&S) aspects is becoming

[78] See III.1. above.
[79] Cf. BlackRock, Portfolio perspectives, February 2020, Sustainability: The tectonic shift transforming investing, p. 3; *Ringe*, Investor-led Sustainability in Corporate Governance, ECGI Law Working Paper No. 615/2021, p. et seqq.; *Pedersen/Fitzgibbons/Pomorski*, Journal of Financial Economics 142 (2021), 572; *Friedman/Heinle*, Review of Accounting Studies 21 (2016), 740, 741; *Pastor/Stambaugh/Taylor*, Journal of Financial Economics 142 (2021), 550; *Bowley/Hill*, The Global ESG Stewardship Ecosystem, ECGI Law Working Paper No. 660/2022; on the history of ESG investing, see *Coffee*, Columbia Business Law Review 2021, 602, 631 et seqq.; *Schanzenbach/Sitkoff*, Stanford Law Review 72 (2020), 381, 392 et seqq. On the origins of the term "ESG", see *Pollman*, The Origins and Consequences of the ESG Moniker, University of Pennsylvania Carey Law School ILE Research Paper No. 22-23.
[80] In the same sense Martin Kaspar, Director Board Services of PwC Germany, as cited in: Börsen-Zeitung, 202212-09 No. 238, p.9. A case in point is board gender diversity, which clearly demonstrates the interdependence with the S-aspect of gender equality in society at large..
[81] BlackRock, Portfolio perspectives, February 2020, Sustainability: The tectonic shift transforming investing, p. 3.
[82] BlackRock, Portfolio perspectives, February 2020, Sustainability: The tectonic shift transforming investing, p. 3; cf. *Barzuza/Curtis/Webber*, Southern California Law Review 93 (2020), 1243.
[83] To date, the development in the EU has been driven much more by regulatory pressure than is the case in the US. Cf. *Coffee*, Columbia Business Law Review 2021, 602, 606 et seqq.

increasingly common[84] and successful[85], while shareholder engagement tackling governance issues has already been well underway since the 1990s. Environmental and social objectives together accounted for only about 10% of all activist campaigns in 2016; this share had already risen to 20% in 2021.[86] The US is clearly at the forefront of this trend, with 168 activist "E" or "S" campaigns in 2021, compared to only 25 in Europe, and only 7 in Asia.[87] Several spectacular collaborations between activist hedge funds (so-called impact funds), such as Jana Impact Capital, with large institutional investors, such as the pension fund California Teachers' Retirement System (CalSTRS), even succeeded in realising activist engagement involving giant companies on a large scale.[88] The most prominent case of collaborative E&S engagement, however, was certainly Engine No. 1's successful proxy contest at ExxonMobil in 2021, which was supported by numerous large institutional investors.[89] According to Lazard 2021 Review of Shareholder Activism, that year saw a "rapid proliferation of ESG as a key plank in activists' platforms" with "more traditional activists incorporat[ing] ESG vectors into their campaigns".[90]

Even though E&S engagement and, in particular, its success rate has abated somewhat in 2022 – also due to the geopolitical developments underway –,[91] the topic remains a pivotal one, with some successful campaigns having been conducted in 2022,[92] particularly due to the emergence of new facets of ESG in the wake of the

[84] For an overview, see, *Condon*, Washington Law Review 95 (2020), 1; *Christie*, University of California Davis Law Review 55 (2021), 875, 918; *Ringe*, Investor-led Sustainability in Corporate Governance, ECGI Law Working Paper No. 615/2021. For a critical assessment, see *Mahoney/Mahoney*, Columbia Business Law Review 2021, 840; *Brest/Gilson/Wolfson*, Journal of Corporation Law 44 (2018), 205. However, according to the Lazard 2021 Review of Shareholder Activism (available at: https://www.lazard.com/media/452017/lazards-2021-review-of-shareholder-activism_vff.pdf), 43 % of activist campaigns in 2021 featured an M&A-related thesis.

[85] Individual shareholders have also been known to criticize environmental and social misconduct by companies in the past. For example, one might think of the protests by small shareholders at the annual general meetings of large German stock corporations. The difference, however, is that these "campaigns" had little or no influence.

[86] S&P Capital IQ, April 2022, available at: https://www.rbccm.com/en/insights/story.page?dcr=templatedata/article/insights/data/2022/04/esg_and_shareholder_activism.

[87] Insightia, ESG Activism Report 2022, available at: https://www.insightia.com/q12022/.

[88] *Christie*, University of California Davis Law Review 55 (2021), 875, 918; *Ringe*, Investor-led Sustainability in Corporate Governance, ECGI Law Working Paper No. 615/2021, p. 25.

[89] *Christie*, University of California Davis Law Review 55 (2021), 875, 918; *Ringe*, Investor-led Sustainability in Corporate Governance, ECGI Law Working Paper No. 615/2021, p. 22 et seqq.; *Bowley/Hill*, The Global ESG Stewardship Ecosystem, ECGI Law Working paper No. 660/2022, p. 6.

[90] Lazard, 2021 Review of Shareholder Activism, available at: https://www.lazard.com/media/452017/lazards-2021-review-of-shareholder-activism_vff.pdf.

[91] Insightia, ESG Activism Report 2022, available at: https://www.insightia.com/q12022/; *Masters*, BlackRock pulls back support for climate and social resolutions, FT-online 26 July 2022. It's a different story in Japan, where climate-related engagement is at a peak in 2022, cf. *Temple-West/Shimizuishi*, Big in Japan Inc: environmental pressure, FT-online 10 August 2022.

[92] *Temple-West*, Abortion and other ESG issues rise up the AGM agenda, FT-online 2 July 2022.

Ukraine crisis and the sanctions against Russia.[93] In particular, a growing – and also financially lucrative – field of activity seems to be opening up for hedge funds that invest specifically in "brown" companies in order to transform them into "green" ones.[94] An important recent structural success is the growing tendency to link executive bonuses, or even remuneration in general, to the attainment of "E" and "S" targets.[95] Allianz Global Investors has even stated that it will vote against European companies that fail to link executive pay to ESG considerations.[96]

On the other hand, more recently, politicians in the US, and also some activist value hedge funds and their managers, have been complaining about "woke" companies;[97] a development that must be carefully observed as well and that may present companies with a number of new challenges.

Finally, the increasing public focus and pressure on climate protection issues leads us to expect entirely new forms of collaboration, namely the involvement of the public or of environmental organizations as collaborators in shareholder engagement. We will turn to this point in more detail in section V.2.f).

1. Why might institutional investors be interested in ES(G)?

Why might institutional investors – and, in particular, broadly diversified passive and active funds or their managers -– be interested in E&S issues, and is it conceivable that the resultant incentives will lead to increased E&S engagement and collaboration? Irrespective of altruistic motivations[98] – the credibility of which is questioned by some,

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[93] *Sommerset/Webb*, Are defence stocks now ESG?, FT-online, 4 March 2022; *Flood*, Energy Crisis prompts ESG rethinking on oil and gas, FT-online, 18 July 2022; *Tett*, ESG exposed in a world of changing priorities, FT-online, 3 June 2022; *Temple-West/Tett/Mundy*, European ESG funds buy up defence and energy stocks, FT-online, 11 July 2022.

[94] *Temple-West/Mundy*, The largest-ever impact fund has $15bn for dirty companies, FT-online, 24 June 2022.

[95] *Temple-West*, US companies add environmental and social targets to executive bonuses, FT-online, 20 February 2022.

[96] *Klasa*, AllianzGI to vote against European companies that fail to link pay to ESG, FT-online, 22 February 2022.

[97] See, for example, the complaint of *Vivek Ramaswamy* against Apple or Walt Disney (*Sorkin/Warner/Giang/Kessler/Gandel/de la Merced/Hirsch/Livni*, An Anti-E.S.G. Activist Takes on Apple and Disney, New York Times, Sept. 20, 2022, available at: https://www.nytimes.com/2022/09/20/business/dealbook/anti-esg-campaign-fund-etf-disney-apple.html. So far, only a very few hedge fund leaders have taken up the call against "woke capitalism". But certain media outlets are giving them significant attention, which amplifies their message. On the issue, see *Bowley/Hill*, The Global ESG Stewardship Ecosystem, ECGI Law Working paper No. 660/2022, p. 33. The backlash is a potent force in the current U.S. political environment and could take root in Europe, too. For an overview on more recent state regulation of ESG investment decision-making by public retirement plans, see: https://corpgov.law.harvard.edu/2022/10/25/state-regulation-of-esg-investment-decision-making-by-public-retirement-plans/ (Harvard Law School Forum on Corporate Governance posted by *Joshua Lichtenstein, Michael Littenberg* and *Reagan Haas*, Ropes & Gray LLP, on Tuesday, October 25, 2022).

[98] Cf. *Azar/Duro/Kadack/Ormazabal*, The Big Three and Corporate Carbon Emissions Around the World, ECGI Finance Working Paper No. 715/2020, p. 2.

and the legal admissibility of which would also be highly questionable in light of fiduciary duties[99] –, the following economic reasons, in particular, are put forward for such interest in E&S investing[100]:

- Prospect of higher returns
- Reduction of systemic risk
- Forestalling of regulation[101]
- Higher fees[102]
- Reputational concerns
- Rising demand (from millennials)

We are unable to examine these potential – and sometimes highly controversial – reasons in detail here. In the following, we would like to briefly address the aspects (1) higher returns, (2) reduction of systemic risk, and (3) rising demand, which in our view are the subject of particularly intensive discussion.

