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Rethinking Acting in Concert: Activist ESG Stewardship is Shareholder Democracy

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Abstract

In May 2021, Engine No. 1, an investment fund, was lauded by the responsible investment community for successfully placing three dissident independent directors on ExxonMobil's board. It achieved this by being a catalyst for institutional investors to become backers of environmental shareholder activism. The unprecedented success of Engine No. 1's campaign has spurred calls for a new, more sustained, activist engagement model by institutional investors, now known as "activist stewardship". However, there is a significant legal hurdle that has been almost entirely overlooked by those calling for this new approach for institutional investors to become activist stewards: acting in concert rules. As we illuminate in this article, the legal barriers posed by acting in concert rules in virtually all jurisdictions prevent institutional investors from engaging in collective shareholder activism with the aim or threat of replacing the board (i.e., "activist stewardship"). Perversely, the current acting in concert rules effectively prevent institutional investors from replacing boards that resist (or even deny) climate change solutions – even if (or, ironically, precisely because) they collectively have enough shareholder voting rights to democratically replace the boards of recalcitrant brown companies. This heretofore hidden problem in corporate and securities law effectively prevents trillions of dollars of shareholder voting rights that institutional investors legally control from being democratically exercised to change companies who refuse to properly acknowledge the threat of climate change. As we reveal, this perverse result has arisen because the legal rules concerning acting in concert were designed in a different age when contests of control – not activist ESG stewardship targeting the existential threat of climate change – formed the foundational rationale undergirding such rules. This has created a panoply of rules which disincentivize – and, in cases of mandatory bids and poison pills, may functionally disenfranchise – institutional investors from using aggressive tactics to drive climate change prevention initiatives supported by a majority of shareholders. As such, we argue that the acting in concert rules must be reformed around the world to promote shareholder-backed climate initiatives – while still maintaining the fair and effective markets for corporate control, which was the original impetus for creating them. By designing a workable model for reforming acting in concert laws, we provide a solution to the problem of brown boards being undemocratically shielded by acting in concert rules.

Keywords: ESG, shareholder activism, stewardship, acting in concert, corporate governance

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ABSTRACT

In May 2021, Engine No. 1, an investment fund, was lauded by the responsible investment community for successfully placing three dissident independent directors on ExxonMobil's board. It achieved this by being a catalyst for institutional investors to become backers of environmental shareholder activism. The unprecedented success of Engine No. 1's campaign has spurred calls for a new, more sustained, activist engagement model by institutional investors, now known as "activist stewardship".

However, there is a significant legal hurdle that has been almost entirely overlooked by those calling for this new approach for institutional investors to become activist stewards: acting in concert rules. As we illuminate in this article, the legal barriers posed by acting in concert rules in virtually all jurisdictions prevent institutional investors from engaging in collective shareholder activism with the aim or threat of replacing the board (i.e., "activist stewardship"). Perversely, the current acting in concert rules effectively prevent institutional investors from replacing boards that resist (or even deny) climate change solutions – even if (or, ironically, precisely because) they collectively have enough shareholder voting rights to democratically replace the boards of recalcitrant brown companies. This heretofore hidden problem in corporate and securities law effectively prevents trillions of dollars of shareholder voting rights that institutional investors legally control from being democratically exercised to change companies who refuse to properly acknowledge the threat of climate change.

As we reveal, this perverse result has arisen because the legal rules concerning acting in concert were designed in a different age when contests of control – not activist ESG stewardship targeting the existential threat of climate change – formed the foundational rationale undergirding such rules. This has created a panoply of rules which disincentivize – and, in cases of mandatory bids and poison

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As such, we argue that the acting in concert rules must be reformed around the world to promote shareholder-backed climate initiatives – while still maintaining the fair and effective markets for corporate control, which was the original impetus for creating them. By designing a workable model for reforming acting in concert laws, we provide a solution to the problem of brown boards being undemocratically shielded by acting in concert rules.

Key words: ESG, shareholder activism, stewardship, acting in concert, corporate governance

I. INTRODUCTION

In May 2021, Engine No. 1, an investment fund, was lauded by the "responsible investment community"[1] for successfully placing three dissident independent directors on ExxonMobil's board. The aim of its activist campaign was to promote a more sustainable business model within ExxonMobil, a company with a history of denying climate change.[2] Remarkably, Engine No. 1 was able to achieve this feat despite owning a mere 0.02 percent of ExxonMobil's shares.[3] The key to Engine No. 1's success was its ability to inspire major institutional investors such as BlackRock, Vanguard, and State Street to vote in support of its activist environmental, social, and governance (ESG) campaign.[4]

The unprecedented success of Engine No. 1's campaign has spurred calls for a new engagement approach by institutional investors known as "activist stewardship".[5] This approach, which goes one step further than the type of activism in the Engine No. 1 case, requires institutional investors to change their corporate governance engagement models to make acting collectively to challenge and replace boards that do not embrace ESG their *modus operandi*. This call for a paradigm shift in the behavior of major institutional investors towards "activist stewardship" is primarily driven by the urgent need to address the serious threat of climate change. Given the significant collective voting power of major institutional investors in the United States, United Kingdom and other major economies, limited engagement with management or occasional independent voting in support of exceptional campaigns led by activist investors

[1] Emmett McNamee, *How Should Responsible Investors Secure Better Boards?*, PRI BLOG (Jul. 30, 2021), available at https://www.PRI.org/pri-blog/how-should-responsible-investors-secure-better-boards/8152.article.

[2] Id.

[3] Matt Phillips, *Exxon's Board Defeat Signals the Rise of Social-Good Activists*, THE NEW YORK TIMES (Jun. 9, 2021), available at https://www.nytimes.com/2021/06/09/business/exxon-mobil-engine-no1-activist.html.

[4] Id.

[5] Robert Eccles, Aeisha Mastagni & Kirsty Jenkinson, *An Introduction to Activist Stewardship*, HARVARD LAW SCHOOL FORUM ON CORPORATE GOVERNANCE (Mar. 1, 2021), available at https://corpgov.law.harvard.edu/2021/03/01/an-introduction-to-activist-stewardship/.

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(such as Engine No. 1) is no longer sufficient. Indeed, recently these exceptional campaigns have been increasing in number, but more often failing to produce any change.[6] The activist stewardship movement suggests the engagement models of major institutional investors such as BlackRock, Vanguard, and State Street should instead be based on collective activist ESG stewardship.

The idea of collective activist ESG stewardship should not be hastily dismissed as an academic pipedream. Its current advocates and the shareholder power they wield deserve serious attention. The United Nations Principles for Responsible Investing (PRI) were established in 2005 by a group of institutional investors and experts who developed a set of principles for responsible investment.[7] Signatories of the PRI voluntarily commit to follow six principles that prioritize ESG considerations in their investor engagement strategies and encourage institutional investors to collaborate in promoting ESG practices in their investee companies.

The number of signatories, influence, and global reach of the PRI have increased exponentially since 2005. Extraordinarily, the PRI now counts over 4,000 institutional investors as signatories, from more than 60 countries, representing a staggering US$120 trillion in assets under management.[8] Most importantly in the context of stewardship, equity holdings of PRI signatories increased from US$0.7 trillion in 2006 to US$18 trillion by 2017 – representing more than half of the world's total institutional investor equity holdings of US$32 trillion.[9] It is also noteworthy that none of the much discussed Big Three Institutional Investors[10] – BlackRock, Vanguard, and State Street – were founding signatories of the PRI. However, they have all now come on board.[11] There is also empirical evidence that "on average, institutional investors who sign the PRI have better portfolio ESG scores and also improve these scores after joining the PRI".[12] Given the ubiquity and scale of institutional investor support for the PRI, the PRI recommendations on institutional investor conduct are of critical importance.

Following Engine No. 1's success, the PRI implored its signatories – which now comprise the majority of major institutional investors in the world – to become activist ESG stewards. In the PRI's own words:

> Rather than hoping for activists [like Engine No.1] alone to swoop in and offer them an alternative, institutional investors will instead need to step up their scrutiny of boards' performance on environmental and social issues and be prepared to challenge ill-

[6] Madison Darbyshire & Brooke Masters, *Vanguard's votes for green and social proposals fall to 2%*, FINANCIAL TIMES (Aug. 29, 2023), available at - https://on.ft.com/3OSaYWJ

[7] Taylor Gray, *Investing for the Environment? The Limits of the UN Principles of Responsible Investment* (Jun. 8, 2009), available at https://ssrn.com/abstract=1416123, at 7.

[8] PRI, *Principles for Responsible Investment*, available at https://www.unpri.org/download?ac=10948, at 6.

[9] Rajna Gibson Brandon, et. al., *Do Responsible Investors Invest Responsibly?*, 26 REV. FIN. 1389, at 1395.

[10] *See*, Lucian A. Bebchuk & Scott Hirst, *Big Three Power, and Why it Matters*, 102 B.U. L. Rev. 1547 (2022).

[11] PRI, *About Us*, PRINCIPLES FOR RESPONSIBLE INVESTMENT, available at https://www.unpri.org/about-us/about-the-pri.

[12] Gibson Brandon, *supra* note 9, at 1390.

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> equipped boards as a matter of course. Voting against board members and nominating suitable alternatives needs to become a part of investors' stewardship toolkits.[13]

The PRI's call for major institutional investors to become activist ESG stewards was echoed by a prominent corporate governance professor at Oxford University and representatives of the second largest pension fund in the United States. Based on their analysis of the Engine No. 1 campaign, they declared that "[t]he time has come for "activist stewardship"".[14]

While these recent clarion calls for activist ESG stewardship were inspired by the Engine No.1 case, the concept of institutional investors acting collectively to challenge and replace recalcitrant boards aligns with the more established fundamental principles at the core of the global shareholder stewardship movement.[15] Despite the widespread adoption of the 2010 UK stewardship code principles globally, in their first decade, stewardship codes failed to achieve their primary objective of transforming "rationally passive" institutional investors into actively engaged shareholder stewards.[16] The conventional explanation for this failure is that for many institutional investors, the cost of collective engagement necessary to steward companies did not fit their business models.[17] However, the emergence of the global ESG movement has challenged this conventional wisdom.[18] ESG is now an integral part of the business models of many institutional investors, for the first time presenting the possibility of aligning their business models with engaging in collective activist ESG stewardship.[19] The latest wave of stewardship codes has seized on this reality by focusing on the promotion of ESG as a core objective of collective engagement among institutional investors – who normally require a plan to escalate their collective pressure on recalcitrant boards to comply with the obligations under their respective stewardship codes.[20]

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[13] McNamee, *supra* note 1.

[14] Eccles, Mastagni & Jenkinson, *supra* note 5.

[15] Tim Bowley & Jennifer Hill, *Stewardship and Collective Action: The Australian Experience*, in DIONYSIA KATELOUZOU & DAN W. PUCHNIAK (EDS.), GLOBAL SHAREHOLDER STEWARDSHIP (2022), at 418 (noting: The stewardship codes of many jurisdictions today refer to, and implicitly support, collective action by institutional investors.").

[16] Dan W. Puchniak, *The False Hope of Stewardship in the Context of Controlling Shareholders: Making Sense Out of the Global Transplant of a Legal Misfit*, EUROPEAN CORPORATE GOVERNANCE INSTITUTE - LAW WORKING PAPER NO. 589/2021, available at https://ssrn.com/abstract=3858339, at 16.

[17] Paul Davies, *The UK Stewardship Code 2010-2020: From Saving the Company to Saving the Planet?*, in KATELOUZOU & PUCHNIAK, *supra* note 15, at 51-52. See also, Lucian A. Bebchuk, Alma Cohen & Scott Hirst, *The Agency Problems of Institutional Investors*, 31 J. ECON. PERSP. 89 (2017).

[18] Paul Davies, *The UK Stewardship Code 2010-2020: From Saving the Company to Saving the Planet?*, in KATELOUZOU & PUCHNIAK, *supra* note 15, at 65.

[19] Dionysia Katelouzou & Dan W. Puchniak, *Global Shareholder Stewardship: Complexities, Challenges and Possibilities*, in KATELOUZOU & PUCHNIAK, *supra* note 15, at 34-35.

