SPACTIVISM

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ABSTRACT

In this Essay, we propose a modified version of the SPAC, called the Activist SPAC, that is uniquely designed to allow the public to participate in the world of corporate activism. This version of the SPAC that we envision is designed for investment in public companies, as opposed to private ones. Such investment is intended to improve the performance of the target public company and change its course of action. Our novel version of the SPAC also overcomes many of the problems that plague conventional SPACs.

At present, direct investment in activism is reserved for affluent individuals and other professional investors of activist hedge funds. The public at large is barred from directly entering the activist arena. The current model comes at a triple price: first, critics argue that activism in its current form is slanted toward short-termed engagements, possibly neglecting potential profitable long-term campaigns. Second, although loud, the current scope of activism is, in fact, relatively limited. Activist engagements reach but 2.3% of the public companies traded on U.S. markets. Third, retail investors cannot directly share in the excess profits stemming from activism.

The introduction of the Activist SPAC can change this reality. The Activist SPAC would allow interested retail investors to invest money in a corporation dedicated to activist engagement. To ensure the success of the enterprise, the future target of the investment would not be made public at the time of the investment. Once the Activist SPAC buys a toehold position in the target and announces its plan, the investors would receive an opportunity to get their money back, should they choose to do so, or go along with the activist plan. As we show in this Essay, setting up Activist SPACs can transform the character of corporate activism by rendering it more attuned to long-term objectives, and is especially fit to pursue ESG

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goals. Activist SPACs would also give the public a voice in the future world of activism and allow it to share in the benefits of activism directly, as well as increase the scope of corporate activism.

TABLE OF CONTENTS

INTRODUCTION

There is much to commend about shareholder activism.[1] Supporters of shareholder activism point to its potential to enhance firm value by disciplining management and improving corporate governance. At present, however, there is an inherent limitation on the potential of shareholder activism to serve as an antidote to corporate failures: its limited scale and uniform character. The central players in shareholder activism are activist

1. *See, e.g.*, Lucian A. Bebchuk, Alon Brav & Wei Jiang, *The Long-Term Effects of Hedge Fund Activism*, 115 COLUM. L. REV. 1085, 1087 (2015) ("Hedge fund activism is now a key aspect of the corporate landscape. Activists have been engaging with and influencing major American companies, and the media has been increasingly referring to the current era as the 'golden age of activist investing.'"); Mark J. Roe, *Corporate Short-Termism—In the Boardroom and in the Courtroom*, 68 BUS. LAW. 977, 985 (2013) (noting that shareholder activism functions as the much needed 'transmission mechanism' between the market and the board room). *But cf.* Martin Lipton, *The Bebchuk Syllogism*, HARV. L. SCH. F. ON CORP. GOVERNANCE (Aug. 26, 2013), https://corpgov.law.harvard.edu/2013/08/26/the-bebchuk-syllogism/ [https://perma.cc/E5F8-TE8X] (arguing that activists have a short-term investment horizon and undermine the creation of value in the long term); Martin Lipton, *Do Activist Hedge Funds Really Create Long Term Value?*, HARV. L. SCH. F. ON CORP. GOVERNANCE (July 22, 2014), https://corpgov.law.harvard.edu/2014/07/22/do-activist-hedge-funds-really-create-long-term-value/ [https://perma.cc/B463-867V] (reinforcing the claim that activist hedge fund focus on short-term economic goals at the expense of long-term economic value).

hedge funds. The resources they can deploy toward engagements are limited: in 2020, activist hedge funds initiated campaigns in only 80 (2.3%) of the 3,463 U.S. publicly traded firms with a market cap of at least $500 million.[2] Needless to say, only a fraction of the activist campaigns are successful. Evidently, in its present form, shareholder activism falls short of realizing its full potential.

The main reason for the limited reach of hedge funds is regulatory. The regulatory framework that applies to activist hedge funds practically forces them to raise money only from private sources, such as private equity firms, pension funds, and affluent individuals, thus constraining their ability to increase the funds that can be used toward engagements.[3] Investments from such private sources are dwarfed by the universe of public investments. The capital deployed by activist hedge funds in the U.S. market in 2020 amounted to $39.6 billion.[4] This sum may seem large, but it is only a tiny fraction—0.0322%—of the market cap of all U.S. public firms, which exceeded $50 trillion.[5]

Activist hedge funds are *de facto* precluded from raising money from the public for several reasons, especially since it would legally bar them from obtaining their traditional compensation package.[6] In addition, Securities and Exchange Commission (SEC) regulations condition raising funds from the public on extensive and comprehensive disclosure. Specifically, there are strict restrictions on public offerings that do not disclose a "specific business plan or purpose."[7] Among other things, this regulation requires the issuer to allow public investors to withdraw their funds prior to the materialization of its business endeavor.

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2. WILSHIRE, WILSHIRE 5000 TOTAL MARKET INDEX FACT SHEET 1 (2020), [https://perma.cc/MBW7-28TE]; S'HOLDER ADVISORY GRP., LAZARD, 2020 REVIEW OF SHAREHOLDER ACTIVISM 6 (2021), https://www.lazard.com/media/451536/lazards-2020-review-of-shareholder-activism-vf.pdf [https://perma.cc/NZQ9-N7PL].

3. The investment of pension funds and other institutional investors in activist hedge funds is to a relatively limited extent. For an explanation of the limited investment of institutional investors in activist hedge funds, see John D. Morley, *Too Big to Be Activist*, 92 S. CAL. L. REV. 1407, 1412-13 (2019).

4. LAZARD, *supra* note 2, at 2.

5. SIBLIS RSCH., *Total Market Value of U.S. Stock Market*, https://siblisresearch.com/data/us-stock-market-value/#:~:text=The%20total%20marke t%20capitalization%20of,about%20OTC%20markets%20from%20here [https://perma.cc/LU4E-SZM4] (last visited Dec. 14, 2022). It should be noted that the share of the total positions of hedge funds from the total capital of U.S. public markets is larger: The $16.1 billion reflects only the fresh capital entering the market—but hedge funds still hold positions from prior years. The total capital held by U.S. hedge funds at the end of 2018 is estimated at $146 billion assets under management. Svea Herbst-Bayliss, *Karmic Reckoning? Investors in Activist Hedge Funds Agitate for Change*, REUTERS (July 30, 2019, 6:29 AM), https://www.reuters.com/article/us-usa-hedgefunds-investors-focus-idUSKCN1UP17T [https://perma.cc/EJ55-C22G].

6. Regarding the legal limitations on compensation packages of funds' investment advisors imposed by the Investment Advisers Act, see *infra* note 150.

7. 17 C.F.R. § 230.419 (2022).

However, the business model of activist hedge funds critically depends on secrecy until a later stage. Complying with the SEC disclosure rules would inhibit activist hedge funds from forming a position under the market's radar—an indispensable aspect of the business model shared by all activist hedge funds. Activist hedge funds search for underperforming companies, identify major deficiencies, and then devise an alternative strategic business plan in order to serve as a remedial measure and increase value. The recoupment of these costly undertakings comes, if at all, months later when the activist hedge fund sells its shares. For recoupment to occur, activist hedge funds must act covertly until the time of the engagement, buying their major stake at a low price. Otherwise, if information about the engagement reaches the market ahead of time, the target's share price will rise before the activist buys its stake, which will foil the hedge fund's plan by rendering it much less profitable.[8]

In this Essay, we introduce a modified version of the Special Purpose Acquisition Corporation (SPAC) which we dub the Activist SPAC. The Activist SPAC is a corporate form uniquely designed for the special needs of shareholders' activism, while raising capital from the public. Our proposal draws inspiration from an existing corporate form, the Special Purpose Acquisition Corporation (SPAC). The SPAC corporate form allows the public to commit funds to acquire a private company. The private target is unknown at the time of the investment, and the funds committed by individual investors are held in trust until a target is identified. Once the target is chosen, its identity is disclosed to the individual investors, who get to decide whether to withdraw their money and receive interest on their investment or go along with the acquisition plan. In 2020 alone, SPAC initial public offerings (IPOs) raised $83.4 billion, more than two times as much as all activist hedge funds.[9]

Similar to the traditional SPAC, the Activist SPAC would allow the public to commit money to a concrete purpose. Yet, there would be several critical differences between the two. As opposed to the SPAC, Activist SPACs would target a public company, selected for the purpose of an

8. *See, e.g.*, Kobi Kastiel & Yaron Nili, *In Search of the "Absent" Shareholders: A New Solution to Retail Investors' Apathy*, 41 DEL. J. CORP. L. 55 (2016) (suggesting utilizing behavioral nudges in order to overcome barriers to more active engagement of retail investors, and tools that would facilitate their automatic supports of activist campaigns by other professional actors).

9. Joshua Franklin, *U.S. SPACs Overtake 2020 Haul in Less than Three Months*, REUTERS (Mar. 17, 2021, 5:22 AM), https://www.reuters.com/article/us-spac-usa-ipo-idUSKBN2B919O [https://perma.cc/VE95-HASB]. Activist hedge funds have deployed $39.6 billion in campaigns during 2020. *See* LAZARD, *supra* note 2, at 2. It should be noted that the capital deployed in campaigns includes "old" capital—capital the hedge fund raised in the past for some other investment which it had liquidated and reinvests for forming a block of shares in a new public company—and is not limited to "fresh" capital which it has raised from its investors for the purpose of forming a block of shares in the aforementioned public company. Thus, the actual gap between the annual capital raised of SPACs and activist hedge funds (for which the information is much more restricted) is actually much more pronounced.

activism campaign, rather than a private company. Limiting the Activist SPAC investment to public firms would also enable it to overcome many of the existing problems with traditional SPACs. Additionally, the money invested in Activist SPACs would not be directed toward a full acquisition of (or merger with) its target, but rather toward purchasing a block of shares, normally 5%–10%,[10] that would enable changing the course of the target corporation.