(1) Higher returns: In empirical financial market research, the question of what, if any, effect the pursuit of ES(G) objectives by companies has on cash flows and the cost of capital is a source of great controversy,[103] even though some studies do support the idea of the existence of theoretically plausible transmission channels.[104] However, no unambiguous empirical evidence as yet exists with regard to a correlation between ESG factors and stock market performance.[105] While empirical studies relating to the period from 2002 to 2010 indicate only minor reactions in share prices to ESG-related news,[106] recent empirical studies have increasingly shown a positive correlation between a favourable ESG profile and company value.[107] Some commentators expect

[99] *Schanzenbach/Sitkoff*, Stanford Law Review 72 (2020), 381; for a comprehensive overview, see Freshfields Bruckhaus Deringer, "A legal framework for the integration of environmental, social and governance issues into institutional investment: Produced for the Asset Management Working Group of the UNEP Finance Initiative, October 2005, p. 30 et seqq., available at: https://www.unepfi.org/fileadmin/documents/freshfields_legal_resp_20051123.pdf.

[100] Cf. *Azar/Duro/Kadack/Ormazabal*, The Big Three and Corporate Carbon Emissions Around the World, ECGI Finance Working Paper No. 715/2020, p. 2; *Bowley/Hill*, The Global ESG Stewardship Ecosystem, ECGI Law Working paper No. 660/2022, p. 4 et seqq.

[101] *Davies*, in Katelouzou/Puchniak, Global Shareholder Stewardship, 2022, p. 44, 62 et seqq.; *Barzuza/Curtis/Webber*, Southern California Law Review 93 (2020), 1243, 1280.

[102] *Ringe*, Investor-led Sustainability in Corporate Governance, ECGI Law Working Paper No. 615/2021, p. 10 et seqq.; *Azar/Duro/Kadack/Ormazabal*, The Big Three and Corporate Carbon Emissions Around the World, ECGI Finance Working Paper No. 715/2020, p. 2.

[103] *Friedman/Heinle*, Review of Accounting Studies 21 (2016), 740, 745; *Cheng/Ioannou/Serafeim*, Strategic Management Journal, 35 (2014), 1, 2 et seqq.

[104] See *Mülbert/Sajnovits*, European Company and Financial law Review 2021, 256, 270 et seqq. with further references.

[105] *Zerbib*, Review of Finance 2022, 1; *Albuquerque/Koskinen/Zhang*, Management Science 65 (2019), 4451, 4452.

[106] *Capelle-Blancard/Petit*, Journal for Business Ethics 157 (2019), 543, with the authors also identifying a small but significant impact of negative ESG-related news.

[107] *Friede/Busch/Bassen*, Journal of Sustainable Finance and Investment 5 (2015), 210 with an evaluation of more than 2000 empirical studies; *Bhaskaran/Ting/Sukumaran/Sumod*, Managerial and

these effects to intensify further in the years to come.[108] In this respect, too, it is important to distinguish between the individual factors, i.e., "E", "S" and "G". This is because most empirical studies show a positive correlation between the G-factor and financial performance, while the correlation has so far been more controversial for the E- and S-factors.[109]

(2) Common ownership and reduction of systemic risk

Madison Condon and then *John C. Coffee* and *Jeff Gordon* have recently pointed out that, due to the lower susceptibility of companies with a positive ESG profile to systemic risks (especially *climate risk*), broadly diversified institutional investors, in particular, have a special interest in actively influencing their portfolio companies to improve their ESG profile.[110] This will hold true, in particular, for passive index funds, which do not have the option of disinvestment.[111] For such investors, pushing for a better ESG profile across the entire portfolio might be a viable strategy even if it reduces the profitability of an individual portfolio company, as long as this strategy lowers the overall susceptibility of their portfolio to systemic market shocks and tail events.[112]

However, the notional appeal of this theory has been contested. In particular, several scholars have questioned the prospect of "portfolio primacy" as a means of tackling climate change.[113] In addition to the fact that many of the world's major carbon emitters are private companies, or are at least controlled by individual blockholders, over which the large institutional investors have no influence,[114] the free rider

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Decision Economics 41 (2020), 710; *Qureshi/Kirkerud/Theresa/Ahsan*, Business Strategy and Environment 29 (2020), 1199; *Pei-yi Yu/Qian Guo/Van Luu*, Business Strategy and the Environment 27 (2018), 987.

[108] *Albuquerque/Koskinen/Zhang*, Management Science 65 (2019), 4451, 4452.

[109] Cf. *Friede/Busch/Bassen*, Journal of Sustainable Finance and Investment 5 (2015), 210, 222 with further references; see also, *Gillan/Starks*, Journal of Applied Corporate Finance 19 (2007), 55. For an overview of empirical studies on corporate governance aspects, see *Klausner*, Empirical Studies of Corporate Law and Governance: Some Steps Forward and Some Steps Not, ECGI Law Working Paper No. 381/2018.

[110] *Condon*, Washington Law Review 95 (2020), 1 (18 et seqq); *Coffee*, Columbia Business Law Review 2021, 602, (p. 13 et seqq., 28 et seqq.); *Gordon*, Journal of Corporation Law 47 (2022), 627; see also *Ringe*, Investor-led Sustainability in Corporate Governance, ECGI Law Working Paper No. 615/2021, p. 15 et seqq. See, also, *Enriques/Romano*, Rewriting Corporate Law for an Interconnected World, ECGI Law Working paper No. 572/2021.

[111] Cf. *Condon*, Washington Law Review 95 (2020), 1 (18).

[112] Cf. *Enriques*, "Missing in Today's Shareholder Value Maximization Credo: The Shareholders", 22 September 2020, available at: https://promarket-org.cdn.ampproject.org/c/s/promarket.org/2020/09/22/milton-friedman-value-maximization-credo-is-missing-the-shareholders/?amp.; for more details on that argument, see *Coffee*, Columbia Business Law Review 2021, 602, (28 et seqq.); *Condon*, Washington Law Review 95 (2020), 1, 6. For a very critical assessment from a corporate law perspective, see Rock/Kahan, Systemic Stewardship with Tradeoffs, NYU Law and Economics Research Paper Series Working Paper No. 22-01, p. 11 et seqq.

[113] In more detail, see *Tallarita*, Vanderbilt Law Review 76 (2023) forthcoming; *Strampelli*, Can BlackRock safe the planet?, The Institutional Investors' role in Stakeholder Capitalism, Bocconi Legal Studies Research Paper No. 3718255, available at: https://papers.ssrn.com/sol3/papers.cfm?abstract_id=3718255.

[114] *Tallarita*, Vanderbilt Law Review 76 (2023) forthcoming (p. 15 et seqq.).

problem[115] and the disincentives resulting from the prevailing remuneration structure[116] also prevent this aspect, in and of itself, from sufficiently incentivizing large passive funds to actively raise a sufficient amount of money for ESG engagement.[117]

(3) Rising demand (from millennials): Maybe the most obvious reason why also largely diversified active and passive funds (resp. their owners and managers) might be interested in ESG engagement seems to be the undeniable rising demand for ESG investing and ESG-compliant conduct.[118] Significant changes in investor preferences could play a major role in shaping the impact of ESG factors on share prices in the future.[119] Furthermore, increasing demand for ESG-compliant investment opportunities and ESG-compliant engagement by end investors could incentivise even passive funds to adopt an approach of active engagement. Tellingly, *Bebchuk* and *Hirst* acknowledge that index fund managers have an incentive "to take positions on issues they expect to appeal to such investors, such as gender diversity on boards and climate change disclosure".[120] In the case of family offices, too, the growing importance of the generation of heirs with a stronger interest in ESG issues can already result in ESG influencing not only investment decisions,[121] but also activism decisions.[122]

2. Incentives for collaborative engagement, in particular

Irrespective of any lasting inconclusiveness as regards the incentives for ESG engagement in general, at least with regard to *collaborative* ESG engagement, some recent studies suggest (i) a higher success rate of collaborative engagements and (ii) a sustainable positive effect of collaborative ESG campaigns on share price performance.