[20] Dionysia Katelouzou & Alice Klettner, *Sustainable Finance and Stewardship: Unlocking Stewardship's Sustainability Potential*, in KATELOUZOU & PUCHNIAK, *supra* note 15. *See also*, MALAYSIAN CODE FOR INSTITUTIONAL INVESTORS, MINORITY SHAREHOLDER WATCHDOG GROUP, SECURITIES COMMISSION MALAYSIA 18 (2014), available at https://www.sc.com.my/api/documentms/download.ashx?id=9f4e32d3-cb97-4ff5-852a-6cb168a9f936; SINGAPORE STEWARDSHIP PRINCIPLES FOR RESPONSIBLE INVESTORS, STEWARDSHIP ASIA CTR. (Mar. 2022), available at https://stewardshipasia.com.sg/docs/saclibraries/default-document-library/sspfor-20responsible-20investor-202-0-1-.pdf?sfvrsn=821339693.

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In this context, the potential of collective activist ESG stewardship to bring about fundamental change in corporate governance to achieve sustainability is significant. If the signatories of the PRI leverage the immense shareholder power inherent in their US$18 trillion of equity holdings, they can collectively compel many recalcitrant brown boards to adopt sustainable corporate governance practices, potentially creating a step change in corporate governance towards sustainability. This dovetails with the common approach taken by stewardship codes globally, which overwhelmingly are designed to incentivize institutional investors to act collectively and to escalate their pressure on recalcitrant boards – with ESG increasingly being their primary focus.[21] Thus, the possibility for collective activist ESG stewardship to become the *modus operandi* of major institutional investors globally and, in turn, to result in a step change in sustainable corporate governance is now a possibility.

However, there is a significant legal hurdle that has been almost entirely overlooked by those calling for collective activist ESG stewardship: acting in concert rules. Even if the majority of the world's major institutional investors support collective activist ESG stewardship (which is already the case if the PRI's statement above is accepted by its signatories) and even if institutional investors collectively hold sufficient voting rights in listed companies to change their corporate governance (which is already the case in most listed companies in the United States and United Kingdom, and in some companies in several other jurisdictions), the legal obstacles created by acting in concert rules in almost every jurisdiction severely limit, and in some cases entirely prevent, institutional investors from acting collectively to replace recalcitrant boards.

Specifically, collective action among institutional investors as shareholders may trigger "acting in concert" rules which, depending on the jurisdiction, could require them to: (i) make disclosures of their shareholding collectively beyond prescribed shareholding thresholds; (ii) make a mandatory takeover offer to the shareholders of the company in certain circumstances; and (iii) deal with the fallout of triggering a "poison pill".[22] Thus, the "acting in concert" regime could effectively operate as a roadblock to activist ESG stewardship by placing considerable limitations on the extent to which institutional investors can escalate matters with companies on ESG issues. This is true even if their goal is to replace a board of climate change deniers, and the institutional investors collectively hold the majority of the company's voting shares. Such a limitation is an afront to shareholder democracy, and, more importantly, endangers the future of our planet.

The legal barriers posed by collective action rules in virtually all jurisdictions prevent institutional investors from engaging in collective activism with the aim or threat of replacing the board. These rules were designed in an era when "changes of control" in the context of takeovers were the focus of acting in concert regimes and the concepts of ESG and climate activism had not yet materialized. As such, acting in concert rules were originally designed to

[21] *Id.*

[22] Although the concepts of "acting in concert" and group shareholding have other implications under domestic legislation in different jurisdictions, in this article we focus on the three aspects listed herein.

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prevent some shareholders (such as acquirers of corporate control or sellers of large blocks of shares) from unfairly benefiting themselves at the expense of minority shareholders, or even other stakeholders.

However, these rules now present a significant obstacle to addressing the pressing issue of climate change. Even if the goal of collective activism is to address climate change, investors are not exempt from these rules. Thus, institutional investors in a listed company face the risk of legal action or severe economic consequences if they attempt to replace a board of climate change deniers, even if they represent a majority of shareholders. This effectively prevents major institutional investors from adopting collective activist ESG stewardship as their *modus operandi* and is antithetical to shareholder democracy. To address this problem, we propose a model to reform the acting in concert rules that would allow for collective activist ESG stewardship, while still safeguarding against abusive activist behavior – which is a major contribution of our article.

The tension between promoting collective action among institutional investors for the benefit of corporate governance and restricting collective action among shareholders who aim to unjustly enrich themselves at the expense of the company, its minority shareholders, and other stakeholders is a problem that has received attention from policymakers and academics.[23] This issue was particularly salient around the time of the introduction of the inaugural stewardship code in the UK in 2010.[24] However, most of this attention arose before climate change was widely viewed as an imminent threat that demands priority in corporate governance. Consequently, it was easier to find a middle ground between these tensions by allowing collective action among institutional investors as long as their actions did not threaten board control changes. This permitted institutional investors to monitor companies without infringing upon acting in concert rules that were largely formulated based on concerns arising from takeover law.

Today, however, certain companies and industries are under constant pressure from investors, policy makers, and civil society to undergo fundamental paradigm shifts for there to be any hope of quickly pivoting towards sustainable business models to meet the necessary goals required to address climate change. In this context, the line between preserving the scope for efficient collective action among shareholders and preventing abusive activism must shift. Institutional investors who are committed to promoting ESG must be allowed to act collectively to replace boards that resist addressing climate change decisions. Without this threat, institutional investors may collectively possess the shareholder power to change the board, but they will be unable to effectively exercise it – a fact that is not lost on recalcitrant boards that

[23] *See, e.g.*, Martin Winner, *Active Shareholders and European Takeover Regulation*, 3 ECFR 364 (2014).

[24] See, for example, UK Takeover Panel, *Practice Statement No. 26 Shareholder activism, practice statement* (Sep. 9, 2009); European Securities and Markets Authority, *Information on shareholder cooperation and acting in concert under the Takeover Bids Directive*—1st update (ESMA/2014/677), public statement (Jun. 20, 2014); Australian Securities and Investments Commission, *Class Order 00/455Collective Action by Institutional Investors* (Oct. 4, 2013) <www.legislation.gov.au/Details/F2013C00876>.

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either explicitly or implicitly deny the urgency of climate change. The fact that institutional investors are legally shackled from engaging in collective ESG activism is confirmed by advice from leading law firms and policy papers from government regulators. Even a legal opinion from the international law firm Linklaters, commissioned by the PRI, paints a sad picture of collective impotence – rather than collective activism – as the legally permissible role for institutional investors when it comes to challenging recalcitrant boards under the law in the UK.[25] The result is that institutional investors are legally cabined to "soft" engagement if they act collectively but are legally prevented from collectively challenging even the most retrograde climate inactive boards – promoting a type of "faux green activism" where activist ESG stewardship is needed the most.

To remedy this problem, we propose a novel model for acting in concert regimes. This model calls for a refinement of the existing law to enable collective activist ESG stewardship where threats of board change (or their execution) by institutional investors are solely a means to achieve broader sustainability goals rather than a ploy to acquire and maintain control over the company to profit. Specifically, we propose redesigning acting in concert regimes to effectively distinguish between ESG activism battles (in which investors seek to utilize board changes as a means to achieve sustainability in the governance of companies) and takeover contests (in which control is an end in itself).

While we expect some stakeholders to embrace our proposal, others will likely revile it. In recent times, corporate management in the United States and Japan have expanded their definitions of "acting in concert" in poison pills to prevent precisely the type of collective activism for ESG stewardship that our model seeks to promote.[26] Conversely, many jurisdictions around the world are now embracing ESG-focused stewardship, inspired by the UK's reorientation of its stewardship code towards ESG in 2020.[27] This shift in focus aims to encourage institutional investors to work collectively towards sustainable corporate governance and our model will help rearticulate the issues relating to acting in concert in these circumstances.

Our model aims to provide a legal solution that promotes collective activist ESG stewardship (more specifically in relation to climate change) while mitigating the risks posed by rent-seeking shareholders who seek control only for profit without promoting sustainable corporate

[25] Linklaters, *Acting in Concert and Collaborative Shareholder Engagement: U.K. Guidance* (2020).

[26] Such pills have taken on the moniker of "anti-activist poison pills", and they have recently generated considerable academic discourse. *See*, *e.g.*, Ofer Eldar, Tanja Kirmse & Michael D. Wittry, *The Rise of Anti-Activist Poison Pills*, EUROPEAN CORPORATE GOVERNANCE INSTITUTE – FINANCE WORKING PAPER NO. 869/2023, available at https://ssrn.com/abstract=4198367; Marcel Kahan & Edward Rock, *Anti-Activist Poison Pills*, 99 B.U. L. REV. 915 (2019); Jeffrey N. Gordon, *The Rejected Threat of Corporate Vote Suppression: The Rise and Fall of the Anti-Activist Poison Pill*, 2022 COLUM. BUS. L. REV. 206 (2022); Zohar Goshen & Reilly S. Steel, *Barbarians Inside the Gates: Raiders, Activists, and the Risk of Mistargeting*, 132 YALE L.J. 411 (2022); Caley Petrucci & Guhan Subramanian, *Pills in a World of Activism and ESG*, 1 U. CHI. BUS. L. REV. 417 (2022).

[27] *See supra* note 20. *See also*, Andrew Jen-Guang Lin, *The Assessment of Taiwan's Shareholder Stewardship Codes: From International Stewardship Principle to Alternative Good Stewardship* in KATELOUZOU & PUCHNIAK, *supra* note 15.

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governance. To achieve this goal, our model suggests that the PRI itself, or other similar organizations, be utilized as a third-party organization to assist in the complex task of distinguishing between control shifts and ESG activism.[28] We believe that this innovative rethinking of the concept of acting in concert has global applicability, unlocking the positive potential of activist ESG stewardship to address the pressing and severe threat of climate change.

Before moving on, we must address a red herring that those who want to prevent institutional investors from becoming activist ESG stewards will predictably raise. It is entirely possible that, even with the legal barriers posed by the acting in concert rules reformed, major institutional investors may still not use their voting power to become activist stewards to drive change in brown companies. This is because of a lack of incentives for major institutional investors to engage in corporate governance reform – even in the absence of legal barriers due to their business models. This is a red herring for two reasons. First, without reforming the acting in concert rules, the law will perversely prevent institutional investors from engaging in activist ESG stewardship even when it would otherwise fit their business models. Second, as explained below, the rise of the ESG movement suggests that the business models of major institutional investors are changing in a way that will make ESG activist stewardship – particularly with respect to climate change – congruent with their business models (absent acting in concert rules perversely preventing such behavior).

In Part II of this article, we discuss the rising potential for activist ESG stewardship to produce a step change in sustainable corporate governance. We find that there is an expressed systemic interest in ESG activism, which is supported by the increasing influence of the PRI and reorientation of stewardship codes to focus on sustainability as a core issue. ESG activist stewardship is also based on coalitions rather than individual actions, with investor networks burgeoning both domestically and internationally. Several such ESG activism efforts have relied upon bringing about board changes on companies to achieve sustainability goals. In Part III, we examine the regulatory barriers imposed by the "acting in concert" regimes. We do so by conducting a comparative study of major economies around the world. Here, we seek to highlight the deficiencies of activist ESG stewardship under the present dispensation. In Part IV, we seek to normatively analyze an ideal model which would permit ESG activism without falling afoul of acting in concert requirements while, at the same time, maintaining the underlying goals of the regime to prevent backdoor changes of control. Conceptually clarifying the distinction between activism and influence that drives sustainability (with board change merely as a tool) from the more straightforward control contests that are replete in the takeover markets would, in our view, clear the air on the debate surrounding acting in concert. We conclude in Part V by highlighting how acting in concert rules must change to give life to shareholder democracy which is essential for institutional investors to be able to have the

[28] The PRI has been used in the past to facilitate institutional investors coming together to solve complex corporate governance problems for ESG-style purposes. *See*, Jean-Pascal Gond & Valeria Piani, *Enabling Institutional Investors' Collective Action: The Role of the Principles for Responsible Investment Initiative*, 52 BUS. & SOC'Y 64, at 79-91.