Another difference between Activist SPACs and traditional SPACs stems from the need of activist hedge funds to keep the identity of the target corporation under wraps prior to the engagement. Unlike the SPAC, the Activist SPAC, as we envision it, would not be required to announce its target ahead of the time of purchase. Investors in the Activist SPAC would be given an opportunity to redeem their investment *following* the transaction. Following the acquisition of its stake in the putative target, the Activist SPAC would have to disclose its planned strategy for activism. Such plans could have a similar form to the "white papers" that activist hedge funds send to the management of the target company and its major shareholders, in an effort to convince them why a certain change in the company is needed.[11] Such white papers would detail the strategic change the Activist SPAC would like the company to adopt, present material support for the claim that such a change is desirable and feasible, and provide an estimate of the increase in value the change may generate.

As is the case with traditional SPAC investors, Activist SPAC investors would be able to redeem their shares and receive their initial investment.[12] Moreover, the Activist SPAC would have to note in advance the rate of non-redeeming shareholders that would be required for advancing its Activist campaign, and thus also provide a market check on its strategy. A 50% threshold, representing a simple majority, seems reasonable, unless the Activist SPAC has reasons to suggest a different threshold.

Importantly, the amount received upon redemption would be capped at the amount of the initial investment, even if there is a spike in the price of the target—and as a result, in the shares of the Activist SPAC. Such cap would prevent a "stag hunt" dynamic whereby investors may prefer to

10. Similar to the average stake held by an activist hedge fund. *See* SIMMONS & SIMMONS, UNLOCKING VALUE: THE ROLE OF ACTIVIST ALTERNATIVE INVESTMENT MANAGERS (2015), http://www.shareholderforum.com/access/Library/20150223_AIMA.pdf [https://perma.cc/7ZWA-A42S] (finding that activist hedge funds hold on average 9% of the stock of the target).

11. *See* Brandon R. Harper, Note, *The Dupont Proxy Battle: Successful Defense Measures Against Shareholder Activism*, 41 DEL. J. CORP. L. 117, 120 (2016). ("The activist will produce analyses and proposed remedies to what they believe are the target company's shortcomings in the form of 'white papers.'").

12. For discussion of the possibility that the investors will fund some of the expenses the sponsor has incurred, such as underwriting expenses, see *infra* Section II.B.

redeem their shares right after the potential spike in the value of the target at the time of the announcement, rather than wait until the goal of the activist campaign materializes.[13] This dynamic, when shared by many shareholders, could prevent the actual activist campaign from being executed, as the capital the Activist SPAC will have left to deploy may be insufficient, and may not pass the threshold of supporting shareholders it has set in advance.

The redemption right in Activist SPACs would be more restricted than SPACs in two dimensions. First, as mentioned before, the Activist SPAC shareholders would have a redemption right only *after* the company has formed its investment position. Second, each investor would not have an absolute right to receive her initial investment plus accrued interest. Because the Activist SPAC incurs costs prior to selecting the target, and given that the target's share price may depreciate in value for various reasons, the funds available for redemption may, in some cases, be lower than the funds initially invested. We believe that this additional risk to Activist SPAC investors is warranted—as it is not considerably different than the risk pattern of investments in public companies in general. Ordinary SPAC shareholders invest in private companies that are not subject to the same stringent disclosure requirements that apply to public ones, and thus do not benefit from the price transparency of publicly traded firms. Hence, there is a serious risk that SPACs are overpaying for the target. Activist SPACs, in contrast, target public corporations that must comply with all SEC regulations. Public corporations offer much greater transparency, and therefore, pose a much smaller risk to investors. In other words, Activist SPAC shareholders are exposed to market fluctuations in the share prices of the activism target, but not to overvaluation by the Activist SPAC managerial team. After all, the activist SPAC purchases the shares of the target on the public market, which prices financial assets efficiently.

Implementation of our proposal can expand the horizons of activism. If Activist SPACs manage to raise even 10% of the amount raised by SPACs in 2020 (over $80 billion),[14] it will significantly increase the resources available for shareholder activism. Hence, the institutionalization of the Activist SPAC has the potential to revamp capital markets and improve the quality of corporate governance of boards by scaling up shareholder activism. Furthermore, Activist SPACs' impact on activism is not limited only to scope—their introduction is likely to improve the quality of activism. One of the major critiques of hedge fund activism is that the structure of such investment vehicles derives a focus on the short-term that may be detrimental to the companies in which they invest in the long run.

13. Regarding the dynamic of a "stag hunt" game, see *infra* note 113.
14. *See* Franklin, *supra* note 9.

Indeed, the average length of a hedge fund activism campaign tends to be quite short,[15] and many of them are aimed at quick fixes.[16]

In contrast, Activist SPAC investors will be able to function as a much more patient source of capital for three main reasons. First, unlike hedge funds that are structured as partnerships with no liquid secondary markets for the partners' investments, the Activist SPAC is structured as a public corporation whose investors would be able to liquidate their investment at any point in time. For this reason, Activist SPAC managers would face less pressure to soothe investors with short-term results: if investors are not happy, they can always sell their share in the Activist SPAC on the stock market. Second, investors in Activist SPACs would be able to commit only a tiny fraction of their wealth to this goal and thereby remain diversified in their investments. Hedge funds, by contrast, require high investment amounts that largely negate diversification. The combination of small investments and diversification would further ease the pressure on Activist SPAC managers, allowing them to pursue a prudent long-term strategy. Third, unlike hedge funds that are partnerships with a predetermined deadline for their dissolution, Activist SPACs are public companies with no deadline for dissolution, and thus managers will be less time-pressured in their investment.

Activist SPACs can, therefore, start a new tide in capital markets, one that would leave a more sustainable impact on public companies and corporate governance. Its actual impact on the market may be exponentially higher than the increase in activist campaigns: the mere prospect of activist engagements exerts a disciplining effect on *all* managements. In the face of high levels of activism, managements would strive to improve their

15. SULLIVAN & CROMWELL LLP, REVIEW AND ANALYSIS OF 2020 U.S. SHAREHOLDER ACTIVISM AND ACTIVIST SETTLEMENT AGREEMENTS 27–28, (2020), https://www.sullcrom.com/files/upload/sc-publication-review-analysis-2020-US-shareholder-activism.pdf [https://perma.cc/4JDA-52V5] (finding that only approximately 5% of activist campaigns which were initiated and settled in 2020 took six months or longer until settlement); Fredrick Cedergren & Magnus Noack, Hedge Fund Activism in Europe: Are Activist Hedge Funds Guardians of Shareholder Value? 45 (May 15, 2020), https://research-api.cbs.dk/ws/portalfiles/portal/62179618/881349_Hedge_Fund_Activism_in_Europe.pdf [https://perma.cc/9NPG-J8TV] (Master Thesis, Copenhagen Business School) (finding that the median period of time for engagements of activist hedge funds in Europe between 2010–19 was 4.2 months and the average was 9.2 months). *But see* Lucian A. Bebchuk, Alon Brav, Wei Jiang & Thomas Keusch, *Dancing with Activists*, 137 J. FIN. ECON. 1, 30 (2020) (finding that the average length of activist campaigns initiated between 2000–13 was approximately 2.5 years). It should be noted that the data on which the Bebchuk et al. study is based is almost a decade old.

16. Assaf Hamdani & Sharon Hannes, *The Future of Shareholder Activism*, 99 B.U. L. REV. 971, 991 (2019).

performance to divert activists to other, less well-performing, companies.[17] Hence, activism generates positive spillover effects and improves the performance of firms that have not been engaged.[18]

Structurally, this Essay unfolds in four parts. Part I discusses the promise and peril of shareholder activism, focusing on the central limitation on activism: its relatively limited scale and uniform, rigid form. Part II introduces the Activist SPAC and lays out its design. Part III discusses the potential impact of Activist SPACs on the market. Part IV discusses possible objections. A short conclusion follows.

I. THE UNLOCKED POTENTIAL OF SHAREHOLDER ACTIVISM

Shareholder activism has been a central theme in corporate law scholarship in recent years. Prominent theorists believe that shareholder activism is the key to improving corporate performance. These scholars see shareholder activism as the cure for many of the ailments caused by the agency problem.[19]

Evidently, it is hard to count on shareholders to supervise managers. Critics have long expressed doubt regarding the ability of shareholders to make use of their power due to their rationally apathetic disposition.[20] Information gathering about firms and market conditions is an expensive endeavour. The cost far exceeds the potential benefits for most shareholders. Worse yet, while the cost of collecting the necessary information falls

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17. *Id.* at 984 ("[B]oards might pursue business or operational moves that would make their companies less attractive as targets for activists."); *see* also FRIED FRANK , M&A/PRIVATE EQUITY BRIEFING, SHAREHOLDER ACTIVISM—1H 2018 DEVELOPMENTS THE IMPACT AND FUTURE OF ACTIVISM, AND UPDATED PRACTICE POINTS 7 (2018), https://www.friedfrank.com/uploads/siteFiles/Publications/FFMAPE1H2018DevelopmentstheImpactandtheFutureofActivism092418.pdf [https://perma.cc/9MH5-JR5V] ("[P]roactive planning--and a relentless focus on performance and execution--are critical to an effective activism risk mitigation plan. Companies, together with outside advisors, should 'think like an activist . . . .'").

18. *See* Ronald J. Gilson & Jeffrey N. Gordon, *The Agency Costs of Agency Capitalism: Activist Investors and the Revaluation of Governance Rights*, 113 COLUM. L. REV. 863, 896–901 (2013) (discussing the spillover effect of activism on all firms); *see also* Adi Libson and Gideon Parchomovksy, *Reversing the Fortunes of Active Funds*, 99 TEX. L. REV. 581, 594–95 (2021) (considering the market-wide effect of activism in tailoring the tax credits for internalizing its positive external effects).