In an empirical study on a total of 2,152 incidences of engagement by an investment company with US target companies published in 2015, *Dimson*, *Karakaş* and *Li* found

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[115] See III.1. above.
[116] See III.1. above.
[117] Cf. *Tallarita*, Vanderbilt Law Review 76 (2023) forthcoming (p. 23 et seqq.), who elaborates further on portfolio conflicts (p. 39 et seqq.).
[118] See, in particular, *Barzuza/Curtis/Webber*, Southern California Law Review 93 (2020), 1243, 1249 et seq.; see also, *Christie*, University of California Davis Law Review 55 (2021), 875, 910; *Ringe*, Investor-led Sustainability in Corporate Governance, ECGI Law Working Paper No. 615/2021, p. 12 et seqq.; *Azar/Duro/Kadack/Ormazabal*, The Big Three and Corporate Carbon Emissions Around the World, ECGI Finance Working Paper No. 715/2020, p. 8.
[119] In particular, BlackRock, Portfolio perspectives, February 2020, Sustainability: The tectonic shift transforming investing, p. 3; *Eccles/Klimenko*, "The Investor Revolution", Harvard Business Review May-June 2019, p. 106.
[120] *Christie*, University of California Davis Law Review 55 (2021), 875, 910.
[121] See, in particular, UBS, Billionaire Ambitions Report 2022, p. 38 et seqq., available at: https://www.ubs.com/global/en/media/display-page-ndp/en-20221207-billionaires.html?caasID=CAAS-ActivityStream.
[122] *Botha*, How Impact Investing Could Move Family Offices Beyond ESG Screened Portfolios, Forbes, Feb. 1, 2022, available at: https://www.forbes.com/sites/francoisbotha/2022/02/01/how-impact-investing-could-move-family-offices-beyond-esg-screened-portfolios/?sh=1536053e4d76.

that collaboration leads to a higher success rate for E&S engagements, in particular.[123] In addition, successful engagement led to positive abnormal returns, improved performance and governance, and increased institutional ownership, while unsuccessful engagement led to zero abnormal returns.[124] Moreover, the authors show in their study published in 2015 that, particularly with regard to "E" and "S" engagement, coordination is key, much more so than in the area of "G" engagement.[125] This would appear to be the case because E&S engagement requires the involvement of a greater number of investors in order to convince a portfolio company to tackle identified E&S issues rather than corporate governance issues. [126] Perhaps lack of collaboration was one reason why Carl Icahn's campaign at McDonalds, which he ran alone, was not successful.[127] The general findings of the 2015 study were broadly confirmed by another study by *Dimson, Karakaş* and *Li* which also observed a significant increase in abnormal stock returns following *collaborative* engagement characterized by a clear lead figure among collaborating institutional investors.[128] In contrast, they observed no change in the financial performance of the target firms in the case of engagement without a lead investor.[129] Overall, these results suggest that coordinated engagement is value enhancing for shareholders and/or successful, especially when headed up by a lead investor.

Given these empirical findings, if institutional investors' interest in ESG were indeed motivated by some of the explanations outlined above, they should definitely think about collaborating with others. Given that these studies indicate the achievement of significant abnormal returns with collaborative engagement, for lead investors, in particular, that may act as an additional incentive to engage and also to organize collaborative efforts. Whether the collaborative efforts will aim at engaging other hedge funds (sheep pack) or, specifically, diversified funds, remains to be seen.

All in all, there is certainly a lot of room for further empirical studies. Moreover, the increased success rate of collaborative engagement and the sizeable incentives, at least for lead investors within a collaboration, does not alter the fact that broadly diversified active and passive funds, in particular, have no interest in increasing the financial performance of individual portfolio companies or in incurring costs for this purpose. In the absence of reliable signals as to the quality of the specialist funds, large institutional investors will not be able to determine which hedge fund is worth following without incurring additional costs (a classic information asymmetry problem,

[123] *Dimson/Karakas/Li*, The Review of Financial Studies 28 (2015), 3225, 3241 et seqq.
[124] *Dimson/Karakas/Li*, The Review of Financial Studies 28 (2015), 3225, 3252 et seqq.
[125] *Dimson/Karakas/Li*, The Review of Financial Studies 28 (2015), 3225, 3228.
[126] *Dimson/Karakas/Li*, The Review of Financial Studies 28 (2015), 3225, 3228.
[127] See *Mundy*, Carl Icahn wades into the ESG debate, FT-online, April 29 2022.
[128] *Dimson/Karakaş/Li*, Coordinated Engagements, ECGI Finance Working Paper No. 721/2021.
[129] *Dimson/Karakaş/Li*, Coordinated Engagements, ECGI Finance Working Paper No. 721/2021.

which could also become a “market for lemons” problem in an increasingly flooded market). Therefore, the prospect of achieving higher returns for individual companies particularly applies to specialist hedge funds and not to institutional investors in general, and as such can hardly be classified as a game changer.

However, as far as the incentives of large active and passive funds and their managers are concerned, the increasing *demand* for ESG-compliant investments and ESG-compliant behaviour will perhaps result in more than mere lip service and letters to CEOs. The current level of support for ESG initiatives by the Big Three – which in the US, for example, has declined this year compared to last year[130] – must not signify a fundamental change. The recent downturn in support for shareholder proposals in the U.S. may well be due to the proponents’ success in the previous year: the high support levels in 2021, along with more lenient SEC guidance, led to more proposals being filed for the 2022 proxy season, some of which pushed the line too far (too prescriptive) for many owners/managers to support.[131] On the other hand, political forces, particularly in the US, and to some degree even value hedge funds, increasingly complain publicly about “woke” corporations and a too heavy focus on E&S issues to the detriment of shareholder value. The next few years will show whether E&S, in particular, can truly be a game changer. We are still at the very beginning of the ES(G) era[132] and we continue to consider its prospects to be very promising.[133]

V. Forms and Strategies of Collaboration

1. Traditional approaches

As regards collaborative shareholder engagement, we have traditionally observed so-called “wolf pack” activism (V.1.a)), coalitions between non-activist institutional investors and hedge funds (V.1.b)),[134] and collaboration via investor organizations.

a) Wolf packs

Wolf packs or wolf pack activism has been the most intensively studied form of collaborative (?) shareholder engagement in recent years. In a typical wolf pack, a

[130] Insightia, ESG Activism Report 2022, available at: https://www.insightia.com/q12022/; *Masters*, BlackRock pulls back support for climate and social resolutions, FT-online, 26 July 2022.
[131] But see also *Briere/Pouget/Schmalz/Ureche-Rangau*, Do the Big Three Vote to Curb Climate Change? (April 21, 2022), available at SSRN: https://ssrn.com/abstract=4245612 or http://dx.doi.org/10.2139/ssrn.4245612 , questioning the universal owner/reduction of systemic risk logic by showing that the big three support for shareholder resolutions tackling climate issues is lower than in other fund families.
[132] *Mülbert/Sajnovits*, European Company and Financial Law Review 2021, 290.
[133] For an optimistic view, that we principally share, see *Ringe*, Investor-led Sustainability in Corporate Governance, ECGI Law Working Paper No. 615/2021 and *Bowley/Hill*, The Global ESG Stewardship Ecosystem, ECGI Law Working paper No. 660/2022, p. 31 et seqq.
[134] Cf. also the comprehensive study by *Becht/Franks/Grant/Wagner*, Review of Financial Studies 30 (2017), 2933, 2934; furthermore, *Ringe*, Investor-led Sustainability in Corporate Governance, ECGI Law Working Paper No. 615/2021, p. 21 et seqq.

hedge fund with a substantial individual stake in a target company acts as the lead activist, while its actions are supported by other hedge funds with smaller blocks, as the supporting members.[135]

Whether wolf pack activism is beneficial from the long-term perspective of the companies concerned, or whether wolf packs typically only "attack" and exploit the companies on the basis of their short-term strategies, is – also empirically – highly controversial.[136] Not controversial, however, is the high success rate of the wolves' (collaborative) activities,[137] from which the clear incentives for collaboration or at least parallel engagement stem. The focus here is on the possibility of bundling influence and the resulting increased clout of engagement. The intensity of the collaboration involved, on the other hand, is unclear.[138] Typically, a great deal of energy is spent on not falling within the scope of the acting in concert provisions,[139] which is why coordination is "implicit" rather than "explicit", whatever that may mean in the individual case. In any event, there are persuasive indications that there are indeed coordinating efforts on the part of the hedge funds involved in the wolf pack.[140]

b) Coalitions between non-activist institutional investors and hedge funds

Another form of co-working, not necessarily of collaboration, that has been extensively studied is that between hedge funds, on the one hand, and non-activist institutional investors – i.e. active and passive diversified funds, in particular –, on the other.[141]

At least in theory, no direct communication between an activist hedge fund and the institutional investors potentially supporting is actually necessary;[142] it probably does not often occur in practice. Rather, a hedge fund will unilaterally plan to obtain support from other institutional investors by aligning its agenda with the publicly available voting

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[135] *Brav/Dasgupta/Mathews*, Management Science 68 (2022), 5557; *Dimson/Karakaş/Li*, Coordinated Engagements, ECGI Finance Working Paper No. 721/2021, p. 4; *Balp/Strampelli*, Ohio State Business Law Journal 14 (2020), 135, 168.

[136] Cf. *Bebchuk/Brav/Jiang*, Columbia Law Review 115 (2015), 1085; *Brav/Jiang/Kim*, Review of Financial Studies 28 (2015), 2723 on the one side (value enhancing) and *Cremers/Giambona/Sepe/Wang,* Hedge Fund Activists: Value Creators or Stock Pickers?, 2021, SSRN-Working Paper, available at: https://papers.ssrn.com/sol3/papers.cfm?abstract_id=3614029 (value destroying) on the other.

[137] *Becht/Franks/Grant/Wagner*, Review of Financial Studies 30 (2017), 2933; *Wong*, Management Science 66 (2020), 2291; *Crane/Koch/Michenaud*, Journal of Financial Economics 133 (2019), 175.