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possibility of taking on the role as activist stewards to deploy their enormous legal and economic power to help save our planet.

II. THE CASE FOR ACTIVIST ESG STEWARDSHIP THROUGH COLLECTIVE ACTION

In this Part, we document the growth of the ESG activist stewardship movement that was spurred by the Engine No. 1/ExxonMobil case. The incorporation of ESG factors into investment decision-making has acquired a great deal of importance more recently, an aspect that has received further impetus from the rise of the PRI and stewardship codes focused on ESG. Given that institutional investors do not singly hold enough shares to act on their own, building coalitions of investors becomes a necessary precondition to environmental or social activism. This occurs either through direct collaboration among investors or, increasingly, through intermediaries such as investor networks that have been established globally or even domestically within individual jurisdictions. Finally, we also note an uptick in ESG activism that is public in nature whereby investors either propose resolutions on specific matters relating to the company or even seek to reconstitute the board.[29]

A. ESG Stewardship

ESG factors and sustainability practices have increasingly become an integral part of investment decision making, particularly by institutional investors. Such institutions tend to actively engage with their investee companies with a view to generating long-term sustainable returns for their own beneficiaries.[30] This is also evident from an increase in shareholder proposals initiated by investors on ESG matters, which now constitute a sizable proportion of all shareholder proposals, thereby highlighting the importance of economic and social considerations in corporate governance.[31] For instance, one survey notes that "96% of respondents expect that activists will increasingly prioritize ESG issues in their demands".[32]

Available evidence suggests that the "Big Three" institutional investors, BlackRock, Vanguard, and StateStreet have sought to exert their influence in discussing environmental and social matters in their engagements with companies.[33] As for motivations of institutional investors towards ESG stewardship, Professor Ringe argues that they may be driven by purely financial

[29] There is anecdotal evidence of even more aggressive forms of action by activists who seek the enforcement of shareholder remedies to address ESG matters, but we leave that discussion for another day. *See, e.g., ClientEarth v. Shell plc* [2023] EWHC 1897 (Ch).

[30] Michael MacLeod & Jacob Park, *Financial Activism and Global Climate Change: The Rise of Investor-Driven Governance Networks*, 11 Global Environmental Politics 54, 55 (2011).

[31] European Securities and Markets Authority, *Report: Undue Short-Term Pressure on Corporations*, ESMA30-22-762 (Dec. 18, 2019), available at 57.

[32] Skadden, *European Activism: More Attacks, More Engagement: More ESG Coming in 2023*, THE INFORMED BOARD (Winter 2023), at [1].

[33] See Wolf-Georg Ringe, *Investor-led Sustainability in Corporate Governance*, WORKING PAPER N° 615/2021, available at https://ssrn.com/abstract=3958960, at 5-7.

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reasons, riding on the increasing popularity of ESG-investing by retail investors.[34] These incentives may also motivate them to take on a more active role in ESG issues either by themselves or alongside activist investors such as hedge funds.[35]

The role of the PRI as the linchpin organization responsible for spreading the paradigm of ESG engagement among institutional investors globally cannot be overstated. As mentioned above, PRI signatories represent more than half of the world's total institutional investors. The signatories voluntarily commit to follow six principles that prioritize ESG considerations in their investor engagement strategies and encourage institutional investors to collaborate in promoting ESG practices in their investee companies. There is empirical evidence that generally signatories improve their ESG scores after signing – suggesting that the PRI's soft law approach has meaningfully driven institutional investors to further engage in promoting ESG.[36]

ESG focused engagement by institutional investors is further buttressed by stewardship initiatives, both public and private. Stewardship codes have proliferated around the world over the last decade, which encourages institutional investors "to *actively engage* as 'stewards' in the *corporate governance* of companies in which they are shareholders."[37] The genesis for the stewardship movement can be ascribed to the world's first stewardship code designed in 2010 in the UK.[38] However, the 2010 UK code came under severe criticism on the ground that, among other things, that investors lacked sufficient incentives to actively engage with companies.[39]

Based on the learnings during the first decade of operation of the stewardship code in the UK, a second iteration was introduced in 2020.[40] Although the original UK stewardship code was predominantly focused on generating shareholder value, there has been a sea change in the 2020 version, with the prominence given to ESG factors and, in particular, climate change.[41] Moreover, the tenor of the 2020 code suggests that ESG matters are not merely of peripheral concern in investment and governance matters but are mainstream.[42] Principle 7 states that institutional investors must "systematically integrate stewardship and investment, including

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[34] See id., at 10-13. See also Hao Liang, Lin Sun & Melvyn Teo, *Responsible Hedge Funds*, 26 Rev. Fin. 1585, 1586 (2022).

[35] See Elroy Dimson, Oğuzhan Karakaş & Xi Li, *Coordinated Engagements*, European Corporate Governance Institute – Finance Working Paper No. 721/2021, available at https://ssrn.com/abstract=3209072, at 4; Bowley & Hill, *supra* note 15, at 427.

[36] Gibson Brandon, *supra* note 9, at 1390.

[37] Dionysia Katelouzou & Dan W. Puchniak, *Global Shareholder Stewardship: Complexities, Challenges and Possibilities*, in KATELOUZOU & PUCHNIAK, *supra* note 15, at 5.

[38] Financial Reporting Council, *The UK Stewardship Code* (July 2010), available at www.frc.org.uk/getattachment/e223e152-5515-4cdc-a951-da33e093eb28/UK-Stewardship-Code-July-2010.pdf.

[39] *See*, Arad Reisberg, *The UK Stewardship Code: On the Road to Nowhere?*, 15 J. Corp. L. Stud. 217 (2015); Brian R Cheffins, *The Stewardship Code's Achilles' Heel*, 73 Modern L. Rev. 1004 (2010).

[40] Financial Reporting Council, *The UK Stewardship Code 2020* (2019), available at www.frc.org.uk/getattachment/5aae591d-d9d3-4cf4-814a-d14e156a1d87/Stewardship-CodeFinal2.pdf.

[41] Davies, *supra* note 17, at 47.

[42] Id., at 48.

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material environmental, social and governance issues, and climate change, to fulfil their responsibilities."[43] Professor Davies finds that " reputational incentives may in fact operate more effectively in relation to ESG factors, including climate change, under the [2020 code] than they did in relation to the [2010 Code]."[44] If this prediction is correct, it would set the stage for rationally active collective ESG stewardship among institutional investors.

Interestingly, the expansion of stewardship to incorporate ESG has taken root globally as well. As one study notes: "Empirical evidence based on a review of the text of the latest versions of stewardship codes reveals that 84 per cent of the codes now refer 'at least once to ESG factors' and that only four current codes (i.e., Danish Code 2016, Korean Code 2016, Swiss Code 2013 and US Code 2017) do not mention ESG factors at all."[45] Most recently, Malaysia and Singapore have released updated versions of their stewardship codes which clearly appear to adopt the UK's shift in focus "from saving the company to saving the planet" by putting ESG – particularly climate change – at their cores.[46] Where stewardship is governed under private codes, the reputational incentives and demand by their own investors motivate institutions to consider ESG as part of their business model.[47] In the case of public stewardship codes, ESG is also driven by political motivations and the need to garner more public support towards social and environmental goals that attract wider public attention.[48] Even though ESG stewardship is generally considered capable of succeeding only in companies with dispersed shareholding, it may also have the effect of exerting "pressure on controlling shareholders into becoming part of the movement."[49] Overall, the expansion of stewardship codes around the world encouraging institutional investors to incorporate ESG into their monitoring process is likely to have a significant influence in mainstreaming ESG issues into the corporate governance of companies in which they have invested.[50]

B. Collective Action as the Sine Qua Non

Due to the dispersion in holdings by institutional investors, engagement by individual institutions with companies with a view to influence their governance practices may not yield the desired results.[51] Hence, it becomes necessary for investors to collaborate with each other or form coalitions to overcome collective action problems and to exercise effective monitoring and to discipline management, and thereby provide them with greater voice.[52] Such a collective

[43] UK Stewardship Code 2020, *supra* note 40.
[44] Davies, *supra* note 17, at 59.
[45] Katelouzou & Puchniak, *supra* note 37, at 5.
[46] Puchniak, *supra* note 16, at 37-38.
[47] Katelouzou & Puchniak, *supra* note 37, at 34. See also, Puchniak, *supra* note 16, at 36.
[48] Katelouzou & Puchniak, *supra* note 37, at 34.
[49] Id., at 37.
[50] See Katelouzou & Klettner, *supra* note 20, at 550.
[51] Iain MacNeil, *Activism and Collaboration Among Shareholders in UK Listed Companies*, 5 Capital Markets L.J. 419, 423 (2010).
[52] Paolo Santella, et al, *A Comparative Analysis of the Legal Obstacles to Institutional Investor Activism in Europe and in the US*, MPRA PAPER NO. 8929 (2008), available at https://mpra.ub.uni-

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action on the part of investors minimizes the cost of action by spreading such cost across all shareholders and mitigates the effect of the free rider problem present in individual engagement.[53] Coordinated action by a group enables members to share their expertise with respect to a company or on a particular issue.[54] Recognizing the benefit of collective action, stewardship codes generally encourage investors to act collaboratively while engaging with companies on specific issues.[55]

Such a "teaming up" strategy has been in existence in shareholder activism wherein hedge funds were often found to collaborate with other relatively passive institutional investors to constitute "wolf packs" that then engage with corporate managements, often through aggressive strategies.[56] The collaborative strategy has made its way into ESG activism as well.[57] In addition to the cost-effectiveness of collective action, Professor Ringe points to another significant benefit arising from collaborative green activism, in that the involvement of multiple investors in campaigns relating to specific companies will operate as an innate system of checks and balances to ensure that the idiosyncrasies of specific investors do not drive engagement decisions.[58] Such a mechanism could operate to weed out measures that are not beneficial to the company and its investors as a whole,[59] or even those that may be driven by a political agenda.

A recent cohort of empirical studies validates the existence and force of investor collaboration in governance engagements. For example, one study that "provides the first detailed evidence of the nature and impact of such engagements in a global setting" demonstrates that the success of the collaboration depends upon capable leadership of the coalition.[60] It finds that the realization of investors' ESG goals through engagements is more likely when there is "a lead investor who is well suited geographically, linguistically, culturally and socially to influencing the target companies" and that other investors within the coalition "are also vital, and they would ideally be major investment institutions that have influence because of their scale, ownership and resources."[61] Another study indicates that the establishment of an investor coalition creates better incentives to be active rather than passive owners, and that the collective voting power of an investor is much larger and hence provides better engagement power with

muenchen.de/8929/1/MPRApaper8929.pdf, at 22; MacNeil, *supra* note 51, at 431, Bowley & Hill, *supra* note 15, at 425.

[53] Davies, *supra* note 17, at 55.

[54] Dimson, et al, *supra* note 35, at 10.

[55] See e.g., UK Stewardship Code 2020, *supra* note 40, Principle 10.

[56] Alon Brav, Amil Dasgupta & Richmond D. Mathews, *Wolf Pack Activism*, FINANCE WORKING PAPER N° 501/2017, available at https://ssrn.com/abstract=2529230, at 2; Wolf-Georg Ringe, *Shareholder Activism: A Renaissance*, in JEFFREY N. GORDON & WOLF-GEORG RINGE (EDS.), THE OXFORD HANDBOOK OF CORPORATE LAW AND GOVERNANCE (2018), at 418; John C. Coffee & Darius Palia, *The Wolf at the Door: The Impact of Hedge Fund Activism on Corporate Governance*, 41 J. Corp. L. 545 (2016).

[57] Ringe, *Investor-led Sustainability in Corporate Governance*, *supra* note 33, at 18.

[58] Id., at 20.

[59] Id.

[60] Dimson, et al, *supra* note 35, at 35.

[61] Id.