19. This confidence that increasing shareholder engagement in the company has potential in curing many of the market's maladies led Lucian Arye Bebchuk to spearhead a wide-ranging campaign that has transcended the boundaries of the academy, empowering shareholders and augmenting their influence on corporations. *See* Lucian Arye Bebchuk, *The Case for Increasing Shareholder Power,* 118 HARV. L. REV. 833 (2005). An important facet of the campaign was the Shareholder Rights Project that encouraged market actors to support and facilitate shareholder empowerment. These efforts bore fruit. A considerable number of market actors heeded Bebchuk's calls and have adopted structures that enable shareholders to influence the board and management by eradicating poison pills and staggered boards clauses. *See* Zohar Goshen & Sharon Hannes, *The Death of Corporate Law*, 94 N.Y.U. L. Rev. 263, 277–82 (2019).

20. *See*, *e.g.*, Bernard S. Black, *Shareholder Passivity Reexamined*, 89 MICH. L. REV. 520, 527 (1990).

squarely on the individual shareholder who engages in this task, the benefits accrue to all shareholders—giving rise to a collective action problem.

Exercising "voice" in shareholder meetings gives rise to a similar challenge. Dispersed shareholders must coordinate their opinions and actions to use their "voice" effectively. Coordination is costly in and of itself,[21] and someone must bear this cost. Once again, each individual shareholder would prefer that her colleagues shoulder this cost. Yet, this mode of thinking, though individually rational, undermines collective action.

Some theorists have pinned their hopes on institutional shareholders as a solution to the rational apathy of individual shareholders. Professor Bernie Black has pointed out that institutional investors, on account of their size and clout, face a different incentive matrix than individual investors. They do not suffer from the rational apathy problem, so goes the argument, since their expected benefit from an increase in firm value due to corporate changes may easily exceed the expected costs involved in activism.[22] Furthermore, they can utilize their "voice" effectively without the help of others. Given their sheer market size, their financial sophistication, and their business acumen, their active involvement in firms will leave an enormous market impact.

Notwithstanding their potential, however, most institutional investors fail to fulfill the promise. Professors Ronald Gilson and Jeffery Gordon have explained that the relative passivity of institutional investors stems from the fact that it does not pay off, even for them, to engage in active monitoring of firms. The prime interest of institutional investors is not the absolute returns on their investments, but rather their relative performance compared to their peers. Investing in active engagements does not improve their relative performance; on the contrary, it may even lower it.[23] Traditional institutional investors are therefore "rationally reticent."[24]

Gilson and Gordon have observed that activist hedge funds are not as diversified as other institutional shareholders, and thus have the incentive to invest in information gathering and processing.[25] The appreciation in a company's share price can surpass the significant costs involved in

21. *See, e.g.*, William J. Carney, *Shareholder Coordination Costs, Shark Repellents, and Takeout Mergers: The Case Against Fiduciary Duties*, 8 AM. BAR FOUND. RSCH. J. 341, 366 (1983) (arguing that the coordination costs of shareholders in the context of mergers and acquisitions may justify the usage of poison pills).

22. Black, *supra* note 20, at 585; Bernard S. Black, *Agents Watching Agents: The Promise of Institutional Investor Voice*, 39 UCLA L. REV. 811, 827–29 (1992).

23. Gilson & Gordon, *supra* note 18, at 889–90.

24. *Id.* at 889 ("Mutual funds and other for-profit investment managers are almost uniformly reticent—very rarely proactive but responsive to others' proposals.").

25. *Id*. at 897.

engaging its management. Moreover, the business model of activist hedge funds allows them to mobilize traditional institutional investors to join their campaign. After an activist hedge fund has invested in deciphering the firm's weakness and the proper solution for its weaknesses, other institutional investors, such as the large mutual fund families, need not bear any additional cost and can gain from supporting activist hedge funds' campaigns. A similar argument has also been suggested by Bebchuk, Cohen, and Hirst.[26]

The first corporate law scholar to identify the potential of activist hedge funds to reduce agency costs was Professor Bill Bratton.[27] Almost contemporaneously, professors Marcel Kahan and Edward Rock pointed out the ability of corporate hedge funds to act as "true owners" and provide effective monitoring of management.[28] Shortly thereafter, Jonathan Macy lauded activist hedge funds as "the newest big thing in corporate governance."[29] On the empirical side, Alon Brav, Wei Jiang, Frank Partnoy, and Randall Thomas, who conducted a comprehensive empirical analysis of activist hedge funds, found that their engagements improve the performance of the target in two-thirds of the cases and yield an abnormal return of 7% above market.[30]

It should be emphasized that not all corporate law scholars agree that activist hedge fund engagements are value enhancing. Some commentators have argued that while activist hedge fund engagements increase value in the short run, they lead to loss of value in the long-term.[31] Activist hedge fund engagements often focus on cost-cutting, dividend distributions, spin-offs, and the sale of the company. All those goals have some short-term flavor. A prime target for activists is the research and development (R&D) budget of firms. Eliminating investments in R&D leads to a rise in the share

26. Lucian A. Bebchuk, Alma Cohen & Scott Hirst, *The Agency Problems of Institutional Investors*, J. ECON. PERSPS., Summer 2017, at 89, 106.

27. William W. Bratton, *Hedge Funds and Governance Targets*, 95 GEO. L.J. 1375, 1397–1401 (2007).

28. Marcel Kahan & Edward B. Rock, *Hedge Funds in Corporate Governance and Corporate Control*, 155 U. PA. L. REV. 1021, 1047 (2007) (noting the potential of activist hedge funds to act as "real owners"). *See also* Frank Partnoy & Randall Thomas, *Gap Filling, Hedge Funds, and Financial Innovation*, *in* NEW FINANCIAL INSTRUMENTS AND INSTITUTIONS: OPPORTUNITIES AND POLICY CHALLENGES 101 (Yasuyuki Fuchita & Robert E. Litan eds., 2007).

29. JONATHAN R. MACEY, CORPORATE GOVERNANCE: PROMISES KEPT, PROMISES BROKEN 241 (2008)

30. Alon Brav, Wei Jiang, Frank Partnoy & Randall Thomas, *Hedge Fund Activism, Corporate Governance, and Firm Performance*, 63 J. FIN. 1729, 1752–53, 1755 (2008); *see also* Bratton, *supra* note 27, at 1381 (pointing to the fact that high success rate of activist hedge funds getting targets to accede to their demands reduces significantly the agency problem generated by the separation of ownership and control).

31. Martijn Cremers, Saura Masconale & Simone M. Sepe, *Activist Hedge Funds and the Corporation*, 94 WASH. U. L. REV. 261, 265 (2016) ("Indeed, attempting to measure long-term valuations is the only method that can address the main challenge raised by the critics of activism, according to which hedge funds would profit from activism at the expense of a firm's long-term value.").

price in the short-term, but often harms the company and its shareholders in the long-term.[32] Naturally, the question whether activist hedge fund campaigns have a positive or negative impact on firm value is an empirical one. Yet, the empirical studies on this issue do not offer an unequivocal answer.

Some studies have demonstrated that hedge fund activism has a positive impact on share value in the long run.[33] However, the vast majority of activist hedge fund campaigns do not last more than two years, and only in a few cases do campaigns last longer than three years.[34] Even if there is no disparity between short and long-term results, it is widely accepted that there is a tendency among activist hedge funds to limit themselves to relatively short engagements.[35] By and large, current activist hedge funds forego opportunities for lengthy engagements enduring several years. The main reason for the "impatient" character of the capital of hedge funds is that hedge funds are structured as limited partnerships.[36] Thus, investments in them are illiquid and opaque. Hedge funds need to meet "milestones" in order to reassure their investors that their investment is moving in the right direction.[37] For this reason, they have to pursue relatively frequent events of realization of profits.

Even if one accepts the view that activist hedge funds have the potential to monitor firms effectively, there is an additional limitation on the potential of activist hedge funds to improve the performance of firms: their limited scope. The resources held by the activist hedge fund industry are estimated at approximately $146 billion.[38] This sum may seem large on a standalone basis, but it constitutes approximately 0.3% of the aggregate value of public

32. *See* Mustafa Ciftci, *Do Analysts Underestimate Future Benefits of R&D?*, INT'L BUS. RSCH., 2012, at 26, 35 ("analysts underestimate earnings long term growth for R&D-intensive firms"); Zohar Goshen & Reilly Steel, *Raiders, Activists, and the Risk of Mistargeting* 4 (Eur. Corp. Governance Inst., Working Paper No. 613/2021, 2021), https://ecgi.global/sites/default/files/working_papers/documents/goshensteelfinal.pdf [https://perma.cc/67T8-TM6T] ("Investors may also systemically undervalue long-term gains over short-term ones, or else might simply be impatient—the 'short-termism' problem.").

33. Bebchuk, Brav & Jiang, *supra* note 1.

34. *See* Bebchuk et al., *supra* note 15, at 30.

35. *Id*.

36. Regarding the impatient nature of hedge funds, *see* Jan Fichter, *Rhenish Capitalism Meets Activist Hedge Funds: Blockholders and the Impact of Impatient Capital*, 19 COMP. & CHANGE 336, 341 (2015).

37. Regarding the need for hedge funds to set milestones, *see:* DELOITTE, HEDGE FUND LAUNCH CONSIDERATIONS—REACHING NEW BOUNDARIES 7 (2013) https://www2.deloitte.com/content/dam/Deloitte/us/Documents/financial-services/us-fsi-hedge-fund-launch-considerations-pov-071713.pdf [https://perma.cc/U28D-LXSW].

38. Herbst-Bayliss, *supra* note 5.

companies in U.S. capital markets, which has surpassed $50 trillion.[39] It bears emphasis that the capital available for deployment in a campaign is much lower. This is because a considerable percentage of the capital of activist hedge funds is tied to exiting investments that have not yet materialized. The aggregate amount deployed by activist hedge funds in 2020 was $39.2 billion, a tiny fraction of the capital they control.[40] This amounts to only 0.074% of the market cap of all U.S. public firms.