[138] See *Balp/Strampelli*, Ohio State Business Law Journal 14 (2020), 135, 169 et seq.

[139] *Dimson/Karakaş/Li*, Coordinated Engagements, ECGI Finance Working Paper No. 721/2021, p. 4; *Wong*, Management Science 66 (2020), 2291; in more detail *Coffee/Palia*, Journal of Corporation Law 41 (2016), 545; see also *Balp/Strampelli*, Ohio State Business Law Journal 14 (2020), 135, 169 et seq.; *Bebchuk/Brav/Jackson Jr./Jiang*, Journal of Corporation Law 39 (2013), 1, 4 et seq.

[140] *Coffee/Palia*, Journal of Corporation Law 41 (2016), 545, 565; *Wong,* Management Science 66 (2020), 2291. See also *Balp/Strampelli*, Ohio State Business Law Journal 14 (2020), 135, 170 et seq.

[141] See, e.g., *Brav/Dasgupta/Mathews*, Management Science 68 (2022), 5557; *Kedia/Starks/Wang*, Review of Corporate Finance Studies 10 (2021), 1; *Balp/Strampelli*, Ohio State Business Law Journal 14 (2020), 135, 172; *Ringe*, in Gordon/Ringe, The Oxford Handbook of Corporate Law and Governance, 2017, p. 387, 419.

[142] *Balp/Strampelli*, Ohio State Business Law Journal 14 (2020), 135, 173.

preferences of large institutional investors. To do this, of course, it must convince those institutional investors that it is pursuing an informed strategy with respect to the target company that is also in line with their interests.[143]

Even if regulatory hurdles may sometimes prevent an activist from doing so, attempts to "convince" will of course usually be more successful if the hedge fund directly contacts institutional investors and thus assures itself of their support, or at least the likelihood of their support, in advance. It can, therefore, already be assured of the potentiation of the voting power, even if active and passive funds will not bear any portion of the costs of the engagement. If hedge funds do not communicate with the institutional investors to ascertain the possibility of support for their plans, they run the risk of the institutional investors deciding not to support a specific engagement and of the campaign failing – an outcome which also occurs in practice (again, Carl Icahn is a good, more recent example).

c) Investor organizations

Other traditional actors enabling shareholder collaboration and collaborative engagement are investor associations and initiatives.[144] In this regard, the Council of Institutional Investors or the Investor Stewardship Group in the US, the Institutional Investors' Forum in the UK, Assogestioni in Italy, and the Bund Institutioneller Investoren in Germany come to mind.[145] Usually, no firm-specific engagement is coordinated via such organizations, at the meetings organized by them or in the statements published by them; rather, there is at most an understanding about certain interests that coincide across the broader portfolio. Traditionally, such consensus has related, in particular, to governance aspects, on which the relevant organizations have exerted influence for decades in aggregating and then communicating the interests of the institutional investors they represent.[146] However, there are national differences, with Assogestioni, in particular, also being heavily involved in the appointment of board members of individual companies.[147]

2. ESG-driven approaches

The E&S engagement that has been observed recently is characterized by the apparent proliferation of – to some extent novel forms of – collaboration between

[143] *Balp/Strampelli*, Ohio State Business Law Journal 14 (2020), 135, 172.
[144] *Doidge/Dyck/Mahmudi/Virani*, Review of Finance 2019, 893, 894; *Balp/Strampelli*, Ohio State Business Law Journal 14 (2020), 135, 141.
[145] See also *Bowley/Hill*, Stewardship and Collective Action: The Australian Experience, ECGI Law Working Paper No. 491/2020, p. 19 et seqq. for a Australian perspective.
[146] A recent study that examines governance engagement by an investor collective action organization in greater detail is *Doidge/Dyck/Mahmudi/Virani*, Review of Finance 2019, 893.
[147] *Balp/Strampelli*, Ohio State Business Law Journal 14 (2020), 135, 181 et seqq.

institutional investors.[148] We have already touched upon the incentives for such collaborations and the solid results that these can produce. In the following, we present several forms of collaborative shareholder engagement that have been observed in recent years. In addition to numerous investor initiatives – particularly in the area of climate protection –, such as Race to Zero, the UN-Convened Net-Zero Asset Owner Alliance, the Net Zero Asset Managers initiative, and the Paris Aligned Investment Initiative, which primarily aim to persuade signatory institutional investors to commit to the attainment of certain general targets, the following section will focus on specific forms of collaboration, or the promotion of such collaboration, with regard to ES(G) commitment.[149]

In addition, we venture an outlook on potentially emergent types of collaborations. The increasing public interest in climate protection, in particular, leads us to expect a potential increase in collaborations between investors on the one hand and the public or public activists on the other hand in the future. In such situations, the management of the company affected by the commitment could feel inclined to give in to the demands made of it, above all from a reputational point of view. In addition, the recent increase in climate lawsuits filed by environmental associations suggests the emergence of a new form of collaboration: Investors building up pressure from within, while climate lawsuits filed by environmental associations reinforcing this pressure from outside.

a) The Big Three

A special role in ESG engagement is attributed to the Big Three, as mentioned in the foregoing.[150] This is due to their special position (too big to be passive), the political and public pressure and the associated reputational effects to which they are subject, and possibly also to their special position as universal owners. To date, at least as far as collaborations are concerned, the Big Three have made their presence felt by supporting the campaigns of activist investors – especially impact funds. In contrast, not much is known about active collaboration among the Big Three themselves, although at least in the context and aftermath of State Street's Fearless Girl campaign, there has been some talk of "concerted" action by the Big Three.[151] In any case, the pressure which has concurrently been exerted on portfolio companies in the US has

[148] *Ringe*, Investor-led Sustainability in Corporate Governance, ECGI Law Working Paper No. 615/2021, p. 20 et seq.; *Bowley/Hill*, The Global ESG Stewardship Ecosystem, ECGI Law Working paper No. 660/2022.
[149] Instructive on the ESG Ecosystem, see *Bowley/Hill*, The Global ESG Stewardship Ecosystem, ECGI Law Working paper No. 660/2022, p. 29 et seqq.
[150] At least as far as shareholder resolutions are concerned, their special role is quite questionable. See *Briere/Pouget/Schmalz/Ureche-Rangau*, Do the Big Three Vote to Curb Climate Change? (April 21, 2022), available at SSRN: https://ssrn.com/abstract=4245612 or http://dx.doi.org/10.2139/ssrn.4245612 .
[151] *Gormley/Gupta/Matsa/Mortal/Yang*, ECGI Finance Working Paper No. 714/2020, p. 1.

led to more than 300 public companies revamping their boards and electing at least one female director within just one year.[152] This shows, unsurprisingly, that the Big Three are able to exert even greater influence when they pursue certain goals jointly or at least in tandem.

b) Specialist funds (e.g. impact funds or value hedge funds) taking the lead: the good wolf pack?

In the area of collaborative ESG engagement, we increasingly see specialist funds working together, sometimes with specific, not exclusively financial, objectives (impact funds). Unlike the traditional wolf packs, collaboration is practiced more openly here. The participating funds explicitly work together, exchange information – also via institutionalized platforms (V.2.d)) – and use their combined influence to bring about ESG-compliant behaviour on the part of investment companies.

In this context, classic value hedge funds have also participated in such "good"[153] wolf packs or even taken on the leading role while, on the other hand, it has even been argued in the past that value hedge funds increasingly attack companies with a positive ESG rating because they see this engagement as a waste of money.[154] One may recall, for example, Elliot Management's engagement against Evergy in early 2020, in which Elliot was supported by Bluescape Energy Partners.[155] However, after a very successful year for E&S engagement, especially on the part of hedge or impact funds, in 2021, ESG-engagement has decreased in the current year – due to, among other things, the changes to the geopolitical landscape currently underway. Nevertheless, 2022 has already seen some spectacular incidences of engagement by specialized activist funds. For example, ThirdPoint's engagement with Shell with a call to split up the company,[156] or the engagements with Total, Standard Chartered and Sainsbury's, each of which was carried by a collaboration of specialized funds.

c) Coalitions between non-activist institutional investors and between non-activist investors and hedge or impact funds

In the area of E&S engagement, large institutional investors ("mainstream" institutional investors[157]), especially pension funds and other mutual funds, are a major driving

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[152] *Ringe*, Investor-led Sustainability in Corporate Governance, ECGI Law Working Paper No. 615/2021, p. 7.
[153] Cf. also *Hill*, Good Activist/Bad Activist: The Rise of International Stewardship Codes, ECGI Law Working Paper No. 368/2017.
[154] *Fletcher*, Ethical CSR focus triggers hostile investor activism, study finds, August 3 2020.
[155] *Ringe*, Investor-led Sustainability in Corporate Governance, ECGI Law Working Paper No. 615/2021, p. 24 with further details.
[156] *Reed*, Third Point, an activist investor, is calling for a breakup of Royal Dutch Shell, New York Times, Oct. 28, 2021, available at: https://www.nytimes.com/2021/10/28/business/third-point-shell-breakup.html.
[157] *Bowley/Hill*, The Global ESG Stewardship Ecosystem, ECGI Law Working paper No. 660/2022, p. 7 et seqq.

force.[158] Numerous – particularly successful – campaigns have been led by such collaborations in recent years. Examples include the Investors for Opioid and Pharmaceutical Accountability campaigns and the Human Capital Management Coalition. Such collaborations between institutional investors must – quite often – be supplemented by coordination with the respective asset managers of the institutional owners, which in practice means additional effort and often complications.