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investee firms.[62] This study also notes companies that are subject to engagement by organized investor collectives are 58 percent more likely to adopt proposals initiated by the investors on governance matters than those made by single investors.[63] Yet another observes the success that lead activist investors and followers enjoy when they "work towards the common goal of improving firm value", which also displays consistency in addressing the principal-agent problems in the governance of companies.[64]

Narrowing to ESG stewardship, investor collaboration has become the name of the game at a global scale. This is due to the emergence of what has been referred to as "investor-driven governance networks" (IGNs), both nationally and globally, that "actively persuade, coerce, and socialize other investors—and corporations—into new norms of corporate behavior", thereby making them the "*raison d'être* of transnational advocacy networks."[65] ESG activism is, therefore, built on investors coalescing to engage companies on environmental and social matters by interacting with one another extensively to share information and expertise and pool other resources in undertaking engagement campaigns in respect of companies around the world.[66] Coalitions may be built on an *ad hoc* basis in respect of ESG engagement in relation to specific companies or issues, or they may be more structured around investor networks who may represent specific investors more broadly on ESG activities.[67] The recent growth of such investment networks as intermediaries has changed the face of ESG stewardship.

Transnational investor networks have begun to play a significant role in ESG stewardship on a worldwide scale. As one study notes:

> Through coordination of activities, provision of relevant analytics and business case information, as well as legal and communications support, these organizations add staff capacity and greatly enhance the collective effectiveness of the investment community. These collaborations combine size, ownership stakes and reputations to increase investor influence, while benefiting from efficiencies derived from sharing research resources, workloads, costs, and preventing duplication of efforts.[68]

Well-known investor networks include the Carbon Disclosure Project (CDP),[69] Ceres,[70] the Interfaith Center for Corporate Responsibility (ICCR),[71] and the PRI.[72] As highlighted

[62] Craig Doidge, et al, *Collective Action and Governance Activism*, 23 Rev. Fin. 893, 896 (2019).
[63] Id., at 897.
[64] Tanya Artiga Gonzalez & Paul Calluzo, *Clustered Shareholder Activism*, 27 CORP. GOV. INT. REV. 210, 211 (2019).
[65] MacLeod & Park, *supra* note 30, at 70.
[66] Bowley & Hill, *supra* note 15, at 30.
[67] Id., at 30.
[68] Ceres, et al, *The Role of Investors in Supporting Better Corporate ESG Performance: Influence Strategies for Sustainable and Long-Term Value Creation*, available at https://www.ceres.org/sites/default/files/reports/2019-04/InvestorInfluencereport.pdf, at 9.
[69] CDP, https://www.cdp.net/en.
[70] Ceres, https://www.ceres.org/homepage.
[71] Interfaith Center on Corporate Responsibility, https://www.iccr.org.
[72] Principles for Responsible Investment, https://www.PRI.org.

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earlier,[73] among these, the "most well-established international initiative for institutional investors is the PRI, a voluntary and aspirational set of six investment principles aimed at incorporating ESG issues into investment practice."[74] These principles commit investors to being active owners by incorporating ESG matters into their policies and practices as owners of shares in companies,[75] and to work collectively to enhancing their effectiveness in achieving the goals of ESG.[76]

The PRI, along with Ceres and other investor networks, has established climate-focused engagement initiatives. For example: (1) the Climate Action 100+ initiative brings together several investor-led engagement initiatives with a commitment to engage with at least one of 166 companies that are considered strategically important to the achievement of net zero transition;[77] (2) the Net Zero Asset Owner Alliance (NZAOA) is an "initiative of institutional investors committed to transitioning their investment portfolios to net-zero GHG emissions by 2050 – consistent with a maximum temperature rise of 1.5°C";[78] (3) the Net Zero Asset Managers Initiative that encourages asset managers "to help deliver the goals of the Paris Agreement and ensure a just transition", which includes implementing "a stewardship and engagement strategy, with a clear escalation and voting policy, that is consistent with our ambition for all assets under management to achieve net zero emissions by 2050 or sooner";[79] and, (4) The Investor Agenda, whose goals includes engagement with "companies to drive and demonstrate real progress in line with a 1.5-degree Celsius future".[80]

While the teaming up strategy was already evident in practice in shareholder activism of the type initiated by hedge funds, the explosion of investor networks focusing on ESG has effectively legitimized engagement and activism through coalitions that operate on a global scale.[81] These developments clearly indicate that collaboration, coordination, and concerted action have been set up in such a manner as to constitute the *modus operandi* for ESG stewardship in the current era.

C. Escalation as a Form of Engagement: Commonly Suggested But Presently Absent

Although collective action has become the *modus operandi* for ESG stewardship, it has generally been associated with institutional investors engaging privately with companies. Even when engagement becomes public, this rarely involves the type of aggressive action of replacing directors in companies with boards that have failed to adequately embrace

[73] *Supra* Part I.
[74] Katelozou & Klettner, *supra* note 20, at 554.
[75] PRI, Principle 2.
[76] PRI, Principle 5.
[77] Climate Action 100+, https://www.climateaction100.org/approach/how-we-work/.
[78] UN-convened Net-Zero Asset Owner Alliance, https://www.unepfi.org/net-zero-alliance/.
[79] The Net Zero Asset Managers Initiative, https://www.netzeroassetmanagers.org/commitment/.
[80] The Investor Agenda: Accelerating Action for a Net-Zero Emissions Economy, https://theinvestoragenda.org/focus-areas/.
[81] Bowley & Hill, *supra* note 15.

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sustainability or other ESG initiatives. This is why the Engine No. 1 case was described as "unprecedented."[82]

There is a history of major institutional investors – such as Blackrock, State Street and Vanguard – "issuing public statements in support of social issues but with unclear goals."[83] However, supporting aggressive action to replace directors on boards that fail to move quickly enough to address sustainability goals has been rare. Major institutional investors leading such campaigns on a regular basis – going one step beyond Engine No. 1 – have not occurred. This is what has prompted the clarion calls for "activist ESG stewardship".

Spurred by Engine No.1's campaign, one group of scholars has referred to this as "activist stewardship", which "means putting the skills and techniques of activist hedge funds to work where a company's financial performance is deteriorating and traditional engagement tools have failed to produce meaningful results to protect value and mitigate long-term risks, including recognizing the importance of [ESG] risks".[84] Boards that resist changes on matters of ESG could be subject to a revamp so that a new board with environmentally- and socially-sensitive directors could apply pressure on management satisfactorily to incorporate ESG factors into business decision-making and capital allocation.[85]

A related recent trend is evident wherein even otherwise passive investors generally insist on boards of companies being sufficiently populated by persons with fluency in matters of climate risk and net zero transition.[86] This trend, along with signs of activist stewardship, was evident in the reinvigoration of ExxonMobil's board through proposals by investors. Board changes as part of ESG stewardship and activist campaigns are, therefore, not merely incidental to engagement by investors, but tend to be intrinsic. As one US SEC Commissioner remarked: "Whatever one's views regarding activist investors or a corporation's role with respect to climate or ESG, this turn of events has focused the attention of directors everywhere."[87] However, the forceful type of activist ESG stewardship necessary to replace boards that fail to adequately address climate change is not evident in the models of engagement of major institutional investors – which as we explain below is unsurprising given the severe legal consequences that may befall investors who take-up such a role.

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[82] Phillips, *supra* note 3.

[83] The asset management industry has a long history of issuing public statements in support of social issues but with unclear goals.

[84] Eccles, Mastagni & Jenkinson, *supra* note 5.

[85] Id.

[86] Kai H.E. Kiekefett, Holly J. Gregory & Leonard Wood, *Shareholder Activism and ESG: What Comes Next, and How to Prepare*, HARVARD LAW SCHOOL FORUM ON CORPORATE GOVERNANCE (May 29, 2021).

[87] Commissioner Allison Heren Lee, *Climate, ESG, and the Board of Directors: "You Cannot Direct the Wind, But You Can Adjust Your Sails*, Keynote Address at the 2021 SOCIETY FOR CORPORATE GOVERNANCE NATIONAL CONFERENCE (Jun. 28, 2021), available at https://www.sec.gov/news/speech/lee-climate-esg-board-of-directors.

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The stewardship codes around the world, too, call for escalation, where necessary, to exert influence over companies.[88] For instance, the 2010 and 2012 versions of the UK stewardship code stipulate that where boards refuse to respond constructively to investor intervention, then one form of escalation could be for investors to requisition an extraordinary general meeting, including to alter board composition.[89] Although the 2020 version of the UK stewardship code, unlike its predecessors, does not explicitly stipulate examples of escalation, boards changes are not ruled out either. As for the rest of the world, one study based on textual analysis of stewardship codes finds that the words "escalat-e/ion" is missing in several codes.[90] However, the result calls for cautious acceptance given that alternative language, especially in non-English jurisdictions, may be used to substantively include escalation principles without mentioning them.[91]

In all, while concluding this Part, we find that not only has ESG stewardship and activism become mainstream, but collaboration among investors and possible escalation in engagement (to include board changes) constitute the key methodologies in the approach followed by institutional investors. Given this scenario, we now move on to discuss key barriers that stand in the way of such concerted action, before then considering how one might rationalize matters moving forward.

III. REGULATORY BARRIERS: "ACTING IN CONCERT" FRAMEWORK

The three factors of activist ESG stewardship, collective action, and escalation operate as a lethal cocktail that necessarily attracts legal barriers in the form of "acting in concert" regimes. This necessitates that institutional investors engaging with companies on ESG matters utilizing these methods be alert to potential adverse consequences emanating from their actions. In this Part, we examine three such effects where investors are treated as acting in concert, namely: (i) disclosure requirements for acquisition of substantial shareholding by the investor group; (ii) the requirement to make a mandatory offer if requisite thresholds are crossed; and (iii) the triggering of poison pills in jurisdictions where such pills are legally and commercially recognized. First, we analyze more broadly the legal regimes relating to acting in concert. Second, we explore the extent to which ESG activism is permissible (or impermissible) considering the legal regimes, which we do so by relying upon the PRI legal opinions. Finally, we critically evaluate the deficiencies of the acting in concert regimes currently in vogue.

A. "Acting in Concert": The Legal Regime

1. Disclosure Requirements

[88] For a more detailed discussion on the spread of the concepts of ESG and escalation around the world, see Katelouzou & Puchniak, *supra* note 37, 15-16.

[89] 2010 and 2012 Stewardship Codes (UK), Principle 4.

[90] Dionysia Katelouzou & Mathias Siems, *The Global Diffusion of Stewardship Codes*, in KATELOUZOU & PUCHNIAK, *supra* note 15, at 649.

[91] Puchniak, *supra* note 16, at 22.

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One of the essential prerequisites for activism in companies is the ability of investors to acquire shares in companies furtively without sounding off management. Their ability to do so is constrained by disclosure requirements that exist in most jurisdictions. Depending upon the legal framework in each individual jurisdiction, such disclosures are governed either by securities law, listing rules, or takeover regulation. The disclosure requirements are usually triggered upon the acquisition of a prescribed number of shares either individually or collectively, regardless of whether the investors obtain (or even intend to obtain) control over the company. Such ownership disclosure is aimed at improving market efficiency and corporate governance.[92]

For instance, in the UK, the disclosure is governed by the Disclosure Guidance and Transparency Rules ("DTR"), whereby shareholders holding more than 3% shares in a UK issuer (and 5% in a non-UK issuer) must report their holdings to the company when they cross certain thresholds.[93] These include both direct holdings as well as indirect holdings (which are defined to include agreements which oblige "them to adopt, by concerted exercise of voting rights they hold, a lasting common policy towards the management of the *issuer* in question").[94] In the US, shareholders who directly or indirectly acquire more than 5% of a class of securities of a company must, within 10 days after such acquisition, file specified information in Schedule 13D with the Securities and Exchange Commission (SEC).[95] When a collection of persons acts as a "group for the purpose of acquiring, holding, or disposing of securities of an issuer", their shareholding is aggregated for the purpose of disclosure of shareholdings.[96] Where certain exceptional circumstances arise, a more abbreviated Schedule 13G may be filed.[97] It is noteworthy, though, that the SEC is contemplating a reform to its beneficial ownership disclosure regime.[98] Where a shareholder shares information about its anticipated obligations to make a substantial shareholding disclosure under Schedule 13D, and the person receiving such non-public information purchases additional shares based on that information, the tipper and tippee both will be considered to be part of a "group" for purposes of disclosure.[99] This would have the effect of enhancing the scope of the group concept under the SEC's shareholding transparency requirements. Conversely, other proposed amendments provide new opportunities in the form of exemptions for investors to communicate and consult with each other, jointly engage with companies, and undertake certain transactions without being considered a "group", including where investors communicate with one another or the

[92] Michael C. Schouten, *The Case for Mandatory Ownership Disclosure*, 15 Stan. J.L. Bus. & Fin. 127, (2009).