It is true that activist hedge funds do not rely exclusively on their own funds: institutional investors support many activist hedge fund campaigns, augmenting the investments of activist hedge funds.[41] However, the activist hedge fund's own capital largely dictates the number of companies it can engage. It must form an initial sizeable stake in the target, which, in turn, determines its potential profits from an engagement. To illustrate, assume that a hedge fund could convince other institutional investors which own over 50% of a public company to cooperate in a campaign that has the potential to increase the value of the company by 50% with a probability of 0.5%, even when it holds 0.1% of the companies' shares. Assume further that the value of the company is $10 billion and thus the stake of the activist is worth $10 million. The cost of the campaign—convincing the other shareholders to support the activist hedge fund strategy—is $5 million. In this case, it is not worthwhile for the hedge fund to engage the company. The expected value of such an engagement is zero, even though it has the support of institutional investors.[42] If the stake of the activist hedge fund were larger—say, $100 million—the engagement would have a positive value of $45 million.

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39. *See* SIBLIS RSCH., *supra* note 5. It should be noted that the actual percentage of the U.S. market cap that hedge funds could acquire is even lower. Much of the resources of activist hedge funds have to divert to funding their campaign in addition to funding its management and employees, and not solely to purchasing stakes in public companies. For example, in Engine No. 1's recent campaign in Exxon, it had purchased shares for $50 million but spent $30 million—over 50% of its initial acquisition—on the campaign. *See* Christopher M. Matthews, *Exxon vs. Activists: Battle Over Future of Oil and Gas Reaches Showdown*, WALL ST. J. (May 25, 2021, 4:31 PM), https://www.wsj.com/articles/exxon-vs-activists-battle-over-future-of-oil-and-gas-reaches-showdown-11621950967?mod=hp_lead_pos7 [https://perma.cc/GTB6-JBLD]. This may be an extreme example, but it demonstrates that activist hedge funds have to spend a sizeable amount of their capital on campaign spending. *See infra* note 41.

40. *See* LAZARD, *supra* note 2 at 2.

41. For example, only recently a small new hedge fund—"Engine No. 1"—was able to obtain two seats on the board of a blue-chip company, Exxon, in a plan to reduce its dependency on drilling and increase its investment in renewable energy. Engine No. 1's stake in Exxon, may not seem small—around $50 million—but in a huge public company like Exxon, that has a market cap of $258 billion, Engine No. 1's shares constitute only 0.2% of Exxon's shares. Engine No. 1 was still able to succeed in its campaign due to the cooperation and support of the three largest institutional investors—BlackRock, State Street and Vanguard. *See* Matt Levine, *Exxon Has a Tough Green Activist*, BLOOMBERG (May 26, 2021, 12:03 PM), https://www.bloomberg.com/opinion/articles/2021-05-26/exxon-has-a-tough-green-activist [https://perma.cc/L6H4-RF4V].

42. It will gain $5 million from the implementation of the successful strategy, but it had also to incur a similar cost on the campaign.

Our analysis thus far has omitted the up-front expenditures that activist hedge funds must incur. These include the cost of detecting the opportunity and forming the strategy, as well as the uncertainty regarding the support of institutional investors. Once these costs are added to the analysis, it becomes apparent that the stake of the activist hedge fund in the target needs to be greater than previously suggested. In the previous example, its stake may need to reach $200 million or more. Indeed, in 2020, the average value of hedge funds' stake in a target stood at $231 million.[43]

Activism data reflect the limited number of targets that activist hedge funds can profitably engage. In 2020, activist hedge funds initiated campaigns in only 80[44] of the 3463 public companies in the United States that have a market value above $500 million.[45] Put differently, activist hedge fund engagements in 2020 covered only 2.3% of the market.[46] This figure is not an outlier. The number of companies engaged by activist hedge funds declined from the peak of 124 companies in 2018, to 107 in 2019, to 80 in 2020.[47] The capital constraints on activist campaigns in U.S. companies are likely to intensify with the opening of European and other foreign capital markets to activism. In 2016, 66% of global activism took place in U.S. firms.[48] That figure has been constantly declining over the years. In 2020, only 45% of the global activist activity took place in U.S. firms.[49] The greater penetration of American activist hedge funds into foreign markets leaves less available capital for deployment in the United States.

It may seem that hedge funds are flush with cash, but, in reality, they face significant barriers when they raise funds. Activist hedge funds are essentially barred by regulation from raising funds in the large capital pool of public funds. The desire of hedge funds to secure funding from public sources can be discerned from the decision of numerous managers of large activist hedge funds to turn to SPACs to raise funds. Pershing Square, one of the largest and most reputable activist hedge funds, raised significant

43. The average stake is $228 million, calculated by dividing the capital deployed globally by activists ($39.6 billion) by the global number of campaigns (173). *See* LAZARD, *supra* note 2, at 2. Besides the lower upside of small stakes, they also require higher spending on the campaign, given the larger number of investors they have to convince in order to implement their strategy. The example above of Engine No. 1's engagement in Exxon may exemplify this: the high spending on the campaign ($30 million for a $50 million stake) may stem (in addition to the high market cap of the target and the high costs of proxy fights) from the relatively low stake of Engine No. 1 in Exxon: 0.2%. *See supra* note 41.

44. LAZARD, *supra* note 2.

45. WILSHIRE, *supra* note 2.

46. *Id.*

47. LAZARD, *supra* note 2, at 6.

48. *Id.* at 5.

49. *Id.*

funds from the public via SPACs.[50] Elliott Management, also one of the leading activist hedge funds, is also raising funds via a SPAC.[51] Likewise, Daniel Loeb, the manager of the activist hedge fund Third Point, has raised public funds through the SPAC Far Point Acquisition Corp.[52] More generally, in the first quarter of 2021 alone, nine SPACs sponsored by activist professionals have raised funds, including Elliott, Corvex, Glenview, Hudson Executive, and Starboard Value.[53] While the funds of all these SPACs can only be invested in *private* companies and cannot be used on public companies, the use of SPACs by large activist hedge funds reflects their "hunger" for additional funding from public capital markets. Because public funds are unavailable for their regular course of business and expertise, they venture to the realm of SPACs. It therefore seems that the current funding sources available to activist hedge funds are insufficient to enable them to realize their full potential.

In the next part, we will propose a novel vehicle that will enable activist hedge funds to tap into public capital pools and scale-up their activism.

II. SCALING-UP ACTIVISM: INTRODUCING ACTIVIST SPACS

A. *The Backdrop of Activist SPACs*

1. *Overview of SPACs*

Two thousand and twenty was the year of the SPAC: SPACs raised over $83 billion in IPOs.[54] This sum constitutes 46% of the total proceeds from IPOs in U.S. markets, which have reached over $179 billion[55] The $83 billion figure represents an increase of 510% compared to the $13.6 billion raised in 2019, which represented 19% of the total amount raised in IPOs that year.[56] The success of SPACs has continued in 2021. As of March 2021,

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50. Michael J. de la Merced, *The Year in Deals Can Be Summed Up in 4 Letters*, N.Y. TIMES, (Dec. 19, 2020), https://www.nytimes.com/2020/12/19/business/dealbook/deals-mergers-acquisitions-2020.html [https://perma.cc/2VT7-BUWD] (noting that Ackman's Pershing Square Tontine Holdings was the largest SPAC IPO, reaching $4 billion).

51. Cara Lombardo, *Elliott Management Explores Raising a SPAC*, WALL ST. J. (Feb. 7, 2021, 5:20 PM), https://www.wsj.com/articles/elliott-management-explores-raising-a-spac-11612730235 [https://perma.cc/Q22Z-GGQU].

52. Cara Lombardo, *Far Point to Buy Global Blue from Silver Lake*, WALL ST. J. (Jan. 16, 2020, 7:52 AM), https://www.wsj.com/articles/far-point-acquisition-nears-deal-to-buy-global-blue-from-silver-lake-11579170605 [https://perma.cc/AP9L-ELBW].

53. CAP. MKTS. ADVISORY GRP., LAZARD, Q1 2021 REVIEW OF SHAREHOLDER ACTIVISM 18 (2021), https://www.lazard.com/media/451619/lazards-q1-2021-review-of-shareholder-activism-vf.pdf [https://perma.cc/URX5-U8LU].

54. *See* SPAC ANALYTICS, *Summary of SPACS*, https://web.archive.org/web/20220505164336/https://www.spacanalytics.com/ [https://perma.cc/2YD8-MAJP] (last visited Dec. 14, 2022).

55. *Id.*

56. *Id.*

the aggregated proceeds of SPAC IPOs have surpassed $80.5 billion, representing 70% of the total proceeds of IPOs in the United States.[57] The increase in SPAC activity is not limited to aggregated proceeds; it is also reflected in the number of SPACs that underwent an IPO. In 2019, there were 59 IPOs of SPACs, and in 2020 the number more than quadrupled, reaching 248. This number was surpassed in the first quarter of 2021, with 252 SPAC IPOs as of March 15, 2021.[58]

The main reason for the popularity of SPACs in recent years is the proliferation of private companies with high market value. It is not only "unicorns"—private companies with a value of over $1 billion—but also "decacorns"—private companies valued at over $10 billion, that have included companies such as Uber, WeWork, Airbnb, SpaceX, and Pinterest—that have attracted the attention of retail investors.[59] The merger of a SPAC with such companies serves both the interests of the SPAC investors and of the target company. SPAC mergers enable individual investors to partake in the success of growing companies. Many investors do not have access to private equity channels, and their only way to invest in such companies is via public markets. A SPAC merger also serves the interest of the target company: it enlarges the potential capital pool available to the target by allowing it to tap into public money and increases the liquidity of prior investments, allowing founders and employees to cash in on their stock and options.[60] Most importantly, a SPAC merger enables the target private company to circumvent the full costs and requirements of an IPO, especially those associated with rigid and detailed disclosure via a prospectus. The target of a SPAC will have to disclose information in the merger with the SPAC, but with greater flexibility.[61]

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57. *Id.*

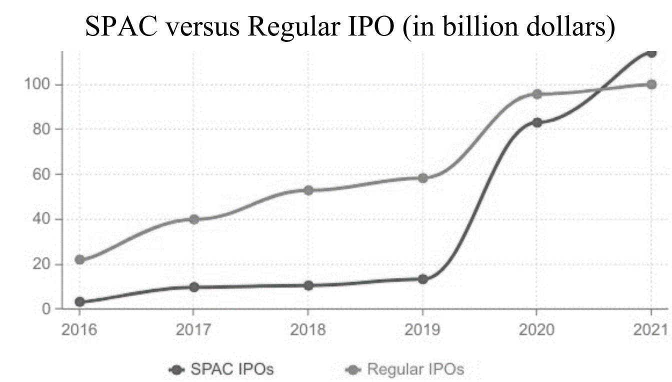
58. *Id.*

59. Conor Cawley, *The Age of the Decacorn: 7 Companies Valued at More than $10 Billion*, TECH.CO (June 7, 2017, 1:30 PM), https://tech.co/news/decacorn-companies-10-billion-2017-06 [https://perma.cc/3FU2-AX82].