Besides, in ESG engagement – much like in traditional shareholder value engagement –, the interaction between specialized (hedge) funds and large institutional investors is hugely important.

In this respect, Engine No. 1's engagement with ExxonMobil has certainly received the most attention. The small impact hedge fund, with a share of only about 0.02% of the voting rights, succeeded in gaining the support of huge institutional investors and, thus, in pushing through three of its four proposals for the board of ExxonMobil at the annual general meeting.[159] This was preceded by increased engagement by Engine No. 1 with numerous – mainly climate-related – criticisms and calls against Exxon. Engine No. 1 was supported from the beginning by CalSTRS, which shows active collaboration between an impact fund and a large institutional investor, especially in this still informal phase.[160]

Other cases of a successful collaboration between hedge (impact) funds and large institutional investors in terms of E&S engagement include the cases of Green Century Equity Fund vs. Procter & Gamble,[161] the engagement on "say on climate" of The Children's Investment Fund (TCI) towards several large US companies,[162] the engagement against the management of Rio Tinto,[163] and the engagement of *Mike Cannon-Brookes* against AGL Energy. The latter was able to push through his climate-

[158] See *Bowley/Hill*, The Global ESG Stewardship Ecosystem, ECGI Law Working paper No. 660/2022, p. 7 et seqq.; see, furthermore, PPI, Engaging with ESG: Climate Change, 2021, with a thorough investigation into the engagements of pension schemes available at: https://www.pensionspolicyinstitute.org.uk/media/3742/20210218-ppi-engaging-with-esg-climate-change-report-final.pdf.
[159] *Ringe*, Investor-led Sustainability in Corporate Governance, ECGI Law Working Paper No. 615/2021, p. 20.
[160] *Ringe*, Investor-led Sustainability in Corporate Governance, ECGI Law Working Paper No. 615/2021, p. 20.
[161] *Gray/Temple-West*, *Investor rebellion at Procter & Gamble over environmental concerns*, FT-online, 14 October 2020, https://www.ft.com/content/1dd92502-e95b-4c21-be1c-c18a598acf1a. See also in this regard *Ringe*, Investor-led Sustainability in Corporate Governance, ECGI Law Working Paper No. 615/2021, p. 22.
[162] *Ringe*, Investor-led Sustainability in Corporate Governance, ECGI Law Working Paper No. 615/2021, p. 22; *Bowley/Hill*, The Global ESG Stewardship Ecosystem, ECGI Law Working paper No. 660/2022, p. 6 et seq.
[163] For a detailed assessment, see *Bowley/Hill*, The Global ESG Stewardship Ecosystem, ECGI Law Working paper No. 660/2022, p. 19 et seqq.

related goals – at least in part – and force important board members to withdraw, primarily with the backing of specialized funds and a large Australian pension fund.[164]

d) Institutionalized platforms and intermediaries

A special feature of ESG collaboration is certainly the establishment of institutionalized platforms for organizing collaborative engagement.[165] These platforms allow to organize collaborations of the kind described herein, while also drawing on the possibilities and resources of a third-party platform operator.

One of the most established platforms in this respect is the Principles for Responsible Investment (PRI) Collaboration Platform, which was created by investors in cooperation with or with the support of United Nations Environment Programme (UNEP) Finance Initiative and the UN's Global Compact (UNGC).[166] The PRI Collaboration Platform is currently the largest platform[167] for organizing collaborative engagements – of varying intensity – and for sharing responsible investment-related issues. Typically, individual investors publish an engagement strategy or topics to be addressed on the platform in the hopes of finding support for their project. At the initial stage, this may involve the submission of requests or demands to the management of a target company, and extend all the way to the coordination of concrete voting behaviour at shareholders' meetings.

An example of a recently initiated collaboration is the project under the lead of Bluebell Capital Partners vis-à-vis Glencore Plc. Bluebell Capital Partners is working towards forming a coalition of stakeholders, requesting the Board of Directors of mining company Glencore Plc, to implement substantial changes to its climate strategy.[168] This engagement – which is at a very early, rather informal stage – will initially only include a request to Glencore's management to present certain issues to the 2023 Annual General Meeting. Currently, the open letter intended for this purpose has the support of several impact funds and also other institutional investors (for example, Austrian Bundespensionskasse AG).

In their recent working paper, *Dimson*, *Karakaş* and *Li* examined a total of 31 PRI-coordinated engagement projects in the areas of ESG and (reflecting the UN origins of

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[164] For further details, see *Fernyhough/Fildes*, Tech billionaire wins activist fight against Australia's biggest polluter, FT-online, 30 May 2022.
[165] *Ringe*, Investor-led Sustainability in Corporate Governance, ECGI Law Working Paper No. 615/2021, p. 25, 42; *Dimson/Karakaş/Li*, Coordinated Engagements, ECGI Finance Working Paper No. 721/2021, p. 14 et seqq.; *Balp/Strampelli*, Ohio State Business Law Journal 14 (2020), 135, 181.
[166] *Ringe*, Investor-led Sustainability in Corporate Governance, ECGI Law Working Paper No. 615/2021, p. 42; *Bowley/Hill*, The Global ESG Stewardship Ecosystem, ECGI Law Working paper No. 660/2022, p. 12 et seqq.
[167] In 2021, there were a total of 3,826 signatories to the Principles of Responsible Investment.
[168] See https://collaborate.unpri.org/group/11606/about.

the PRI) work related to the UNGC and its sustainable development goals.[169] As has already been touched upon, they concluded that collaborative engagements are particularly successful when a lead investor leads the coordination and the investor group - unsurprisingly - has a larger voting stake in the target company.[170] Moreover, the research indicates that a significant incentive for involvement in an engagement stems from the location of the investors, in particular, from whether the potentially participating investors are located in the same country.[171] This finding is in line with an application of network theory. Since institutional investors are involved in a complex network of relationships, these relationships have a very decisive influence on their behaviour.[172]

Another growing platform is the Climate Change 100+ initiative, which has been joined by more than 600 institutional investors with a total of more than $65 trillion in assets under management, [173] including BlackRock, the California Public Employees' Retirement System (CalPERS), Fidelity, and J.P. Morgan Asset Management. Climate Change 100+ also provides a platform for collaboration.[174] The initiative aims to reduce climate risk throughout the global economy and to encourage companies to seize related opportunities. By collaborating with other investors in engaging with important emitters and large companies involved in the net-zero transition, signatories can benefit from a louder collective voice while also pooling engagement resources.[175] Recently, however, criticism has been voiced about the sincerity of some of the signatories.[176]

In addition to communication platforms, there are also intermediaries that actively seek to organize ESG-driven collaborations, such as ShareAction, with participation by or involvement of private investors. Earlier this year, for example, a coalition of investors organized by ShareAction issued a shareholder resolution calling on Unilever to set ambitious targets for increasing the proportion of healthy food items in its product

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[169] *Dimson/Karakaş/Li*, Coordinated Engagements, ECGI Finance Working Paper No. 721/2021, p. 1.
[170] *Dimson/Karakaş/Li*, Coordinated Engagements, ECGI Finance Working Paper No. 721/2021, p. 30.
[171] *Dimson/Karakaş/Li,* Coordinated Engagements, ECGI Finance Working Paper No. 721/2021, p. 26.
[172] *Enriques/Romano,* University of Illinois Law Review 2019, 223, 242 et seq.; cf. also *Bowley/Hill*, The Global ESG Stewardship Ecosystem, ECGI Law Working paper No. 660/2022, p. 24 et seqq.
[173] *Mundy/Temple-West/Talman*, 'It's greenwashing': Climate Action 100+ members let standards slip, FT-online, February 2, 2022; *Ringe*, Investor-led Sustainability in Corporate Governance, ECGI Law Working Paper No. 615/2021, p. 25; *Bowley/Hill*, The Global ESG Stewardship Ecosystem, ECGI Law Working paper No. 660/2022, p. 24 et seqq.
[174] *Ringe*, Investor-led Sustainability in Corporate Governance, ECGI Law Working Paper No. 615/2021, p. 25.
[175] Available at: https://content.ftserussell.com/sites/default/files/r3_200091_pri_lseg_investor_guide_to_climate_v14.6.pdf
[176] On the success and impact: See the Report: Majority Action, Fulfilling the Promise: How Climate Action 100+ Investor-Signatories Can Mitigate Climate Risk, 2022: https://static1.squarespace.com/static/5d4df99c531b6d0001b48264/t/61f9dd286de416510cf30326/1643765035439/MajorityAction_CA100_Report2022.pdf; *Mundy/Temple-West/Talman*, 'It's greenwashing': Climate Action 100+ members let standards slip, FT-online 2 February 2022.