[93] DTR, rule 5.1.2.

[94] DTR, rule 5.2.1 [emphasis in original].

[95] Securities and Exchange Act of 1934, s. 13(d)(1).

[96] Securities and Exchange Act of 1934, s. 13(d)(3).

[97] Securities and Exchange Act of 1934, s. 13(g)(1).

[98] Securities and Exchange Commission, *SEC Proposes Amendments to Modernize Beneficial Ownership Reporting* (Feb. 10, 2022), available at https://www.sec.gov/news/press-release/2022-22.

[99] Securities and Exchange Commission, *Modernization of Beneficial Ownership Reporting*, 17 CFR Parts 232 and 240, at 81.

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company "*without* the purpose or effect of changing or influencing control of the issuer".[100] Hence, any action that either changes or influences control would be outside the purview of the exemption.

Similar disclosure requirements arise in other leading jurisdictions where the concert party or group concept applies, including at a European level under the EU Transparency Directive,[101] and in other common law jurisdictions such as Australia[102] and Singapore.[103] Disclosure requirements have been at the forefront in hedge fund activism, especially in the US. Investors deploying the "wolf pack" strategy tend to take precautions to ensure that any form of arrangements among the investors does not lead to their being treated as part of a "group", thereby remaining beneath the radar from a disclosure point of view.[104] In other jurisdictions too, there is considerable uncertainty on whether collective action among shareholders in engaging in activist stewardship, on ESG matters or otherwise, will necessarily trigger the disclosure norms. This provides securities or takeover regulators with extensive discretion in determining transparency requirements on a case-by-case basis.

2. Mandatory Offers

Perhaps the most significant consequence of investors acting in concert is the requirement to make a mandatory takeover offer to the shareholders of the company where they cross a specified threshold that triggers such offers. While mandatory offers have been introduced in most takeover regimes around the world, they are not recognized in the US (except in a few states that carry some analogous rules).[105] Mandatory offers are intended to provide two specific protective measures in favor of a target's shareholders whenever there is a control shift.[106] The first is an exit opportunity to the non-controlling shareholders due to a potential threat they may face under a new controller. The second measure is embedded in the idea of equality of opportunity whereby shareholders who hand over control of a company to an acquirer must share their private benefits of control with all other shareholders of the company. More importantly, the mandatory offer requirement can be triggered by shareholders acquiring shares beyond the prescribed threshold either individually or in the aggregate (where they are acting in concert).

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[100] Id, at 91-92 [emphasis added].

[101] DIRECTIVE 2004/109/EC OF THE EUROPEAN PARLIAMENT AND OF THE COUNCIL of 15 December 2004 on the harmonisation of transparency requirements in relation to information about issuers whose securities are admitted to trading on a regulated market and amending Directive 2001/34/EC, arts. 9 and 10.

[102] Corporations Act 2011, s. 602.

[103] Securities and Futures Act 2001 (2020 Rev Ed), s. 135.

[104] See Coffee & Palia, *supra* note 56, at 562; Gaia Balp & Giovanni Strampelli, *Institutional Investor Collective Engagements: Non-Activist Cooperation vs Activist Wolf Packs*, 14 OHIO ST. BUS. L.J. 135, 168 (2020).

[105] Marco Ventoruzzo, *Takeover Regulation as a Wolf in Sheep's Clothing: Taking UK Rules to Continental Europe*, 1 U PA J BUS L 135, 136 (2008).

[106] See William D. Andrews, *The Stockholder's Right to Equal Opportunity in the Sale of Shares*, 78 HARV. L. REV. 505 (1965); Ruth Luttmann, *Changes of Corporate Control and Mandatory Bids*, Int'l Rev. L. & Econ. 497 (1992).

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The fact that shareholder activism through collective action could be ensnared within the scope of the mandatory offer requirement (thereby magnifying the cost of such activism) is not new. In the UK, for example, perhaps the most elaborate treatment of collective action from a comparative perspective was introduced into its Takeover Code more than two decades ago.[107] Through a significant reform of takeover regulation for this purpose, note 2 to rule 9.1 of the Takeover Code was introduced, which deals with the interaction between the mandatory offer requirement under the Code and collective shareholder action. At the outset, the Code is clear in that the UK Takeover Panel would "not normally regard the action of shareholders voting together on a particular resolution as action which of itself indicates that such persons are acting in concert."[108] However, where shareholders collectively "requisition or threaten to requisition the consideration of a board control-seeking proposal at a general meeting", the Code takes a drastic turn.[109] In such a case, which usually involves an alteration to the composition of the board of directors of the company, the Code states that the Panel would normally presume that such shareholders are acting in concert. In other words, whether a shareholder proposal is board control-seeking or not makes a world of difference.

The precise nature of a "board control-seeking" proposal is the subject matter of elaborate treatment under the UK Takeover Code.[110] The Code undertakes a multilayered approach in this regard. First, to determine whether a proposal is board control-seeking, the Code sets out several factors, including a consideration of the relationship between any of the directors proposed to be elected by the activist shareholders and the shareholders themselves. For this purpose, the Code considers any existing or prior relationship between the activist shareholder and the proposed directors, any arrangements or agreements between the activist shareholders and the proposed directors, and any remuneration payable by the activist shareholders to the proposed directors. The absence of any relationship between the activist shareholders and the proposed directors would end matters there, as the proposal to appoint such directors would not be considered board control-seeking.

However, where a relationship does exist that is not insignificant, the Code proceeds to a second-level analysis based on the proportion of the number of directors to be appointed relative to the overall size of the board. The Code clarifies that where a sole director is to be appointed (even if such a director bears a relationship to the appointing shareholders), the proposal would not be considered board control-seeking. Where either the entire board or the majority of the directors are being replaced, the proposal would normally be considered board control-seeking.

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[107] See The Panel on Takeovers and Mergers, *Consultation Paper Issued by the Code Committee of the Panel: Shareholder Activism and Acting in Concert*, PCP 10 Issued on 14 March 2002. Singapore has subsequently followed suit by incorporating provisions relating to collective shareholder action that are almost identical to the regime prevalent in the UK. Takeover Code (Singapore), rule 14, notes 2-3, which was introduced following a consultation in 2012. See Securities Industry Council, *Consultation Conclusions on Revision of the Singapore Code on Take-overs and Mergers* (23 March 2012) at para [8].

[108] UK Takeover Code, r. 9, n. 2.

[109] Id.

[110] Id.

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Even where the majority of the directors are not being replaced, the Code seeks to unravel a third layer wherein it considers an additional set of factors to determine whether a proposal nevertheless ends up a board control-seeking one. This includes a consideration of the board positions held by the replaced directors, the nature of any mandate for the proposed directors, any benefit accruing to the activist shareholders as a result of the board overhaul, and any relationships between the existing directors, proposed directors and/or the activist shareholders. The UK Takeover Code also lists out factors to be considered when the circumstances following a successful collective shareholder action would lead to the cessation of a concert party relationship between such shareholders.

Despite the existence of such an elaborate treatment of shareholder activism in the UK Takeover Code, there continued to be concerns that collective action could nevertheless lead to a concert party situation. As the Walker review in 2009 highlighted:

> It is important that there are no regulatory impediments, real or imagined, to the development of effective dialogue. Accordingly, a clear delineation will need to be established between shareholder initiative which is designed to achieve a degree of control on a continuing basis … and collective initiative which has a limited, specific and relatively immediate objective that does not involve any plan to seek or exercise control and could not be regarded as disadvantageous to the interests of other shareholders. It is essential that investors undertaking the latter collective Initiative should be left in no doubt that this action does not contravene the provisions of Rule 9 of the Takeover Code.[111]

Heeding to such calls, the Takeover Panel issued a Practice Statement[112] which clarifies that a "resolution will not be considered to be 'board control-seeking' if the directors to be appointed are independent of the activist shareholders or if the primary purpose of the proposal is to appoint additional non-executive directors in order to improve the company's corporate governance."[113] This provision came up for consideration in May 2017, when the shareholders of Petropavlovsk plc submitted resolutions proposing changes to the company's board of directors. The Takeover Panel was then asked by Petropavlovsk to determine whether the shareholders and the new directors it proposed should be considered to be acting in concert under note 2 to rule 9 and, if this was the case, whether any such persons had acquired interests in shares of Petropavlovsk following the date on which they were presumed to be acting in concert, with the result that an obligation to make a mandatory offer had been triggered under rule 9.1. The Panel concluded that three of the proposed four directors were, for the purpose of note 2 to rule 9, independent of the shareholders proposing their appointment.[114] Only one director was not regarded as independent due to his existing employment with one of the shareholders. Hence, the Panel found that the proposed resolutions were not 'board control-seeking' and that the shareholders did not have to make a mandatory offer under the Code.

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[111] David Walker, *A review of corporate governance in UK banks and other financial industry entities* (16 July 2009), at para. 5.43.

[112] Takeover Panel, Practice Statement No. 26 (9 September 2009).

[113] Id, at para. 1.3.

[114] The Takeover Panel (UK), *Petropavlovsk plc* (15 June 2017).

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At the same time, the Practice Statement cautions that if activist shareholders utilize their ability to effect a board change as a lever in their engagement with companies, the Takeover Panel will consider that to be a board control-seeking proposal. This would severely restrict the ability of institutional investors to engage in activist ESG stewardship as it would prevent them from indicating to incumbent management that if the shareholder proposals on governance matters – including ESG – are not accepted, they would proceed to replace board members, especially if such a replacement would install a majority of directors.[115] In other words, this significantly impairs institutional investors from engaging with management in the shadow of potential board changes in case of recalcitrance to their proposals, even if such boards fail to act on climate change initiatives.

Similar issues have been highlighted in the European Union as well. Recognizing the uncertainty surrounding the concept of acting in concert where investors cooperate to enhance the governance of companies, the European Securities and Markets Authority ("ESMA") issued a public statement to provide clarification to investors.[116] Highlighting the tension between takeovers involving control shifts and activism, ESMA noted "that shareholders may wish to cooperate in a variety of ways and in relation to a variety of issues for the purpose of exercising good corporate governance but without seeking to acquire or exercise control over the companies in which they have invested."[117] Most importantly, the ESMA public statement established a "white list" of activities which, if undertaken, would not lead to cooperation among investors for the purpose of acting in concert.[118] The white list includes matters such as: (a) discussions among investors regarding possible issues to be raised with the company's board; (b) representations to the board about policies, practices and actions of the company; (c) the exercise of statutory rights by shareholders; and, (d) coordinating shareholder actions on matters such as directors' remuneration, acquisition or disposal of assets, and certain forms of capital restructuring and financial matters. Specifically with reference to ESG, the coordination referred to above may extend to "the company's policies in relation to the environment or any other matter relating to social responsibility".[119]

Unlike the UK regime which addresses issues of board changes head-on, the ESMA public statement permits engagement on the above matters only as long as shareholder action does not involve the appointment of board members. In fact, it cautions that shareholder coordination on matters of board appointment "can be particularly sensitive in the context of the application of the mandatory bid rule."[120] Hence, the white list "does not include any

[115] Id, at para. 3.11. At the same time, if the appointed directors are independent of activist shareholders and they do not constitute a majority of the replaced board, there would be no concert party relationship. Id.

[116] European Securities and Markets Authority, *Public Statement: Information on shareholder cooperation and acting in concert under the Takeover Bids Directive*, ESMA/2014/677-REV (20 June 2014).

[117] Id, at para. 3.1.

[118] Id, at para. 4.1.

[119] Id.

[120] Id, at para. 5.1.