60 *See, e.g.*, Mike Bellin, *Why Companies Are Joining the SPAC Boom*, PRICEWATERHOUSECOOPERS (Sept. 22, 2020), https://www.pwc.com/us/en/services/deals/ blog/spac-boom.html [https://perma.cc/K497-7A44].

61. A main difference between the disclosure requirement in the IPO and that of a merger is the more limited legal liability in the case of the latter, in respect to forward-looking statements and projections. In contrast to potential legal liability for forward-looking statements in IPOs, forward-looking statements disclosure in the context of mergers benefit from a safe-harbor protection from legal liability. *See* Michael Klausner, Michael Ohlrogge & Emily Ruan, *A Sober Look at SPACs* 9 (Eur. Corp. Governance Inst., Finance Working Paper No. 746/2021, 2022) https://papers.ssrn.com/sol3/papers.cfm?abstract_id=3720919 [https://perma.cc/BK6E-JE64]. *But see* John Coates, *SPACs, IPOs and Liability Risk Under the Securities Laws*, U.S. SEC. & EXCH. COMM'N (Apr. 8, 2021), https://www.sec.gov/news/public-statement/spacs-ipos-liability-risk-under-securities-laws [https://perma.cc/XM9T-6AK3] (arguing that the legal distinction between disclosure in the context of an IPO and disclosure in the context of a SPAC merger is questionable).

Table 1



Based on data from SPAC ANALYTICS, https://www.spacanalytics.com/ (July 2021).

2. How does a SPAC work?

A SPAC, also known as a "blank check company," is a company with no commercial operations that raises capital from the public in an IPO in order to merge with an unspecified private company.[62] Thus, SPACs enable private companies to raise funds indirectly from the public, without going through the process of an IPO. The basic structure of SPACs, as well as certain requirements that apply to them, is determined by SEC regulation, but many common features of SPACs are based on accepted market practices.

SPACs are formed by sponsors, usually professionals with relevant expertise, but, in some cases, even celebrities, such as Shaquille O'Neal. These celebrities have no background in investments or capital markets but are able to attract large numbers of investors thanks to their high profile.[63] The lifespan of a SPAC can be divided into four phases: the pre-IPO phase, the post-IPO search phase, the announcement phase, and the merger phase, dubbed as de-SPAC merger.

The pre-IPO phase is defined by the SPAC's formation. A SPAC is set up by a sponsor, who purchases a block of shares at a nominal price, commonly equivalent to 25% of the SPAC's equity. This block of shares is dubbed as the sponsor's "promote," and provides her with a financial interest in the success of the SPAC, as well as compensation for her work in forming and operating the SPAC. In addition, the sponsor purchases

62. Lola Miranda Hale, *SPAC: A Financing Tool with Something for Everyone*, J. CORP. ACCT. & FIN., Jan. 2007, at 67.

63. Kori Hale, *Shaq Moves into SPACs with Former Disney Execs & MLK Jr.'s Son*, FORBES (Oct. 20, 2020, 7:50 AM), https://www.forbes.com/sites/korihale/2020/10/20/shaq-moves-into-spacs-with-former-disney-execs--mlk-jrs-son/?sh=72ce0ba16c77 [https://perma.cc/H9W2-JC8N].

additional shares and warrants for their fair market value. The proceeds from these transactions enable the sponsor to cover the cost of the IPO. The main cost is that of an underwriter. Although the formation of a SPAC does not require a regular prospectus, these costs are still significant, varying at around 5.5% of the SPAC IPO *proceeds* (compared with an underwriter costs range of between 6.1%–6.8% of a conventional IPO of comparable size).[64]

The second phase is the post-IPO search phase. During this period, the SPAC searches for a target with which to merge. This phase is limited by regulation to a period of two years.[65] During this period, all proceeds from the IPO are held in a trust account accumulating interest.

The third phase is the announcement phase, which occurs after the SPAC has detected a potential target and proposes a deal for a merger. At this point, the shareholders of the SPAC have the option to redeem their shares for the price paid in the IPO stage, plus the interest accumulated in the trust. In many cases, the redeeming shareholders keep warrants that were granted to them in the IPO phase together with the shares. This is done to compensate investors for the period of time that their cash was "trapped" in the SPAC trust account. Both sides of the merger—the SPAC and the target—cannot know the amount of cash that will be available for the actual merger after the announcement, because it depends on the number of shareholders who choose not to exercise their redemption option and withdraw the sums they invested. For that reason, most mergers with SPACS are accompanied by a private equity firm, an institutional investor, or a commitment of the sponsor, to fill in some portion of the amount that will be redeemed.

The fourth and final phase is the de-SPAC merger: the SPAC shareholders vote on the proposed merger with the private company. Once the merger is approved, the shareholders of the target receive shares in the

64. Klausner et al., *supra* note 61, at 27–28. As Klausner et al. note, of that fee, 3.5% is conditioned on the SPAC consummating a merger and deferred until that point in time. They also note that the fee from the proceeds that are actually funnelled toward the target company is higher. Given that a high number of shares are redeemed before the merger—a mean of 58%—the actual underwriting fees from the proceeds transferred to the target are much higher, around 11%. *See id.* at 19, 27–28. Regarding the average underwriting cost in regular IPOs for the same range of market cap as SPACs ($100 million–$500 million), see *Considering an IPO? First Understand the Costs*, PRICEWATERHOUSECOOPERS, https://www.pwc.com/us/en/services/consulting/deals/library/ cost-of-an-ipo.html#:~:text=Underwriting%20fee,-Investment%20banks%20charge&text= Underwriting%20fees%20are%20the%20largest,7.0%25%20of%20gross%20IPO%20proceeds. [https://perma.cc/R8C2-5B3J] (last visited Dec. 14, 2022).

65. *Regulatory Notice 08-54: Guidance on Special Purpose Acquisition Companies*, FINRA (2008), https://www.finra.org/rules-guidance/notices/08-54 [https://perma.cc/Y2H5-F6A6].

merged company, typically leaving the SPAC shareholders with a minority interest.[66]

3. *The Advantages of SPACs*

Commentators have pointed to at least three key advantages of SPAC mergers over IPOs. The first is that a SPAC merger is said to be cheaper for the target company and its founders because it avoids the "IPO pop." The "IPO pop" is a phenomenon where share prices typically increase in the first day of trading by an average of 14%.[67] This increase reflects the fact that, in most IPOs, the underwriters underprice the shares of the issuing company to benefit their clients who participate in the IPO. This systematic undervaluation constitutes what scholars have dubbed as "money left on the table"—the issuing company does not receive the full value of its shares in the IPO.[68] There are no such "price-pops" in SPAC mergers as the pricing mechanism of the merger of the SPAC is much different from an IPO.[69] The elimination of the price pop that accompanies IPOs enables SPACs to transfer a larger amount of cash to the target company for the same equity share to their new shareholders.

The second benefit of SPACs is pricing certainty. While the price of an IPO depends on the valuation of numerous actors during the IPO roadshow, the price to be paid in a SPAC merger depends only on the valuation by the SPAC sponsors. Although there is no certainty regarding the actual amount transferred from the SPAC to the target after redemption, which depends on the redemption rate, the valuation of the deal is locked.[70] In many cases, the

66. Klausner et al., *supra* note 61, at 15. Until this point in time, only a small fraction of SPACs has liquidated because they were not able to complete a merger. Out of a total of 944 SPACs, only 90 have liquidated without consummating a merger. *See* SPAC ANALYTICS, *supra* note 54. It should be noted that these numbers may not reflect the real probability that the SPACs in the market today will liquidate. As noted above, the large majority of these SPACs have incorporated in the last year. Only a small fracture of the operating SPACs has reached the end of the two-year window. Thus, in the future, the proportion of liquidating SPACs might be higher.

67. *See* Tim Loughran & Jay R. Ritter, *Why Don't Issuers Get Upset About Leaving Money on the Table in IPOs?* 15 REV. FIN. STUD. 413, 435–36 (2002). There are scholars that dispute the observation that there is money left on the table in IPOs, claiming that that company could not have sold a sizeable amount of its shares at the maximum price of the first day of trading, and that the high price is generated by a very small group of overly optimistic investors. *See, e.g.*, Jay R. Ritter & Ivo Welch, *A Review of IPO Activity, Pricing, and Allocations*, 57 J. FIN. 1795 (2002). For a recent survey of "IPO pops", see Kylie Gilbey, Terry Marsh & Sharon Purchase, *ASX Small Firm/Microcap Listings: The IPO 'Pop' and Two Decades of Subsequence Returns,* 62 ACCOUNTING & FIN. 3285 (2022).

68. Loughran & Ritter, *supra* note 67, at 413.

69. *See id.* at 30.