range. This resolution was supported by 11 key institutional investors (including Candriam, Dutch asset manager ACTIAM, US healthcare provider Trinity Health, and the UK's Guy's & St Thomas' Foundation, asset manager CCLA Good Investment, and the Greater Manchester Pension Fund). In response to the resolution, Unilever has actually committed to disclosing the healthiness of its products sold measured on the basis of major government-endorsed nutrient profile models – as requested by the resolution – as well as their own internal metrics. It will also publish annual assessments of this data for 16 of its key strategic markets.[177]

e) Investor organizations

Recently, also some investor organizations with a particular focus on ES(G) issues were established. These include the Asia Investor Group on Climate Change (AIGCC), an initiative with 49 members representing more than $11 trillion in assets under management; the Investor Group on Climate Change (IGCC), a collaboration of Australian and New Zealand institutional investors focused on the investment implications of climate change; and the Institutional Investors Group on Climate Change (IIGCC), a European membership organization for climate change investor collaboration with more than 270 members, mainly pension funds and asset managers, with over €35 trillion in assets under management.

f) Collaboration between institutional investors and the public, climate activists, and environmental organizations

The increasing public focus and pressure on climate protection issues, in particular, leads us to expect entirely new forms of collaboration, namely the involvement of the public or environmental organizations as collaborators in shareholder engagement. We have already seen in the recent past that public pressure, also channelled through climate action initiatives – such as Fridays for Future – have been able to exert considerable pressure on companies. One example is the debate surrounding a coal mine in Australia supplied by Siemens, in the course of which the former Siemens CEO "offered" climate activist *Luisa Neubauer* a seat on the supervisory board of Siemens Energy.[178] If such climate protests are accompanied by a simultaneous exertion of (potentially bundled) pressure from investors, they can certainly have a considerably reinforcing effect on the attainment of the underlying objectives of those protests.

Moreover, investors, on the one hand, and environmental protection organizations, on the other, could in the future increasingly engage in work-sharing in the context of their activist endeavours. One example of this would be the internal exertion of

[177] https://shareaction.org/shareholder-resolutions/shareholder-resolutions-2022.
[178] See, e.g., *Connolly*, Climate activist turns down Siemens' offer of seat on energy board, Guardian, 13 January 2020, available at: https://www.theguardian.com/environment/2020/jan/13/climate-activist-turns-down-siemens-offer-of-seat-on-energy-board.

pressure by investors, accompanied by the filing of environmental complaints by external parties (as in the Shell case in the Netherlands). In this respect, too, external pressure from environmental organizations and the public could significantly increase the clout of activist shareholders.

VI. Obstacles to (Effective) Collaboration

Collaborative engagement by institutional investors must overcome certain obstacles. In the following, we focus on legal obstacles knowing full well that legal obstacles can also be economic ones ("compliance risks"). We do not discuss obstacles that are not specific to collaboration, but rather impede engagement in general. In the context of legal obstacles, these include fiduciary duties owed by institutional investors to end investors[179] or to the company or other shareholders and proxy solicitation rules,[180] in particular.[181]

With respect to legal obstacles, it should be noted that while stewardship codes have recently encouraged collaborative engagement,[182] the legal hurdles have by no means been completely eliminated and are still seen as an obstacle to effective collaboration.

The legal obstacles described below are in place for the most part in the US, as well as in the EU and the UK. Nevertheless, there are certainly differences in substantive law and also in enforcement issues, particularly between the EU/UK, on the one hand, and the US, on the other. Our analysis focuses on the regulatory barriers that exist in the EU and Brexit notwithstanding, still exist in the UK although the significance of the interpretative decisions of ESMA and the ECJ – depending on the point in time of the specific judgement or order – for the UK regime will diminish.[183]

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[179] *Schanzenbach/Sitkoff*, Stanford Law Review 72 (2020), 381, 399 et seqq. with further references; an overview over several jurisdictions is available in the report by Freshfields Bruckhaus Deringer, "A legal framework for the integration of environmental, social and governance issues into institutional investment: Produced for the Asset Management Working Group of the UNEP Finance Initiative", October 2005, p. 30 et seqq., available at: https://www.unepfi.org/fileadmin/documents/freshfields_legal_resp_20051123.pdf.

[180] *Christie*, University of California Davis Law Review 55 (2021), 875, 942; *Ringe*, Investor-led Sustainability in Corporate Governance, ECGI Law Working Paper No. 615/2021, p. 40.

[181] Nor does the duty of loyalty owed by shareholders to the company or their co-shareholders result in any limits specific to collaboration. Rather, shareholders (depending on the jurisdiction, there are of course particularities and disputes about the details here) must act in the interests of the company and their co-shareholders, in particular not to the detriment of the company.

[182] *Balp/Strampelli*, Ohio State Business Law Journal 14 (2020), 135, 173 et seqq.; *Bowley/Hill*, Stewardship and Collective Action: The Australian Experience, ECGI Law Working Paper No. 491/2020, p. 3; ACCA, A Review of Corporate Governance in UK Banks and Other Financial Industry Entities – Final Recommendations'(26 November 2009) (Walker Review), note 5.43.

[183] Under the Agreement on the withdrawal of the United Kingdom of Great Britain and Northern Ireland from the European Union and the European Atomic Energy Community, 2019/C 384 I/01 (Withdrawal Agreement), judgments and orders of the ECJ handed down before the end of the transition period, as well as judgments and orders handed down in certain pending cases and certain new cases (Art. 86, 87 of the Withdrawal Agreement), have binding force in their entirety on and in the

1. Acting in concert

The focal point of the discussion on legal hurdles is the danger that the collaborative interaction will be classified as "acting in concert", which can have consequences both (i) for the disclosure of shareholdings and, (ii) at least in the EU and in the UK, within the framework of takeover law.[184] ESMA has simplified matters in practice, at least as far as acting in concert under Directive 2004/25/EC of 21 April 2004 on takeover bids (the "Takeover Bids Directive") is concerned, by publishing a so-called "White List".

(i) First, with respect to *disclosure of shareholdings* and the obligation of parties acting in concert, pursuant to Art. 10(a) of the Transparency Directive, two or more persons will only be deemed to be acting in concert where they have "concluded an agreement" "which obliges them to adopt, by concerted exercise of the voting rights they hold, a *lasting* common policy towards the management of the issuer in question".

With regard to the binding nature of the "agreement", it must be, at a minimum, a "gentlemen's agreement" with an actual commitment secured by "sanctions of a social, moral or economic nature".[185] Thus, informal communication forums or platforms between investors are excluded from the outset, provided that these do not require a specific commitment with regard to the exercise of voting rights.

The requirement of a "lasting common policy" is intended, in particular, to rule out collaboration in individual cases.[186] Especially in the case of ES(G)-related activism, however, the line between an individual case and a "lasting common policy" is very thin. For example, where the commitment in question is aimed at bringing about a general change in corporate policy, even if it is limited to a one-off action against the company concerned, it is certainly debatable whether it crosses the threshold to a lasting common policy. However, at least the German Federal Court of Justice (Bundesgerichtshof) understands the "individual case criterion" as being a purely formal one; the degree of the influence exercised and the sustained nature of its effects are not decisive.[187] If the ECJ were to uphold this line of argumentation in its

United Kingdom (Art. 88 of the Withdrawal Agreement). For more details, see Art. 86 et seqq. of the Withdrawal Agreement.

[184] See *Balp/Strampelli*, Ohio State Business Law Journal 14 (2020), 135, 203; *Ringe*, Investor-led Sustainability in Corporate Governance, ECGI Law Working Paper No. 615/2021, p. 40 et seq.; cf. *Taleska*, European Business Organization Law Review 19 (2018), 797; see also *Bowley/Hill*, Stewardship and Collective Action: The Australian Experience, ECGI Law Working Paper No. 491/2020, p. 27 et seqq. for the Australian perspective.

[185] See, e.g., BaFin, Emittentenleitfaden, 5th ed. 2018, B No. I.2.5.10.1.

[186] See, in particular, German Federal Court of Justice (Bundesgerichtshof), BGHZ 169, 98, 107 = Neue Juristische Wochenschrift Rechtsprechungs-Report 2007, 1179, 1181 et seq.; Higher Regional Court (Oberlandesgericht) of Frankfurt Neue Juristische Wochenschrift 2004, 3716 on the German Securities Acquisition and Takeover Act.

[187] German Federal Court of Justice (Bundesgerichtshof) Neue Zeitschrift für Gesellschaftsrecht 2018, 1350 para. 34 et seqq.

interpretation of Art. 10 of the Transparency Directive, this would considerably pave the way for (substantial) ESG engagement in particular.

(ii) European takeover law stipulates to some degree similar requirements for a finding of "acting in concert". Under the implementation provisions of Art. 5 of the Takeover Bids Directive, persons acting in concert may be obliged to make a mandatory bid under the mandatory bid rule. Pursuant to the definition of acting in concert in Art. 2(d) of the Takeover Bids Directive, acting in concert refers to "natural or legal persons who cooperate with the offeror or the offeree company on the basis of an agreement, either express or tacit, either oral or written, aimed either at acquiring control of the offeree company or at frustrating the successful outcome of a bid".

In practice, however, the obstacle posed by takeover law will be far less significant, given that, in many cases, the higher 30% threshold will not be reached.