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activity relating to cooperation in relation to board appointments."[121] The ESMA statement, though, includes some broad principles by which shareholders might be considered to be acting in concert while collaborating on board revamp proposals, such as the nature of the relationship between the shareholders and the proposed board members, the number of board members being proposed, whether shareholder coordination for board appointments has occurred more than once, and whether there results in a change board power due to collective shareholder action.[122] In that sense, shareholder activism in the context of board changes is more generic in the EU as opposed to the more specific treatment it receives in the UK. However, despite these differences, both regimes effectively prevent challenges to boards that fail to act on climate change initiatives – forestalling the type of activity that is intrinsic to activist stewardship to address climate change.

Moving to Australia, its corporate regulator, the Australian Securities and Investment Commission ("ASIC"), too recognizes the tension between collective activist shareholder engagement and the provisions that limit shareholder cooperation.[123] Hence, it issued a regulatory guide to provide guidance to investors on the circumstances in which ASIC will consider collective action to constitute a concert group for the purposes of triggering obligations under the Corporations Act.[124] The guide seeks to achieve the dual objective of encouraging collective action on the part of investors to enhance corporate governance of companies and, at the same time, to prevent such action from engaging in control shifts that militate against the letter or spirit of the provisions regulating substantial acquisitions of shares and takeovers.[125] In this background, ASIC has adopted the method of providing illustrative examples where collective shareholder action is either likely or unlikely to trigger the control provisions under the Corporations Act. While measures such as holding discussions among investors, exchanging views on matters relating to the company, disclosing individual voting intentions, and making representations to the company's management are unlikely to trigger the concert party relationship for control shifts, any measure that relates to board appointments or composition of the board is more likely to constitute acting in concert.[126] ASIC's apprehension regarding the possible use of collective action mechanisms as a backdoor means to secure control is evident in its following statement:

> Particularly in circumstances where the proposed directors have a connection with the investors who may be engaged in collective action, board control activity can be used as a pathway to control over the entity and more traditional control transactions. It can be used to exert illegitimate undisclosed control by using threats to the position of existing board members to persuade an entity's board to make particular decisions.

[121] Id.
[122] Id, at para. 5.3.
[123] Australian Securities and Investment Commission, *Collective action by investors*, Regulatory Guide 128 (June 2015), RG 128.2-128.3.
[124] Id, at RG 128.10.
[125] Id, at RG 128.13.
[126] Id, Table 1 and Table 2.

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> We will be particularly concerned by collective action that seeks to change the composition of the board for the purpose of facilitating the investors proposing the change pursuing their plans for the company.[127]

It is clear that, like the EU, the Australian position is that any proposal by shareholders that involves altering board composition would likely result in their acting in concert for the purpose of takeover regulation. In all, barring the UK and Singapore, which adopt a more nuanced approach to board control-seeking proposals, regulators in other jurisdictions generally tend to treat any board revamp attempts by activist investors as resulting in those investors acting in concert, thereby triggering the mandatory offer requirements. In addition, even in the UK and Singapore, collective action by institutional investors which threatens to replace boards unless action is taken on climate change (or other governance matters) risks the crippling sanction of a mandatory bid. This is the case even if the purpose is to change the governance of a company by threatening to replace a board that is failing to adequately address climate change – but is not at all intended to take over a company for the purpose of profiting from the takeover itself.

3. Anti-Activist Poison Pills

Largely applicable in the US, since the 1980s, poison pills have formed the mainstay of takeover defenses adopted by companies seeking to protect themselves against corporate raiders who act with a view to obtain control of a company by means of a hostile takeover.[128] However, more recently though, poison pills have been utilized by companies to defend themselves against attacks by activist shareholders, where such shareholders only seek to bring about changes in corporate governance rather than to obtain control over the target.[129] This phenomenon has been exacerbated by market uncertainties and economic shock triggered by Covid-19 that witnessed corporate managements scrambling to institute "crisis" pills to defend against "opportunistic activism".[130]

The so-called "anti-activist poison pills" are distinct from traditional pills on several counts. Here we focus on two that are most relevant to our analysis. First, the newer pills were established with a low trigger threshold at 5% or 10% compared to the previous higher threshold of 15% or 20%.[131] This imposed significant constraints on the ability of activist shareholders to amass sufficient stock in the company to successfully wage a proxy contest with a view to initiating a board reconstitution. Second, and more importantly, the new age anti-activist pills contained wide-ranging acting in concert provisions. At the outset, at the bare minimum the pills tended to treat a collectivity of shareholders as a "group" based on the

[127] Id, at Table 3.

[128] Poison pills have been the subject matter of scrutiny by the Delaware courts. See e.g., *Moran v. Household International*, 493 A.2d 946 (Del. 1985).

[129] Kahan & Rock, *supra* note 26, at 919. See also, Eldar, et al, *supra* note 26.

[130] Gordon, *supra* note 26, at 207.

[131] See e.g., Goshen & Steel, *supra* note 26, at 466-467.

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definition stipulated in section 13(d) of the Securities and Exchange Act of 1934.[132] This would permit wolf-packs to operate by communicating with each other and acquiring shares, so long as there is no agreement or understanding among them.[133]

More controversially, the anti-activist pills have sought to expand on the definition of acting in concert in at least two other ways. First, they include "parallel" arrangements whereby a person shall be *deemed* to be acting in concert with another towards a common goal of changing or influencing the control of a company if it enters into a transaction with the other person where at least one of several factors determined by the board of the target company is present. Such factors may include "exchanging information, attending meetings, conducting discussions, or making or soliciting invitations to act in concert or in parallel."[134] This is regardless of whether there is an agreement, arrangement, or understanding among the parties. Second, the anti-activist poison pills include "daisy chain" connections by which two persons can be treated as acting in concert simply because each of them independently and separately was acting in concert with a common third party.[135]

The legality of anti-activist poison pills has received mixed judicial reaction. It was affirmed in two cases about a decade ago.[136] It came up for consideration again more recently before the Delaware Chancery Court in *The Williams Companies Stockholder Litigation*.[137] In this case, The Williams Companies Inc. instituted a poison pill that, among other features, included a 5% trigger threshold and an expansive definition of "acting in concert", which extended to parallel conduct and the "daisy chain" concept.[138] In assessing the veracity of the pill, Vice Chancellor McCormick applied the two-part inquiry established in *Unocal Corp. v. Mesa Petroleum Co.*[139] "on, first, whether the board had reasonable grounds for identifying a threat to the corporate enterprise and, second, whether the response was reasonable in relation to the threat posed."[140] In striking down the pill as unenforceable, she observed:

> Although the 5% trigger is a marked departure from market norms, it is not the most problematic aspect of the Plan … The primary offender is the [Acting in Concert] Provision, whose broad language sweeps up potentially benign stockholder communications 'relating to changing *or influencing* the control of the Company.' The definition gives the Board discretion to determine whether "plus" factors as innocuous as 'exchanging information, attending

[132] Kahan & Rock, *supra* note 26, at 962; Gordon, *supra* note 26, at 229-230.
[133] Kahan & Rock, *supra* note 26, at 962; Gordon, *supra* note 26, at 229-230.
[134] Such an expansive approach is evident in the poison pill adopted by Genesco, as discussed in Kahan & Rock, *supra* note 26, at 963.
[135] Gordon, *supra* note 26, at 215-216. For instance, if A were acting in concert with B, and B with C, the "daisy chain connection" would automatically treat A and C to be acting in concert, even though they were in fact acting independent of each other.
[136] See Goshen & Steel, *supra* note 26, at 467, referring to *Yucaipa Am. All. Fund II, L.P. v. Riggio*, 1 A.3d 310, 313 (Del. Ch. 2010) and *Third Point LLC v. Ruprecht*, C.A. No. 9469, 2014 WL 1922029 (Del. Ch.).
[137] 2021 WL 754593 (Del. Ch.).
[138] The broad design of the anti-activist poison pill in *Williams* was like that of Genesco discussed in text accompanying *supra* notes 134-135.
[139] 493 A.2d 946 (Del. 1985).
[140] *Williams*, *supra* note 137, at 1.

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> meetings, [or] conducting discussions' can trigger the Plan. This language encompasses routine activities such as attending investor conferences and advocating for the same corporate action. It gloms on to this broad scope the daisy-chain concept that operates to aggregate stockholders even if the members of the group have no idea that the other stockholders exist.[141]

The *Williams* ruling, which was upheld by the Delaware Supreme Court,[142] has received both praise[143] and criticism[144] alike. Interestingly, although the *Williams* ruling relates to conventional shareholder activism (e.g., by hedge funds), the analysis will equally resonate with aspects of activist ESG stewardship. In fact, the Delaware Chancery Court was quick to note that "[m]ore recently, 'ESG activism' has come to the fore, and stockholders have begun pressuring corporations to adopt or modify policies to accomplish environmental, social, and governance goals."[145] Academic commentary discussing the ruling too recognizes that shareholder activism extends to encapsulate ESG activists who rely on board revamps as a means to pursue broader goals relating to corporate purpose.[146]

Another jurisdiction that has witnessed poison pills, albeit in rather different form compared to the US, is Japan.[147] Even there, given the rising incidence of shareholder activism, companies have begun to adopt anti-activist poison pill plans.[148] This has now extended to matters of ESG as well. As two Japanese law experts have noted: "ESG activism is becoming increasingly influential in Japan and is a source of angst for Japanese managers."[149] Although not in the context of ESG, anti-activist poison pills in Japan have recently attracted judicial attention. One shareholder rights plan instituted by Mitsuboshi was challenged by an institutional shareholder, Adage Capital. The plan had an expansive concept of persons acting in concert, which brought within its fold shareholders who did not expressly agree to act together with a view to obtaining control over the company (i.e., wolf-pack activists).[150] The District Court placed a stop on such a shareholder rights plan, which was upheld by the Japan Supreme Court. One of the reasons is because "the identified group consisted of multiple parties with indirect and in some cases tenuous relationships with each other. The court criticized the overly broad and nebulous definition of the group and the prohibited acts that would trigger the poison

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[141] Id., at 22-23 [emphasis in original].
[142] *The Williams Companies Inc. v. Stephen Wolosky* (Nov. 3, 2021).
[143] Gordon, *supra* note 26, at 214.
[144] Goshen & Steel, *supra* note 26, at 470; Petrucci & Subramanian, *supra* note 26.
[145] *Williams*, *supra* note 137, at 1.
[146] Gordon, *supra* note 26, at 217, 222.
[147] Alan K. Koh, Masafumi Nakahigashi & Dan W. Puchniak, *Land of the Falling "Poison Pill": Understanding Defensive Measures in Japan on Their Own Terms*, 41 U. PA. J. INT'L L. 687 (2020); Dan W. Puchniak & Masafumi Nakahigashi, *The Enigma of Hostile Takeovers in Japan: Bidder Beware*, 15 BERK. BUS. L. J. 4 (2018); Curtis J. Milhaupt, *Bull-Dog Sauce for the Japanese Soul? Courts, Corporations, and Communities—A Comment on Haley's View of Japanese Law*, 8 WASH. U. GLOBAL STUD. L. REV. 345 (2009).
[148] Oh-Ebashi LPC & Partners, *Wolf Pack Activism vs. Poison Pill in Japan* (Mar. 7, 2023), available at https://www.legal500.com/developments/thought-leadership/wolf-pack-activism-vs-poison-pill-in-japan/.
[149] Curtis J. Milhaupt & Zenichi Shishido, *The Enduring Relevance of the Poison Pill: A US-Japan Comparative Analysis* (Jan. 30, 2023), available at https://ssrn.com/abstract=4339701, at 14.
[150] Oh-Ebashi LPC & Partners, *supra* note 148.

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pill."[151] The courts found that the process adopted by the target company for determining acting in concert relationships was arbitrary.[152]

In all, a doctrinal analysis of the concept of acting in concert involving activist ESG stewardship indicates that in the context of disclosures and mandatory offers, the regulators have been grappling with the identification of a balance that permits the initiation of ESG activism (that benefits the company as a whole) but, at the same time, prevents backdoor control shifts (made to the detriment of minority shareholders). On the other hand, we find that in the case of anti-activist poison pills, the contractual nature of the arrangement has led to companies using expansive concert party definitions that have invited judicial wrath as being disproportionate to the threat posed by shareholder activism, which is likely to include ESG activism as well. After considering the law on the books, we transition to an exploration of the law in action, primarily through the lens of the PRI legal guidance.