70. *See, e.g.*, *What You Need to Know About SPACs – Updated Investor Bulletin*, U.S. SEC. & EXCH. COMM'N (May 25, 2021), https://www.sec.gov/oiea/investor-alerts-and-bulletins/what-you-need-know-about-spacs-investor-bulletin [https://perma.cc/K9VY-HHDH] ("Certain market participants believe that, through a SPAC transaction, a private company can become a publicly traded company with more certainty as to pricing and control over deal terms as compared to traditional initial public offerings, or IPOs.").

SPAC merger agreement will include a backup of a private investor (private investment in public equity, or PIPE) in order to increase the certainty of the closing of the merger, given the uncertainty regarding the actual amount transferred. The PIPE replaces redemptions up to a certain threshold to reach the minimum capital required for the transaction to be executed.[71] Also, the PIPE investment could encourage the SPAC investors, as the deal is done in a promising company, with reliable forecasts and at an appropriate value.[72] The public investor can save time and effort in analyzing publicly available information by implicitly relying on the PIPE investor's due diligence.[73]

The third advantage of SPAC mergers relative to an IPO is their speed. SPAC mergers enable companies to become publicly traded much faster than conventional IPOs—in a timeframe of weeks instead of months.[74] SPAC mergers are not subject to the expansive disclosure requirements that apply to IPOs and can thus be completed more expeditiously.[75]

Furthermore, SPACs provide an additional advantage for investors: they enable investors who do not have access to private equity to bet on the skills of the management of the SPAC in identifying an attractive target. For this reason, SPACs have been dubbed a "poor man's private equity."[76]

4. *Disadvantages of SPACs*

While some have lauded SPACs as a mechanism to perfect capital markets, some commentators are quite critical of the aforementioned efficiencies of SPACs. The strongest criticism of SPACs comes from the market itself: the average return on investments in SPACs is significantly lower than most market benchmarks. Out of twenty-four SPACs that announced and completed a merger between the beginning of 2019 and February 10, 2021, fourteen have reported a depreciation in value in the

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71. *See* Klausner et al., *supra* note 61, at 14.
72. *Id*. at 80.
73. *Id*. at 55.
74. *SPAC vs Traditional IPO & Reverse Takeover*, BRIDGE POINT CAP., http://18.218.104.51/spac-vs-ipo/ [https://perma.cc/YEP4-26CH] (last visited Dec. 14, 2022) ("As compared to traditional IPOs, SPAC IPOs can be significantly quicker. Due to its lack of fundamental operation, both financial statements and prospectus filed during a SPAC IPO are significantly shorter and can be prepared in a matter of weeks (compared to months for a traditional IPO).").
75. Scholars point to an additional fourth advantage of SPACs: their applicability to companies to which traditional IPOs are irrelevant. Companies with a complex business model or with a high level of uncertainty are not well-suited for IPOs. SPAC mergers are the only reasonable way to enter such companies into publicly traded markets. *See* Klausner et al., *supra* note 61, at 51–52.
76. *See id*. at 3.

period of one month after the merger.[77] The most relevant benchmark—the IPO index—has significantly outperformed the return on SPACs that executed a merger in the period between the beginning of 2019 and June 2020. The mean return on SPACs in the three months after the merger was -2.9%, which is 13.1% lower than the IPO index for the same period, generating a positive return of 10.2%. Longer time frames only worsen the picture for SPACs: returns on SPACs 12 months after mergers have trailed the IPO index by 47.1%, with a negative return of 34.9% as compared to a positive return of 12.2% for IPOs.[78] SPACs have also underperformed relative to the S&P 500: the average SPAC share has increased in value by 45% in the period of time between the beginning of 2019 and February 2021, while the S&P index exhibited an increase of 52% in the same period.[79]

The actual underperformance of SPACs, despite their potential advantages relative to IPOs, has not evaded market participants. Recently, many sophisticated investors have started to bet against SPACs.[80] Some scholars and commentators have even warned that there is a SPAC bubble that is about to burst.[81]

Some commentators are quite critical of the aforementioned efficiencies ascribed to SPACs. Professors Michael Klausner, Michael Ohlrogge, and Emily Ruan have provided an account for why SPACs have not delivered on their promised efficiencies. They claim that underwriting fees are higher than in traditional IPOs—not lower as the prevailing belief suggests. Although the fee as a percentage of the IPO seems lower in the case of SPACs—5%–5.5% versus 6.1%–6.8%—these figures do not reflect the actual proceeds transferred to the company. While the SPAC pays the underwriting fees as a percentage of all its proceeds in the IPO, only a fraction of that sum is transferred to the target company. As we have noted

77. Grace Maral Burnett, *ANALYSIS: Post-Merger SPAC Performance is Mixed*, BLOOMBERG L. (Feb. 12, 2021, 3:36 AM), https://news.bloomberglaw.com/bloomberg-law-analysis/analysis-post-merger-spac-performance-is-mixed [https://perma.cc/DGB8-42WX]. In the wider timeframe of the year to date (2021 at the time) since the merger, SPACs have fared relatively better, but still one third of the SPACs have reported a depreciation in value. *Id.*

78. Klausner et al., *supra* note 61, at 34–35 (the positive return for IPOs could be derived by calculating the gap between the returns for SPACs and the access of the return over the IPO index, which is given in the table).

79. Greg Iacurci, *Blank Check Funds Are Hot but May Be Risky: 'The Trust Level is Through the Roof'*, CNBC (Feb. 17, 2021, 11:07 AM), https://www.cnbc.com/2021/02/17/spacs-are-hot-but-may-be-risky-the-trust-level-is-through-the-roof.html [https://perma.cc/YB4B-U3B9].

80. Matt Wirz & Juliet Chung, *Short Sellers Boost Bets Against SPACs*, WALL ST. J. (Mar. 14, 2021, 5:30 AM), https://www.wsj.com/articles/short-sellers-boost-bets-against-spacs-11615714200 [https://perma.cc/A9FX-9UZV].

81. Ivana Naumovska, *The SPAC Bubble Is About to Burst*, HARV. BUS. REV. (Feb. 18, 2021) https://hbr.org/2021/02/the-spac-bubble-is-about-to-burst [https://perma.cc/PFV9-A9ZZ]; Joshua Franklin & Aaron Saldanha, *Wall Street's SPAC Sell-Off Drags on Amid Fears of a Bubble*, YAHOO! FIN. (Mar. 5, 2021), https://finance.yahoo.com/news/wall-streets-spac-sell-off-022317571.html [https://perma.cc/KU5T-RRUH].

above, after a target is announced, shareholders have the right to redeem their shares for the cash in the trust of the SPAC plus interest and not participate in the merger. On average, 73% of the SPAC shares are redeemed. When taking redemptions into account, the underwriting fee from the actual cash transferred to the company is much higher and the median is estimated to reach 16.3%.[82]

In addition to the underwriting fee, the cost of the sponsor's "promote" is significant,[83] and so is the cost of warrants provided to shareholders that redeem their shares after the announcement, which in total reaches a staggering average of 50.4% of the cash delivered.[84] This figure is much higher than the cost of a traditional IPO—even when taking into account the "IPO pop," which altogether is estimated at 21%.[85]

Klausner, Ohlrogge, and Ruan also claim that the price certainty of SPACs is exaggerated. The uncertainty surrounding SPAC redemptions also creates price uncertainty of its own. For example, if the sides agree to a one-for-one share exchange or any other ratio, the level of redemptions will impact value per share that the target will receive. If there are no redemptions, all costs, including underwriting and the promote, are spread over a larger number of shares, increasing profitability for investors and the value transferred to the target. If there are many redemptions, all costs are spread over a smaller number of shares, decreasing profitability for investors and the value transferred to the target.

Finally, the claim regarding the speed of SPAC IPOs relative to traditional IPOs is also debated. Some practitioners claim that there is no significant gap in the speed of the two processes,[86] and it is hard to measure the gap controlling for the different types of companies that undergo each process.[87]

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82. Klausner et al., *supra* note 61, at 22–23.

83. *Id.* at 23–25.

84. *Id.* at 26. The net promote provided to the sponsor is estimated to be 31.3% of the cash delivered to the company. In addition, the estimated cost of warrants and rights provided to shareholders that pulled out is 16.6%. *Id.*

85. *Id.* at 31. This calculation is based on the upper estimates of IPO pop as around 14%, *see* Loughran & Ritter *supra* note 67, and an underwriting fee of close to 7%, *see* Klausner et al., *supra* note 61.

86. E. Ramey Layne, Brenda Lenahan, S. Gregory Cope & Scott D. Rubinsky, *Alternative Routes to Going Public: Initial Public Offering, De-SPAC or Direct Listing* 17, VINSON & ELKINS (Oct. 12, 2020), https://www.velaw.com/insights/alternative-routes-to-going-public-initial-public-offering-de-spac-or-direct-listing/ [https://perma.cc/6VRV-9V4R].

87. Klausner et al., *supra* note 61, at 49. For a similar critique of SPACs, see Holger Spamann, *Indirect Investor Protection: The Investment Ecosystem and Its Legal Underpinnings* 36 (Eur. Corp. Governance Inst., Working Paper No. 594/2021, 2022), https://ssrn.com/abstract=3707249 [https://perma.cc/H2M8-3UCQ] (noting that SPACs enable the subsidization of sophisticated investors by unsophisticated investors).