(iii) The remaining doubts as to the interpretation of the term "acting in concert" under the Transparency Directive and under the Takeover Bids Directive obviously create considerable legal uncertainty for the practice of collaborative engagement. For practitioners, such uncertainty is unfortunate, to say the least. Even taking into account that it is rather difficult to show that companies have been acting in concert, at least under the current EU regime (in this respect, the TCI/Deutsche Börse case might come to mind), less risk averse investors should keep in mind that the ECJ has adopted a rather simplified approach to the discharging of the EU Commission's burden of proof under antitrust law with regard to the existence of agreements,[188] a practice which could conceivably also be extended to capital markets law.

Unsurprisingly, then, the European Commission had already stated in its 2012 report on the Takeover Bids Directive to the European Parliament and the Council of the EU that clarification of the concept of "acting in concert" was required in order to reduce uncertainty for international investors who want to cooperate on corporate governance issues but feel deterred from doing so for fear of a mandatory offer.[189] It then reiterated this view in its 2012 Action Plan on European Company Law and Corporate Governance, stating that "effective, sustained shareholder engagement is one of the cornerstones of the corporate governance model of listed companies". It went on to say that "without the proposed clarification, shareholders could avoid cooperation, which in turn could undermine the potential for long-term engaged share ownership where shareholders effectively hold the board accountable for its actions".

Following on from this, ESMA has drawn up a White List of collaborations or collaborative engagements that are generally not intended to constitute acting in

[188] Cf. ECJ, judgement of 17 May 2013 - Trelleborg Industrie and Trelleborg v Commission, Joint Cases T-147/09 and T-148/09.
[189] Cf. COM(2012)347.

concert within the meaning of the Takeover Bids Directive.[190] According to this White List, it does not constitute acting in concert per se if shareholders cooperate in "(a) entering into discussions with each other about possible matters to be raised with the company's board; (b) making representations to the company's board about company policies, practices or particular actions that the company might consider taking; (c) other than in relation to the appointment of board members, exercising shareholders' statutory rights to: (i) add items to the agenda of a general meeting; (ii) table draft resolutions for items included or to be included on the agenda of a general meeting; or (iii) call a general meeting other than the annual general meeting; (d) other than in relation to a resolution for the appointment of board members and insofar as such a resolution is provided for under national company law, agreeing to vote the same way on a particular resolution put to a general meeting".

However, the "White List" is not legally binding for the interpretation of the relevant implementation provisions of the Takeover Bids Directive in the Member States and certainly not for the UK. Moreover, it does not, in principle, provide any orientation for the interpretation of the Transparency Directive. It does, however, provide some orientation for the assessment and evaluation of collaborative engagements by ESMA, which is helpful in practice. Fortunately, in its recently published "Sustainable Finance Roadmap 2022-2024", ESMA has indicated in its list of planned activities and deliverables that it will contribute to "developing further guidance in the area of stewardship and engagement to ensure acting in concert does not impede collaborative engagement by investors around common sustainability goals".[191]

2. Insider Regulation

Another fairly significant obstacle to collaborative engagement is insider law.[192] In this context, one must distinguish from the outset between (i) inside information that individual investors obtain about the issuer or its financial instruments and (want to) exchange with other investors as part of the collaboration and (ii) inside information the precise subject of which is the planned collaborative engagement and which is therefore "produced" by the collaborating investors themselves.

(i) As regards inside information which individual investors have obtained and which they intend to exchange with other investors for collaborative purposes, *sedes materie*

[190] ESMA, Public Statement – Information on shareholder cooperation and acting in concert under the Takeover Bids Directive, ESMA/2014/677, 20 June 2014 (last updated: 8 January 2019), available at: https://www.esma.europa.eu/sites/default/files/library/esma-2014-677-rev_public_statement_concerning_shareholder_cooperation_and_acting_in_concert.pdf. See also *Balp/Strampelli*, Ohio State Business Law Journal 14 (2020), 135, 203; *Ringe*, Investor-led Sustainability in Corporate Governance, ECGI Law Working Paper No. 615/2021, p. 41.
[191] ESMA, Sustainable Finance Roadmap 2022-2024, ESMA30-379-1051, p. 29.
[192] Cf. *Balp/Strampelli*, Ohio State Business Law Journal 14 (2020), 135, 190; *Ringe*, Investor-led Sustainability in Corporate Governance, ECGI Law Working Paper No. 615/2021, p. 41; *Taleska*, European Company and Financial Law Review 2020, 558, 580 et seqq.

in European Union market abuse law are Arts. 14 and 10 of the Regulation (EU) No 596/2014 of 16 April 2014 on market abuse (MAR). Pursuant to these provisions, inside information – regardless of how it was obtained – may not be unlawfully (selectively) disclosed to other persons, while Art. 10 of the MAR stipulates that a lawful disclosure is one "made in the normal exercise of an employment, a profession or duties".[193] Thus, the MAR recognizes situations in which the interest in disclosure may outweigh the market's interest in containing the disclosure of information.[194] As regards the interests of the affected parties, the ECJ's Grøngaard and Bang decision clarified that the legitimate interest in disclosure can be based on national law, while the interest in the containment of information as well as the standards for balancing the interests are to be derived from EU law.[195]

The interest of an individual investor in sharing inside information with the collaboration partners may well be justified, since it serves the purpose of collaborative engagement intended by the investor to facilitate the pursuit of certain legitimate (economic) objectives.[196] However, the individual investor may not already have obtained the information by way of a violation of the prohibition of disclosure by, for example, the issuer in the context of an impermissible selective disclosure of information to individual investors[197], and the investor sharing the information may not also be in violation of a confidentiality agreement[198].

(ii) With respect to the information about an imminent collaborative engagement or concrete activist plans of the collaborators, the legal position is even more difficult. Indeed, such knowledge may also qualify as inside information within the meaning of Article 7 of the MAR. If knowledge of an imminent engagement qualifies as inside information – a parallel discussion is currently underway in Germany regarding the classification of knowledge of the publication of a research report in the case of short seller attacks[199] –, this may pose an obstacle to trading (Art. 14(a) and (b) of the MAR) and, additionally, may prohibit the disclosure of such information (Art. 14(c) of the MAR), in each case with an inhibitory effect on any intended collaborative engagement.

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[193] For more details, see *Mosca*, in Ventoruzzo/Mock, Market Abuse Regulation, 2nd ed. 2022, Art. 10 note 10.46 et seqq.; *Gerner-Beuerle*, in Lehmann/Kumpan, European Financial Services Law, 1st ed. 2020, Art. 10 MAR note 4 et seqq.

[194] Cf. *Klöhn* in Klöhn, Marktmissbrauchsverordnung, 1st ed. 2018, Art. 10 note 36.

[195] ECJ judgment of 22 November 2005 – Case C-384/02, OJ 2005, I-09939 para. 40, 44, 47 et seq., 50–52 (Grøngaard and Bang). For more details, see *Klöhn* in Klöhn, Marktmissbrauchsverordnung, 1st ed. 2018, Art. 10 note 38 et seqq.

[196] Cf. *Mosca*, in Ventoruzzo/Mock, Market Abuse Regulation, 2nd ed. 2022, Art. 10 note 10.88.

[197] See *Klöhn* in Klöhn, Marktmissbrauchsverordnung, 1st ed. 2018, Art. 10 note 187 et seqq.; *Hirt/Hopt/Mattheus*, Die Aktiengesellschaft 2016, 725; *Bachmann*, in: Vereinigung für Gesellschaftsrecht Tagungsband 2016, p. 135; *Fleischer/Bauer/Wansleben,* Der Betrieb 2015, 360; *Leyendecker-Langner*, Neue Zeitschrift für Gesellschaftsrecht 2015, 44.

[198] See *Klöhn* in Klöhn, Marktmissbrauchsverordnung, 1st ed. 2018, Art. 10 note 59 et seqq.

[199] Cf. *Langenbucher/Hau/Wentz*, Journal of Banking Law and Banking 2019, 307.

It is true that Art. 9(5) of the MAR provides that the mere fact that a person uses their knowledge of their decision to acquire or dispose of financial instruments in acquiring or disposing of those financial instruments does not in itself constitute use of inside information. However, the exception provided for by Art. 9(5) of the MAR only applies to a person's own decision, and not to a collusive decision, which affects not only that person's own decision but also that of a third party.[200] In the Georgakis case before the ECJ, the main question posed – and answered in the affirmative by the Court – was whether inside information can also consist of a decision to "support" a share price by several members of a group who agree among themselves to artificially influence the price of securities.[201] Moreover, information about upcoming collaborative engagement is frequently not limited to one's own or to joint *trading* decisions, but also comprises information about other activist activities, such as the introduction of an agenda item at the AGM or the removal of a board member.

All in all, the insider prohibitions of the MAR substantially limit the exchange of information in many collaborations and, hence, will also hamper ESG collaborative engagement on the part of institutional investors.

3. Non-disclosure obligations generally

Further statutory non-disclosure obligations may result from statutory law, in particular, from the organizational law of the legal entities of the institutional investors in question.