B. Boundaries of Activist ESG Stewardship

Although the PRI legal guidance is specific to the three jurisdictions of the UK, South Africa, and Germany, its tenor is indicative of the general concerns faced by activist ESG stewards. The legal guidance essentially focuses on what institutional investors are permitted to do in the context of ESG activism, and when they may breach the acting in concert framework that might lead them to be subject to adverse consequences, such as making premature disclosures or triggering the mandatory offer or anti-activist poison pill, as the case may be.

The PRI legal guidance shines the green light on soft forms of engagement, while it raises the red flag on the more aggressive forms. In the context of activist ESG stewardship, the guidance outlines several examples that would constitute soft engagement and, hence, pass muster without triggering the adverse consequences under the acting in concert regime. They include investors coming together and agreeing (whether in writing or orally) to engage with a number of companies on specific issues, such as the environmental impact of plastics on the oceans, and to promote more sustainable practices.[153] Collective action practices include dialogue with the companies and submitting written representations. This may or may not include filing resolutions with companies on the issue of voting for or against directors depending upon their approach to the environmental impact on plastics in the oceans. Similarly, where investors sign a letter to the company asking it to set a target for reducing greenhouse gas emissions, meet with each other on matters of labor rights, meet with the company on labor rights or matters such as water use in the company's supply chain, the actions are protected under the acting in concert regime so long as they are not accompanied by a board control-seeking proposal.[154]

[151] Stephen Givens, *Mitsuboshi Case Leaves Poison Pill Doctrine Unresolved* (Aug. 2022), available at https://blog.bdti.or.jp/en/2022/08/10/mbpil/.
[152] Milhaupt & Shishido, *supra* note 149, at 16-17.
[153] Linklaters, *supra* note 25, at 23-24.
[154] Id., at 27.

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On matters of voting, investors' actions such as disclosing how they will vote at a shareholders' meeting to adopt a responsible sourcing policy, telling other investors that they will vote in favor of such a resolution, and agreeing to vote in favor of a resolution requiring the company to be more energy efficient are matters that would fall beneath the threshold to trigger the acting in concert regime.[155] However, other matters such as a group of investors agreeing to vote the same way on all votes at a company's annual general meeting could give rise to disclosure obligations, while the question of whether a mandatory offer is attracted would depend upon whether the resolutions involve board control-seeking proposals. Other measures such as tying executive compensation to sustainability metrics, statements by investors that they intend to divest from companies that do not publish sustainability reports, agreeing to vote against directors' remuneration report and remuneration policy, and agreeing to vote against reappointment of auditors are generally considered safe from an acting in concert perspective.

In effect, the PRI legal guidance endorses the use by investors of soft forms of engagement on ESG matters. However, despite the significant treatment offered by the UK Takeover Panel on the question of board control-seeking proposals, the PRI legal guidance pays short shrift to the concept. It takes a binary approach in that wherever any of the above engagement measures are accompanied by board control-seeking proposals, they are likely to fall within the scope of the acting in concert regime, thereby potentially triggering a mandatory offer. The guidance does not venture into the next level of analysis of when a proposal is said to be board control-seeking, which is evidence of the ambiguity surrounding the concept in practice. In that sense, investors (and the practitioners advising them) appear unwilling to be drawn into the somewhat complex and convoluted discussion of when a proposal becomes board control-seeking, and instead have preferred a more conservative approach of advising investors to adopt the soft measures.

The unsatisfactory nature of the acting in concert frameworks, even in the most developed takeover jurisdictions, leaves much to be desired. Despite the forceful calls for institutional investors to make activist ESG stewardship their *modus operandi* following the Engine No. 1/ExxonMobil case, the current acting in concert regimes widely appear to prevent the full realization of the benefits of such activism – even if they would be significant in addressing climate change. Under such a framework, institutional investors will be unable to exert pressure on companies to achieve their sustainability goals and practices – even (or, ironically, especially) if this is supported by institutional investors holding a majority of the shares in a company, who are forcefully promoting sustainable corporate governance initiatives in companies recalcitrant to change (but are not interested in a takeover). The role of activist ESG stewardship is diminished, as several of the examples discussed in the PRI guidance suggest that such mild forms of engagement can be undertaken by anyone for that matter, even someone who holds no shares in a company. Hence, without the threat of a board change, there is no reason why managements may be sufficiently incentivized to heed to the calls of activist ESG stewards on environmental (social or governance matters). The rather cautious approach

[155] Id., at 30-31.

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adopted by the PRI legal guidance is attributable to the shortcomings of the acting in concert regime generally.

On the one hand, the PRI in its public statements seeks to be at the forefront of promoting ESG engagement by facilitating collective shareholder action among institutional investors. On the other hand, the limitations imposed by its legal advice for avoiding acting in concert restrictions risks converting its signatories into non-responsible investors engaged in "*faux* green" activism. While the PRI's public statements call for institutional investors to be activist ESG stewards, its legal advice clearly guides institutional investors to mild, and even entirely passive, engagement with investee companies. The PRI's legal advice even suggests that institutional investors should engage in passive activities which do not require exercising any shareholder power at all.

This begs the question of why one must even be a shareholder to engage in such activities – in essence the legal advice often suggests institutional investors to engage in soft politics over the exercise of legitimate shareholder power. This has the effect of turning ESG stewardship into merely rhetoric through written and oral representations that investors can make to companies in which they own shares, as the acting in concert regime (as outlined in the PRI legal opinions) limits the ability of investors to convert their ESG wishes into action. The "*faux* green" activist approach promoted by the PRI suggests that whenever shareholder power is utilized, it must focus on specific "green issues" that can be discussed among the investors and with the company. However, any hint of a control contest fundamentally will require the investors to apply brakes to their strategy, thereby transforming the tool of ESG monitoring into something that merely allows them to promote an ESG agenda – in essence converting ESG stewardship from a corporate governance tool to a political tool or even false advertising.

C. Deficiencies in the Acting in Concert Framework

As seen, there are several uncertainties surrounding the acting in concert regimes that have led to it being considered a significant barrier to collective shareholder action. This is particularly so in the context of mandatory offers and poison pills, which generate the severest consequences for breach. While the UK position is rather elaborate, there continue to be several loose ends. For instance, a proposal fails to be board control-seeking only if the directors proposed by the shareholder coalition are independent of the proposing investors. Yes, there are some criteria for independence, but they are rather broad, conferring considerable discretion in the hands of the regulators to determine the fact, that too on an *ex-post* basis.[156] The UK Takeover Panel has clarified that "if the activist shareholders make it known that, if their initial proposals are not implemented, they will put forward 'board control-seeking proposals', this may cause the Executive to determine that the proposals should be considered to be 'board control-seeking', and that a concert party has arisen."[157] This leaves considerable risk with the shareholders who may be unwilling to bear them in the backdrop of adverse consequences for

[156] Winner, *supra* note 23, at 371.
[157] Takeover Panel (UK), Practice Statement No. 26, *Shareholder Activism*, at para. 3.11.

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the breach of the acting in concert regime. Hence, any engagement by shareholders that includes as part of the strategy the threat to reconstitute the board of directors is permissible only in very limited circumstances where the independence of the proposed directors raises no doubts whatsoever.[158]

In other jurisdictions, independence of the proposed directors has no bearing on the determination of the acting in concert regime, thereby minimizing the scope of any protection for activist ESG stewards. In the EU, ESMA's public statement clarifies that any form of soft engagement by institutional shareholders will not raise an acting in concert risk. However, when it comes to more aggressive forms of activism, including even the threat of a board reconstitution, the ESMA statement fails to offer any safe harbor to investors.[159] One commentator goes to the extent of questioning any utility at all of ESMA's efforts:

> The ESMA Public Statement has actually limited utility in practice and, in my opinion, it indicates to what extent the notion of concerted action has been disproportionately distorted in many European countries, and as a consequence the mandatory takeover bid system itself. The white list has very little value. This is due to its very content, i.e. a list of corporate actions that are generally futile and commonplace and which are mostly unable to have any significant impact on a company's control, and which should be neither unclear or questionable.[160]

Curiously enough, ESMA has itself questioned the utility of its statement in the context of ESG activism, whose rise in popularity it has recognized. It has even considered the need to review the statement and explore whether the white list should "explicitly include coordination activities among institutional investors in the area of ESG risks in order to address potential obstacles to related engagement."[161]

As for the US, there continue to be issues surrounding the operation of wolf-packs, and whether they can skirt the disclosure requirements for acquisition of substantial shareholding. As the SEC is seized of the matter and considering reforms to the disclosure regime, including on acting in concert, there is likely to be some uncertainty. Moving to anti-activist poison pills, given that their legitimacy is a product of the Delaware court system, there is bound to be some degree of indeterminacy, although the ruling in *Williams* mitigates uncertainty to some extent. The *Mitsuboshi* ruling in Japan reflects the presence of similar considerations elsewhere in the world.

Overall, the predominant sentiment emerging from the literature is that the overbearing nature of the regulation surrounding acting in concert and the ambiguities and diversity in

[158] An example of a successful investor campaign on these lines arose in *Petropavlovsk plc*, *supra* note 114.

[159] Javier García de Enterría, *Reflecting on concerted action in relation to mandatory takeover bids: Shareholders agreements and the concerted exercise of voting rights* (2023), available at https://ssrn.com/abstract=4343791, at 29.

[160] Id., at 30.

[161] European Securities and Markets Authority, *supra* note 31, at 69.

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interpretation would have the effect of hindering shareholder activism.[162] This would include activist ESG stewardship. The onerous nature of the regime for shareholder coalitions inhibits shareholders from coalescing to demonstrate their collective strength in achieving ESG objectives. Whether by design or default, this situation allows recalcitrant managements to rely on the "acting in concert" playbook to repel activist attacks on the ESG front, thereby undermining the shareholder-backed movement to accomplish ESG goals. In such a context, we now proceed to examine the issues normatively by considering whether we can build a model in which activist ESG stewards are not inhibited by acting in concert provisions, but at the same time those provisions are not in any way diluted to address attempts by raiders seeking to control targets.

IV. THE WAY FORWARD: A WORKABLE MODEL

A significant reason for the dissatisfaction surrounding the current regime governing acting in concert is that it was developed essentially with takeovers in mind, which involve a complete acquisition of control by an acquirer or controlling shareholder. The acting in concert regime was devised as an anti-abuse mechanism that would prevent a group of shareholders from splitting their shareholding to circumvent various triggers resulting in disclosures, mandatory offers, or poison pills. The conceptual cloudiness surrounding acting in concert arises essentially because the trend of collective shareholder action only developed subsequently, and the acting in concert frameworks had to respond by making necessary adjustments, such as those witnessed in the UK, US, EU, Japan, and Australia. Given the reactive nature of the acting in concert regime, it has failed to fully capture the nuances of shareholder activism (whether traditional or that involving ESG). Here, we examine the possible refinements of shareholder activism in the ESG space (and more particularly in the context of climate change) and propose a model that would enable activist green stewardship without enabling backdoor changes of control.

At a conceptual level, our model is premised on two key considerations. The first relates to the fact that control shifts, which inspired acting in concert mechanisms, must be distinguished from activism (especially one that is climate-related). The second pertains to the presence of intermediary organizations in ESG activism, which could operate to impose checks and balances to mitigate any abuse by investors of ESG activism as a stratagem to seek backdoor changes or control and thereby circumvent the true spirit of the acting in concert mechanisms. We now elaborate on each of these factors.

[162] Winner, *supra* note 23, at 373; Riccardo Ghetti, *Acting in Concert in EU Company Law: How Safe Harbours Can Reduce Interference with the Exercise of Shareholder Rights*, 11 ECFR 594, 594 (2014); Ringe, *Investor-led Sustainability in Corporate Governance*, *supra* note 33, at 413; Balp & Strampelli, *supra* note 104, at 208.