The problems that accompany SPACs are not insoluble. The market can and does correct some of these problems, as can be seen in the recent case of the Pershing Square Tontine Holdings SPAC.[88] In July 2020, Pershing Square went public with a modified SPAC structure, addressing the problem of the high cost of SPACs. The sponsor—Pershing Square—did not take the standard promote of 25% of the shares. Instead, it received warrants that were out-of-the-money and could be exercised or sold only in a three-year time. In addition, redeeming shareholders received warrants for only one-ninth of a share, much lower than in standard SPACs.[89]

Pershing Square offered additional warrants for non-redeeming shareholders to incentivize non-redemption. It secured this result by arranging that the warrants of redeeming shareholders would be transferred to non-redeeming shareholders. The implementation of this mechanism had the effect of ensuring that, as more shareholders redeem shares, non-redeemers will gain more, incentivizing them to stay put. As Pershing Square noted in its SPAC IPO documents, this structure significantly reduced the high cost and dilution created by conventional SPACs.[90] This improved structure elicited a positive reaction from the market: after the IPO, the share price of Pershing's SPAC has increased by 15% and maintained that level in the weeks following the IPO, a rare event in the pricing of SPACs.[91]

In the next section, we draw on the lessons from SPACs to design a new corporate structure, the Activist SPAC, that would enable direct public investment in activist campaigns. In constructing the Activist SPAC, we combine the positive aspects of SPACs with unique new features that correct for the shortcomings of SPACs. This purpose will require more than a market correction of the execution structure of SPACs, but also some regulatory changes that will create a different form of company, reminiscent of the SPAC.

88. Kenneth Squire, *Bill Ackman and Tontine Holdings Rewrite the Terms for SPACs*, CNBC (July 22, 2020, 7:05 AM), https://www.cnbc.com/2020/07/22/bill-ackman-and-tontine-holdings-rewrite-the-terms-for-spacs.html [https://perma.cc/JZH4-9P35].

89. *Id.*

90. Pershing Square Tontine Holdings, Prospectus (Form 424B4), at 7 (July 26, 2020).

91. Klausner et al., *supra* note 61, at 53 (noting that only three SPACs have maintained prices of 15% or more above IPO price for at least a week during the first two months following the IPO). The value of Pershing Square SPAC has more than doubled since then, standing as of March 18, 2021 at 26.23. *See Pershing Holdings Historical Data*, INVESTING.COM, https://www.investing.com/equities/pershing-square-tontine-historical-data [https://perma.cc/ N8YW-WTX9] (last visited Dec. 14, 2022). However, following a major downturn in the stock market, the Pershing Square SPAC did not eventually merge with any target and returned the money to its investors. *See* Lauren Hirsch, *Largest-Ever SPAC Will Return $4 Billion to Investors After Failing to Complete a Deal*, N.Y. TIMES (July 11, 2022), https://www.nytimes.com/2022/07/11/business/bill-ackman-spac-pershing.html [https://perma.cc/3G7A-7HVM].

B. The Unique Structure and Features of Activist SPACs

In this Section, we propose a new corporate form, termed the Activist SPAC. The introduction of the Activist SPAC form is aimed at achieving two purposes: scaling-up shareholder activism and allowing the public to share in the potential upside of Activist engagements, which, in turn, may also improve the nature of shareholder activism. The Activist SPAC is intended as a vehicle for raising capital from the public without designating it to a particular business activity. In this respect, the Activist SPAC is similar to the SPAC, but this is where the similarity ends. Activist SPACs, as we envision them, would be designated for investments in *public* companies and for shareholder activism purposes only. Standard SPACs, by contrast, are limited to the acquisition of *private* companies. This is a fundamental difference which also affects the mechanism design of Activist SPACs.

The sponsor of an Activist SPAC, who is the lead activist, would set the company up for the purpose of purchasing a block of shares in an unspecified public corporation. This would enable her to influence or pressure management to change the strategic course of the target company. The sponsor can be an individual within the activist hedge funds industry—for example, an activist hedge fund manager who needs additional capital to realize her investment plans. The sponsor can also be an outsider, who cannot devise activist strategies within the hedge fund industry but would like to initiate an activism campaign of her own.

Similar to the strategy employed by activist hedge funds, the block purchased by the Activist SPAC would only be a modest percentage of the public target's shares, normally up to 10% of the target.[92] Together with the cooperation of other shareholders—primarily large institutional investors and, possibly, also hedge funds—the block of shares would be enough to influence the management of the target. Exerting power through the purchase of a small block of shares enables activists to engage even blue-chip companies with a market cap of over $200 billion, such as Walt

92. Hamdani & Hannes, *supra* note 16, at 978 n.26.

Disney,[93] AT&T,[94] PayPal,[95] Procter & Gamble,[96] Exxon-Mobile,[97] General Motors,[98] and even a company with a market cap of over $1 trillion dollars, like Apple.[99] The financing of activism through Activist SPACs would make it possible to influence an even greater number of the largest S&P 500 and Nasdaq companies by harnessing the resources of retail investors. The universe of potential targets for activism, which requires a significant amount of capital of at least $100 million, is immense,[100] and is not limited to blue-chip companies. Given the assumption that, in a classic activism campaign, the activist has to obtain approximately 10% of the target's shares, the activist would require $100 million for a target of $1 billion or more. Globally, there are almost 3,800 public companies with a market cap of at least $1 billion.[101] Hence, there are numerous potential targets for which an activist would need a significant amount of capital. The Activist SPAC could provide the needed capital to scale up activism.

The life cycle of the Activist SPAC, as we conceive of it, would be comprised of five stages: the IPO stage, the search stage, the redemption stage, the activist campaign stage, and the dissolution or exit stage.

The first stage is the IPO of the Activist SPAC. Prior to the IPO, a portion of the shares would be allocated to the sponsor who initiated the Activist SPAC and bears all the expenses involved with the IPO and future engagements, including the costs of research and public relations with respect to the activist campaign. Immediately following the IPO, all funds raised from the public would be secured in a trust account. The prospectus

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93. Alex Sherman, *Activist Investor Dan Loeb Calls on Disney to End Its $3 Billion Annual Dividend and Use the Funds for Disney+ Content*, CNBC (Oct. 7, 2020, 1:55 PM), https://www.cnbc.com/2020/10/07/dan-loeb-calls-on-disney-to-suspend-dividend-invest-it-in-disney-plus.html [https://perma.cc/HW44-65NX].

94. Drew FitzGerald, *Activist Investor Challenges AT&T over Strategy, Board*, WALL ST. J. (Sept. 9, 2019, 6:29 PM), https://www.wsj.com/articles/elliott-management-discloses-3-2-billion-stake-in-at-t-11568031530 [https://perma.cc/FU56-L739].

95. Greg Bensinger, *Icahn: eBay Should Sell 20% of PayPal*, WALL ST. J. (Mar. 19, 2014, 7:43 PM), https://www.wsj.com/articles/icahn-ebay-should-sell-20-of-paypal-1395251394 [https://perma.cc/GPP6-B7LY].

96. Julie Creswell, *An Epic, and Costly, Boardroom Battle at Procter & Gamble*, N.Y. TIMES (Oct. 8, 2017), https://www.nytimes.com/2017/10/08/business/economy/an-epic-and-costly-boardroom-battle-at-procter-gamble.html [https://perma.cc/BE62-7339].

97. Christopher M. Matthews, *Activist Likely to Gain Third Seat on Exxon Board*, WALL ST. J. (June 2, 2021, 6:11 PM), https://www.wsj.com/articles/activist-likely-to-gain-third-seat-on-exxon-board-11622664757 [https://perma.cc/L99E-M6EU].

98. Patti Waldmeir, *GM CEO Hits Out at Activist Investor Ahead of AGM Showdown*, FIN. TIMES (June 6, 2017), https://www.ft.com/content/dd17bbda-848d-31f4-8523-edfb7542ee38 [https://perma.cc/ZR4Z-QHCB].

99. Robert G. Eccles, *Why an Activist Hedge Fund Cares Whether Apple's Devices Are Bad for Kids*, HARV. BUS. REV. (Jan. 16, 2018), https://hbr.org/2018/01/why-an-activist-hedge-fund-cares-whether-apples-devices-are-bad-for-kids [https://perma.cc/BK6C-KJSK].

100. Less than $100 million is unlikely to justify the fixed costs required for an IPO of an Activist Investment Company (quite parallel to the case of SPACs).

101 *Largest Companies by Market Cap*, COMPANIESMARKETCAP.COM https://companiesmarketcap.com/page/38/ [https://perma.cc/NRG3-BHGH] (last visited Dec. 14, 2022).

of the IPO of an Activist SPAC would not include the name of the target company whose shares will be purchased. The sponsor, however, may restrict the Activist SPAC mandate in the prospectus to a certain business sector, e.g., the energy sector, or to a particular activist purpose, e.g., spinning off a part of the target company. Size limitation on the relevant targets may also appear in the prospectus,[102] and in any case, such size would be effectively limited by the amount raised by the Activist SPAC. However, it would be possible for a few Activist SPACs to cooperate by purchasing shares of the same target to reach beyond their individual limits. Cooperation is also possible with other activists, as well, including activist hedge funds, forming "wolf packs" of activists,[103] which is quite common in the context of activism.

The Activist SPAC sponsor cannot be required to disclose the name of the intended target, even if she knew which company she would like to engage, for a strategic reason: she cannot publicize this information. The business model of activist funds is buying shares in an under-performing company relatively cheaply, improving the target's performance and then selling the shares for a higher price. If the activist were to disclose her intention before acquiring its stake, the share price is likely to rise once the information is shared with the market. This, in turn, would vitiate the activist's plan, preventing her from capturing the full gain from the engagement. Thus, we propose that an Activist SPAC would be required to disclose its block of shares 10 days after crossing the 5% ownership threshold, just like any other entity acquiring over 5% of companies' shares.[104]

Of course, strategic considerations are not the only reason not to mandate that an Activist SPAC sponsor disclose the identity of a target prior to the IPO stage. As is true of SPAC sponsors, an Activist SPAC sponsor may simply not have a specific target in mind at the time of the IPO. This is not necessarily bad. Devising an activist campaign requires meticulous research and considerable resources. It necessitates close analysis of a few public companies until the right target is identified. It is not trivial to expect a sponsor to shoulder these costs alone. A possible solution would be to allow

102. Activist investment companies would have to engage a sizable target to justify the use of the public markets to raise funds for the sake of activism. However, as mentioned in the text above, there are many such relevant targets. In U.S markets, the median size of a company on the Russell 3000 stock index is $2.2 billion, well above the required threshold. *See Market Capitalization Ranges*, FTSE RUSSELL, https://www.ftserussell.com/research-insights/russell-reconstitution/market-capitalization-ranges (May 6, 2022) [https://perma.cc/93PP-F5PM].