Moreover, confidentiality agreements concluded by individual investors with the issuer may have an inhibitory effect on institutional investors' ESG collaborative engagement. Pursuant to Art. 17(8) of the MAR, such confidentiality agreements are a basic prerequisite for an issuer to be able to pass on inside information selectively to individual investors.[202]

4. Competition/antitrust law

Very recently, it has been suggested that collaborative ESG engagement may violate antitrust law.[203] In this respect, the question at issue is not whether the concentration of share ownership, especially among the Big Three, can have anti-competitive effects

[200] *Klöhn* in Klöhn, Marktmissbrauchsverordnung, 1st ed. 2018, Art. 9 note 133.
[201] ECJ, judgment of 10 May 2007 – Case C-391/04, ECLI:EU:C:2007:272 – Georgakis para. 33 et seqq; on that issue, see *Sajnovits*, Zeitschrift für Unternehmens und Gesellschaftsrecht 2021, 804, 824 et seqq. On the basis of the old Insider Dealing Directive (89/592/EEC), however, the ECJ then denied that the members of such a group, in carrying out their plan, were exploiting the inside information they possessed within the meaning of Art. 2 of Directive 89/592/EEC.
[202] See, in more detail, *Mülbert/Sajnovits*, Wertpapier-Mitteilungen 2017, 2041, 2044.
[203] *Brnovich* (Attorney General of Arizona), ESG May Be an Antitrust Violation, WSJ, 6 March 2022, https://www.wsj.com/articles/esg-may-be-an-antitrust-violation-climate-activism-energy-prices-401k-retirement-investment-political-agenda-coordinated-influence-11646594807; see also *Bryan/Mundy/Shimizuishi*, The antitrust threat to climate action, FT-online, 22 July 2022; *Temple-West/Bryan/Edgecliffe-Johnson*, Net zero group cites antitrust threat – legal experts don't buy it, FT-online 29 July 2022.

on product and service markets (anti-competitive effects of common ownership),[204] but whether specific investors involved in collaborative (ESG) engagement could be deemed to be acting in violation of the prohibition against cartels pursuant to Art. 101 of the TFEU or corresponding national antitrust law.

While it may be unlikely that the European Commission or national antitrust authorities would initiate proceedings in matters involving ESG engagement, it is also doubtful that ESG collaborative engagement would generally be deemed to constitute a violation of Art. 101 of the TFEU.

Even though it is true that numerous cases of collaborative engagement will involve at least concerted practices, a prevention, restriction, or distortion of competition is not likely to take place in every case. Although the collaborating investors may well be in a competitive relationship with each other, this will not necessarily be affected by their collaboration with regard to one or more portfolio companies. Rather, such investors will compete with each other in the market for the distribution of their collective investment schemes to end investors, but not in connection with their activism with regard to portfolio companies.

Even if an agreement or a concerted practice were to qualify as a restriction of competition – perhaps not generally but, for example, because it is part of the agreement not to invest in certain companies –, an exception under the ancillary restraints doctrine[205] or an exemption under Art. 101(3) of the TFEU, may apply, in particular if the collaboration rectifies a market failure. In the latter case, the agreement must be one which "contributes to improving the production or distribution of goods or to promoting technical or economic progress", i.e. it will be eligible for exemption under Art. 101(3) of the TFEU if the (economic) benefits provided by it at the level of the individual or, in the Commission's view, also at the level of all consumers, are greater than its adverse effects on competition.

In any case, the European Commission seems to take a favourable view of sustainability-related endeavours.[206] National antitrust authorities have also announced that they do not wish to stand in the way of collaborations aimed at achieving sustainability goals. For example,[207] the Dutch competition authority has issued guidelines that significantly expand the scope for companies to cooperate on

[204] See *Azar/Schmalz/Tecu*, Journal of Finance 73 (2018), 1513; for legal implications, see, e.g., *Enriques/Romano,* University of Illinois Law Review 2019, 223, 262 et seq.
[205] Cf. ECJ judgment of 19 February 2002 – Case C-309/99 – Wouters, para. 97 et seqq., 107, 110.
[206] See the proposed guidelines on the Horizontal Directive., Chap. 9 on Sustainability Agreements. Available at: https://competition-policy.ec.europa.eu/public-consultations/2022-hbers_en.
[207] *Andreas Mundt*, President of the Bundeskartellamt (German Federal Cartel Office), has emphasized that his authority "does not want to stand in the way of cooperations to achieve sustainability goals", 5. Cf. press release of the Bundeskartellamt) from 18 January 2022, available at: https://www.bundeskartellamt.de/SharedDocs/Meldung/DE/Pressemitteilungen/2022/18_01_2022_Nachhaltigkeit.html.

sustainability initiatives, providing companies with interpretation criteria and demonstrating, in the spirit of a more sustainable economic approach, that antitrust law does not necessarily pose an obstacle to companies entering into joint commitments to foster greater climate protection, animal welfare, and social production chains.[208]

5. Data protection law

Another obstacle to collaborative engagement, or at least another aspect that should be taken into consideration in this context, arises out of data protection law. We are unable to delve more deeply into this aspect here. However, if investors process personal data for the purpose of planning collaborative engagements, they must also take the requirements of the General Data Protection Regulation into account. This may become relevant, for example, in cases involving the processing of personal data of board members of portfolio companies.

VII. Conclusion

Collaborative engagement by institutional investors – both the traditional shareholder value-driven and the modern ESG-driven form – has been studied intensely since at least the 1990s. For obvious reasons, most studies have focused on the outcomes, for example the percentage of successful campaigns, the effects on share prices, or other effects on the target company. The situation is less clear with regard to less readily observable factors, for example, how collaborations are set up and how they work internally. Apart from making some informed guesses supported by theoretical considerations,[209] for example, empirical studies to date have for the most part neglected to address the matter of the specific establishment of collaborations.[210]

However, given the great potential of collaborations for effectively carrying out engagements, it is worth taking a closer look at the legal issue in this context as well. Particularly in the context of E&S-related engagements, many see collaboration among institutional investors as an essential way to encourage companies to act responsibly. The future of E&S-driven collaboration, however, is still somewhat unclear, not least in light of the recent backlash from some value hedge funds and, particularly, politicians criticising the proliferation of “woke” corporations.[211] It may well be that, for some time at least, companies will find themselves somewhat torn between ESG-friendly collaborations, on the one hand, and value-focused collaborations, on the other. One may hope that the former will gain and then retain the upper hand, but without outside

[208] Autoriteit Consument & Markt, Guidelines Sustainability claims, 2021, available at: https://www.acm.nl/sites/default/files/documents/guidelines-suistainability-claims.pdf.
[209] See *Enriques/Romano*, University of Illinois Law Review 2019, 223.
[210] But see *Dimson/Karakaş/Li*, Coordinated Engagements, ECGI Finance Working Paper No. 721/2021.
[211] See above at IV.1. and IV.2.(i). See also, for example, *Livingstone/Rosenblum/Alon-Beck/Agmon-Gonnen*, The Attack on Nasdaq’s Board Diversity Rule, OBLB 23 September 2022, available at: https://blogs.law.ox.ac.uk/blog-post/2022/09/attack-nasdaqs-board-diversity-rule.

pressure and support from the political arena, regulators and society at large (NGOs), this is by no means certain.

Among the actions identified in this paper for easing the way for E&S-driven collaboration, creating legal certainty regarding the admissible extent and content of collaborative engagement is of paramount importance. Specifically, ESMA should – as already indicated in its recent Sustainable Finance Roadmap 2022-2024[212] – update its Whitelist, and national regulators should also publish opinions on their interpretive practices. As for Germany, in particular, the mere concern about interference with the acting in concert provisions – even if these are no stricter than in other jurisdictions and are not applied more strictly – is a non-negligible barrier to collaboration, which maybe in part also for cultural reasons.[213] However, contrary to the proposal of the Sustainable Finance Advisory Council of the German Federal Government (Sustainable Finance Beirat der Bundesregierung), which recommended amendments to the German Securities Trading Act and to the German Takeover Act to the German Federal Government,[214] the issue must be addressed at the EU level. Therefore, ESMA's announced intention in its Sustainable Finance Roadmap 2022-2024 to create more legal certainty in that regard is highly welcomed.

Furthermore, one could consider guidance on insider regulation. However, we should not expect too much in that regard given that impediments from the insider regulation are not covered as an issue in ESMAs Sustainable Finance Roadmap 2022-2024. Therefore, for collaborators, organizing an effective framework for detecting inside information and dealing with such information seems to be key. The European Commission and the national antitrust authorities also have a role to play: They should explicitly extend the scope of the approach they have recently taken with regard to sustainability agreements between manufacturing companies, in particular, to include investor agreements.

[212] ESMA, Sustainable Finance Roadmap 2022-2024, ESMA30-379-1051, p. 29..
[213] Cf. *Ruppert/Juschus*, Acting in Concert – Bremsklotz der Transformation, in BörsenZeitung, 12.10.2022; see also Sustainable-Finance-Beirat, Shifting the Trillions: Ein nachhaltiges Finanzsystem für die Große Transformation, Empfehlung 31, p. 128 et seq.
[214] Sustainable-Finance-Beirat, Shifting the Trillions: Ein nachhaltiges Finanzsystem für die Große Transformation, Empfehlung 31, p. 128 et seq.

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