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At the outset, there is a need to distinguish shareholder activism from control change. More than a decade ago, Professors Cheffins and Armour articulated the distinction (albeit in the context of traditional shareholder activism, not ESG):

> The investment approach hedge funds employ is markedly different from the approach private equity adopts. Private equity firms believe that taking a "hands on" role with the management of companies they take private is necessary to set the stage for a profitable exit and thus are comfortable deploying sufficient capital to obtain outright voting control. Activist hedge funds rarely have any interest in going this far with the companies they target. Instead, they prefer not to tie up capital in the form of majority or sole ownership of companies and instead anticipate profiting as minority shareholders when shareholder returns improve due to change management makes, in response to investor pressure if necessary.[163]

Any protection accorded to activist investors from the acting in concert regime must extend not only to soft forms of engagement but also to aggressive forms that involve the threat (or execution) of board changes. So long as board changes are only a means to the achievement of specific objectives on environmental, social or governance matters, they should not trigger the consequences arising under the acting in concert regimes.

This is especially relevant given that the trend of stewardship codes around the world – which have come to include the promotion of ESG as a goal – call for active engagement by shareholders with companies in which they have invested, including escalation where necessary. As Professors Balp and Strampelli note, "the very notion of collective engagement – as conceived of within the context of stewardship codes and principles – makes it clear that collective action is not about seeking control or exerting decisive influence over the firms' management, but basically about performing active monitoring."[164] They also allude to the Italian example of Assogestioni where, "even where board representations are sought, coordinated collective engagements" are considered to be in tune with broader stewardship principles and are not considered to be control-seeking.[165] In that sense, merely because institutional investors may collectively exercise their ESG stewardship commitments in any manner as they may deem fit, they cannot be considered to be in pursuit of control over the management of the company in the way that an acquirer or corporate raider would.

We argue that widely worded acting in concert provisions, whether in regulatory instruments or private contractual arrangements (such as poison pills) must be reconsidered. Clear distinctions must be introduced between situations involving a change of control and those that involve activism (or corporate influence). In a change of control scenario, we recognize the need for acting in concert provisions to trigger a mandatory bid (where applicable) or a poison pill (where instituted), as the control shift arguably affects the interest of the company and its shareholders as well as other stakeholders. Since the acquisition of control is the primary

[163] Brian R. Cheffins & John Armour, *The Past, Present, and Future of Shareholder Activism by Hedge Funds*, 37 J. CORP. L. 51, 59 (2011).
[164] Balp & Strampelli, *supra* note 104, at 197.
[165] Id., at 198.

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purpose of a collective purchase of shares in the target, whereby an acquirer exercises such control by shaping the composition of the board and the senior management of the company, there could be an adverse impact on the company and other shareholders requiring regulatory or contractual protection.

However, when it comes to ESG activism, it is clear that the activist shareholders do not seek to obtain control over the target by exerting their dominance in determining the identity of the board and senior management to generate enhanced value for themselves in a manner that resonates with control shifts. Instead, the intention of activists is merely to cause the company to address a specific issue (or set of issues), such as climate change or corporate diversity. The threat of a board change is only secondary and is merely a means to achieving environmental and social goals through investing. Through our model, we argue that measures where collective shareholder engagement and escalation on ESG issues occurs in the shadow of a potential board change should be viewed through a different lens altogether. The mischief that acting in concert provisions have historically sought to address do not operate in the same manner, and to the same extent, as they do in control shift transactions. In that sense, the measures introduced to mitigate the risk of abuse in the context of takeovers are completely unjustifiable in an era where they can easily be used by boards that fail to address climate change to thwart attempts of institutional investors (or other shareholders) to remove directors – even when such shareholders control a majority of shares and are not even acting in concert in the traditional sense.

Moving to our second factor, given that coordinating institutions such as the PRI are at the forefront of bringing together shareholders to initiate ESG engagement and activism with companies, their role needs to be considered as well. Situations exist where shareholder actions through coordinating institutions are considered to avoid the acting in concert provisions in tightly controlled circumstances.[166] Scholars have highlighted the Australian example where the actions of intermediary organizations would fall outside the purview of the acting in concert regime.[167] This is because the Corporations Act states that a person is not an "associate" of another by virtue of giving advice or acting on the other's behalf through "a professional capacity or a business relationship."[168] Professors Bowley and Hill analyzed the Australian position and found that "stewardship activities undertaken by an industry body will generally fall outside the reach of takeover laws provided that the activities are based on the body's independent assessment of where its members' interests lie and do not involve an agreement or understanding with its investor-members regarding an intervention against a particular company."[169]

Accordingly, we argue for a safe harbor for intermediary-led activist ESG, which ought not to fall within the constraints of the acting in concert rules. This is particularly important given the meteoric rise of ESG investment intermediaries, including the PRI. Such an intermediary-led

[166] Id., at 189, 190, 207-210.
[167] Bowley & Hill, *supra* note 15, at 432-434.
[168] Corporations Act 2001, s. 16(1)(a).
[169] Bowley & Hill, *supra* note 15, at 432.

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ESG activism would also ensure that the preferences of individual investors do not dominate the decision-making regarding engagement with issuer companies. The intermediary would have the role of filtering engagement proposals and ensuring that only meaningful proposals are initiated and pursued. Given that such investment intermediaries are repeat players in the market and are vying for global market expansion, reputational considerations would operate to make certain that their actions are not value-destructive or, in our context, carried out in a manner to circumvent the spirit of the acting in concert provisions to seek backdoor control over the target companies.

In all, there should be ex ante protection where shareholders only seek to bring about changes on climate, they expressly disclaim their interest in obtaining control, and they do not acquire a majority of the shares of the company (or other forms of control) for a period of time after the activist episode. At the same time, critics of our proposal will likely argue that the term "ESG" bears no consensus and is too ambiguous even though it has been debated extensively in recent years.[170] In particular, the "combination of E, S, and G into one term has given rise to several challenges that are increasingly becoming apparent."[171] The lack of clarity surrounding the concept of ESG has helped spark an "anti-ESG" movement that has not only sought to politicize the issue, but it has also resulted in leading institutional investors adopting a more cautious approach towards ESG activism.[172] ESG has even been branded "woke capitalism."[173]

Hence, we recommend that our proposal initially be limited to matters of climate activism by shareholders.[174] We outline the reasons for our approach. First, climate change is an existential risk that the world is facing, and perhaps more immediate than the other aspects of ESG. Second, climate risk has been the subject matter of domestic and international legislative efforts that will have a significant effect on the business, operations and management of companies. As Professor Gordon highlights:

> This sort of global governance consensus, concerted follow-up and concrete action plan does not exist for any other prospective component of ESG and is unlikely to exist because governments differ on social values and differ on trade-offs of social rights for economic development.[175]

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[170] Elizabeth Pollman, *The Making and Meaning of ESG*, EUROPEAN CORPORATE GOVERNANCE INSTITUTE - LAW WORKING PAPER NO. 659/2022, available at https://ssrn.com/abstract=4219857, at 31.

[171] Id.

[172] Heidi Welsh, *Anti-ESG Shareholder Proposals in 2023*, HARVARD LAW SCHOOL FORUM ON CORPORATE GOVERNANCE (Jun. 1, 2023).

[173] Andrew Edgecliffe Johnson, *The war on 'woke capitalism'*, THE FINANCIAL TIMES (May 28, 2022); Kenza Bryan, *US investors ditch green funds as "woke capitalism" backlash bites*, THE FINANCIAL TIMES (Apr. 29, 2023).

[174] In a similar vein, Professor Gordon has forcefully argued why climate risk must be decoupled from the wider rubric of ESG. *See*, Jeffrey N. Gordon, *Unbundling Climate Change Risk from ESG*, THE CLS BLUE SKY BLOG (Jul. 26, 2023).

[175] Id.

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As this suggests, climate change is a universal consideration, while other social causes play out varyingly in different jurisdictions. While our model may be considered for non-climate matters in relation to local initiatives in individual jurisdictions that may have attained a greater deal of acceptability, the one initiative that has garnered attention in a universal matter is climate risk. Given the importance climate change has received in the scholarly discourse as well as regulatory sphere, we argue for its prioritization when it comes to shareholder activism as compared to other aspects of ESG.

Third, climate change is a "material financial risk" that has direct financial implications for a company, and hence merits greater attention.[176] Climate risk is no longer confined to voluntary conduct by companies and their managements, but it imposes duties on directors of corporate boards to recognize and mitigate the risk in order to address the interests of shareholders and other stakeholders.[177]

In all, climate initiatives are easier to clearly define and therefore to challenge ex post if there is abuse. This final part of model may seem radical – however stakeholderism in the US and ESG itself were seen this way years ago – and climate change is becoming a first order issue that must be addressed with radical solutions for an existential problem.

V. CONCLUSION

The urgency of addressing climate change and other social issues through corporate governance has generated a clarion call for activist ESG stewardship. Increasingly, this call has the potential to result in a step change in sustainable corporate governance as the increasing power of institutional investors, stewardship codes, and the PRI set the stage for a wave of activist ESG stewardship. If this movement results in shareholders acting collectively to support ESG initiatives in companies, such initiatives should result in systemic changes to corporate governance in the direction that shareholders desire – especially in the US and UK where institutional investors dominate, but even in companies in other countries where institutional investors may be a significant catalyst for change. To deny such a change – especially when supported by a majority of shareholders – would be to deny corporate democracy and, with respect to climate change, may endanger our very existence.

Unfortunately, however, the legal rules concerning acting in concert were designed in a different age when contests of control – not activist ESG stewardship – formed the foundational rationale undergirding such rules. This has created a panoply of rules which disincentivize – and, in cases of mandatory bids and poison pills, may functionally disenfranchise – institutional investors from using aggressive tactics to drive an ESG agenda supported by shareholders. This suggests that the acting in concert rules must be reformed around the world to promote shareholder-backed ESG initiatives – while still maintaining the fair and effective markets for

[176] Lisa Benjamin, *The Road to Paris Runs Through Delaware: Climate Litigation and Directors' Duties*, [2020(2)] UTAH L. REV. 313, 325.

[177] Sarah E. Light, *The Law of the Corporation as Environmental Law*, (2019) 71 STAN. L. REV. 137, 140.

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corporate control, which was the original impetus for creating them. By providing a workable model for reforming acting in concert laws, this article attempts to provide a solution to this problem.

Until such reforms are made there is a real risk that the current acting in concert regimes are promoting "faux green activism" by putting institutional investors between a rock and a hard place. The "rock" is that institutional investors stand to benefit financially and are under increasing pressure to demonstrate their commitment to ESG. The "hard place" is that their lawyers – no doubt having read the PRI legal opinions and aware of the ESMA Public Statement – are likely to (correctly) advise institutional investors to limit their activities with investee companies to soft forms of engagement. Such legal advice is prudent considering that engaging in activist ESG stewardship, which is what is required to achieve the real change that shareholders support, ironically risks disastrous consequences for institutional investors and their ultimate beneficiaries. This undoubtedly creates a situation where much is said softly about the ESG preferences of institutional investors – even when collectively such institutional investors have the voting power to threaten to change board control. Ultimately, however, far less is done by such institutional investors as speaking softly signals their commitment to ESG, while avoiding the serious risks of acting in concert: the perfect regulatory recipe for prompting faux green activism.

Conversely, the failure to make the necessary changes to acting in concert regimes to support activist ESG stewardship may miss a significant opportunity to mitigate the existential threat of climate change. The meteoric rise among institutional investors to commit to the PRI, combined with the reorientation of the global shareholder stewardship movement towards ESG with a focus on climate change, suggests that institutional investors are in a unique position to drive a paradigm shift towards sustainable corporate governance. The opportunity for institutional investors to drive such change is most pronounced in the US and UK where institutional investors have the voting power to dominate. However, in other major economies with a large carbon footprint, such as Australia, Canada and Japan, institutional investors hold enough sway in enough companies to make a sizable difference. Even in jurisdictions dominated by controlling shareholders, collective action among institutional shareholders with minority stakes may pressure controlling shareholders to pay more attention to climate change. However, unless there is a new model for acting in concert rules, the potential for activist ESG stewardship to address climate change will never be realized.

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