103. Activists tend to act in a parallel manner, while intentionally avoiding the formation of a "group" for the purposes of federal securities laws, which allows them to evade disclosure duties and corporate defenses. *See* John C. Coffee, Jr. & Darius Palia, *The Wolf at the Door: The Impact of Hedge Fund Activism on Corporate Governance*, 41 J. CORP. L. 545, 549 (2016).

104. *Id*. at 562–68.

the sponsor to use some of the investments in the Activist SPAC to this end. Yet this might prove problematic: resources that would be invested in research would not be able to be returned to investors. For this reason, we think that research expenses should be precluded—the Activist SPAC should utilize the resources of the trust account only for the purchase of shares of its target. As noted above, the sponsor would incur all the expenses related to the activist campaign including the research cost in return for the promote she receives.

While in SPACs the size of the promote typically revolves around 20% to 25%, the size of the promote in the case of Activist SPACs, as we envision it, will be somewhat more limited. The share of the pie of Activist SPAC sponsors should instead be comparable with those in the hedge fund industry. The typical cut of hedge fund managers is the so-called "carried interest," typically 20% of the upside generated for the limited partners who are the hedge fund investors.[105] Recall that the average increase in share price following the entry of an activist is estimated at around 6%,[106] so there is a hefty upside for skilled Activist SPAC sponsors. Interestingly, it is possible that the current trend in SPACs would bring their model closer to that of the hedge fund industry, so that the compensation of the SPAC sponsor becomes more sensitive to the post-merger appreciation of share prices of the target. Thus, the promote is modified to shares that could be sold only when the public SPAC investors are at the money, in order to realign the incentives of the sponsor with those of the other investors.[107] In any case, the specific size and structure of the promote in Activist SPACs will be determined by market forces and not regulation.

After completing the IPO, the Activist SPAC would enter the second phase of its existence: searching for a target (if it has not done so already) and acquiring its shares. As with SPACs, Activist SPACs should have a predetermined window in which they can search for a target to prevent tying up the capital of investors for too long. The two-year limit found in SPACs seems reasonable for Activist SPACs as well. Unlike the SPAC, however, the Activist SPAC would not have to disclose the identity of its target before acquiring its shares, for the strategic reason noted above—an early disclosure would significantly decrease its potential profits.

105. A carried interest in hedge funds is a fixed percentage of the profits generated by the fund, usually 20%, which the general partner receives as compensation. The payment of the carried interest is typically conditioned upon exceeding a specific return level for the limited partners of the fund, often known as the "hurdle rate." Failure to meet the predetermined threshold will lead to a reduction in the carried interest and might even deny its payment altogether. *See* Roger Wohlner, *What Is Carried Interest and How It Work?*, THESTREET (Aug. 21. 2019, 10:45 AM), https://www.thestreet.com/investing/funds/what-is-carried-interest-15062756 [https://perma.cc/KWS8-YCVL].

106. Lucian A. Bebchuk, Alon Brav, Robert J. Jackson, Jr. & Wei Jiang, *Pre-Disclosure Accumulations by Activist Investors: Evidence and Policy*, 39 J. CORP. L. 1, 18 (2013).

107. Klausner et al., *supra* note 61, at 20–21.

At first glance, investment by public investors without complete information may appear problematic, but it is actually much less troubling than it seems. Unlike SPACs that invest in private companies, Activist SPACs would invest only in public companies. Investment in public companies is less risky than investment in private ones for four main reasons. First, the shares of public companies, especially those of the size relevant for Activist SPAC activism, are subject to an efficient market pricing mechanism.[108] Frequent market trades by professional investors both reflect and update the value of the shares on a constant basis, making it easier to calculate the value of publicly traded companies. In contrast, the shares of private companies are not traded on a regular basis, which renders their value highly speculative.[109] Since Activist SPACs would only target public companies, they involve only a small risk of over-paying for the target's shares. Furthermore, since the Activist SPAC is itself a public company, the shareholders of the Activist SPAC can always sell their share for approximately the same value of the shares of the targeted public company. It should also be borne in mind that activist campaigns typically increase the value of the target company, and it is extremely rare that the share price of the company decreases after the activist campaign is launched.[110]

Second, many private companies that go public via SPAC have very low or no revenues.[111] Tellingly, they chose the route of SPAC over the more conventional IPO process, which makes them a highly risky investment. In contrast, the vast majority of public companies have a steady stream of revenues and are thus safer for investors. Third, and relatedly, private companies rely on projections of future success to raise money. Projections, of course, are not hard facts. They are not readily ascertainable. Indeed, the inclusion of projections in a prospectus of an IPO is problematic and can expose the company to securities fraud liability.[112] Public companies' reports offer investors information about actual performance and transactions. Fourth, and finally, public companies are subject to stricter

108. *See, e.g.*, Ronald J. Gilson & Reinier Kraakman, *Market Efficiency After the Financial Crisis: It's Still a Matter of Information Costs*, 100 VA. L. REV. 313, 325 (2014) ("It is active trading that aggregates information in price, which is why a claim of price efficiency is weaker all else equal for prices in initial public offerings than for prices in actively traded secondary markets.").

109. The structure of the SPAC induces it even more to pay a high price for the target, because the sponsor has a strong incentive to close a deal, even if the terms are detrimental for the SPAC. *See* Klausner et al., *supra* note 61, at 23.

110. Alon Brav, Wei Jiang, Frank Partnoy & Randall S. Thomas, *The Returns to Hedge Fund Activism*, FIN. ANALYSTS J., Oct.–Nov. 2008, at 45.

111. Chris Bryant, Opinion, *No Revenue Is No Problem in the 2020 Stock Market*, BLOOMBERG (Sept. 18, 2020, 3:39 AM), https://www.bloomberg.com/opinion/articles/2020-09-18/spac-deals-no-revenue-is-no-problem-in-the-2020-stock-market [https://perma.cc/9Q75-AH8U].

112. Klausner et al., *supra* note 61, at 52–53.

regulation than are private companies. Hence, investors in public companies have a regulatory safety net that investors in private companies do not enjoy.

Even though the risk for investors in an Activist SPAC is limited, we still think that investors in Activist SPACs should be provided with a redemption option. A redemption option serves as a market check on the Activist SPAC activism plan because a high redemption rate may preclude the Activist SPAC from moving forward with its activism plan. A redemption option enables investors in the Activist SPAC to receive back their investment in the Activist SPAC if they do not have confidence in its planned activism strategy, which means that the Activist SPAC would have to sell part of its stake in the target. Accordingly, the third phase in the Activist SPAC's life cycle would be the redemption process. An Activist SPAC would be required to disclose its purchase of shares 10 days after reaching a 5% threshold, as well as its basic activism plan for the target company. In cases in which an Activist SPAC settles for a block of less than 5%, and does not face a regulatory obligation to disclose its position, the redemption phase should start 60 days after the purchase of the first share. When one of these events occurs and the target of the Activist SPAC is disclosed, the investors in the Activist SPAC would have the option to redeem the shares of their initial investment minus a portion of the underwriting costs. To accommodate redemptions, the Activist SPAC will have to liquidate part of its stake of the target company.

We do not think that the investors in Activist SPACs should be entitled to redeem their shares for their initial investment plus interest accrued when there is a drop in the market price of the target following the acquisition of the Activist SPAC stake. As the risk in Activist SPACs is much more limited than that of an investment in a SPAC, the redemption right should also be more limited. The downside in the case of Activist SPACs is smaller, consisting mainly of the risk of depreciation of the shares of the public target due to market fluctuations. In the case of SPACs, the potential risk is much greater: in the absence of a market pricing mechanism, the fear of overpayment is substantial.

As noted earlier, redemption would be capped up to the initial investment minus a portion of the underwriting and research expenses, in order to prevent an inefficient "stag hunt" dynamic.[113] If share prices of the target go up because of the activism, those who redeem their Activist SPAC investment would not enjoy those gains (but they can sell their activist

113. The stag hunt is a paradigmatic game in game theory, which depicts the following scenario: a group of hunters attempts to capture a stag. Every hunter must cooperate to capture the stag. All prefer the stag, but if a hare passes by one of the hunters, a hunter may catch and eat it, depriving the others of the opportunity of capturing the stag (but not hares if they begin chasing them). In such scenarios, the players may fail to cooperate while rushing to achieve the certain but less desired goal. BRIAN SKYRMS, THE STAG HUNT AND THE EVOLUTION OF SOCIAL STRUCTURE 1 (2004).

SPAC shares on the exchange). Otherwise, Activist SPAC shareholders may be tempted to redeem their investment following the spike in the target's share price, once the acquisition and activism plan is disclosed. In any case, redemption poses less of a problem for Activist SPACs than for traditional SPACs: there are no exact terms an Activist SPAC must meet, nor a certain amount it must reach to go forward with its plans. The volume of redemptions only has a quantitative effect and not a qualitative effect: as the block of shares of the Activist SPAC in the target is larger, there is a greater likelihood that the Activist SPAC would be successful in its Activist engagement, but there is no formal threshold for an Activist engagement. The sponsor will have to note the rate of redemptions that would preclude it to go forward with its campaign, as that information will serve as a market check for the strategy plan of the sponsor.[114] For instance, an Activist SPAC could state in its charter or bylaws that it will not proceed with its activism plan if over 30% of the SPAC shareholders decide to redeem their investment after the announcement of its plan.

The fourth phase of the Activist SPAC is the actual activist campaign. One of the purposes of the Activist SPAC is to enable an activist campaign of longer horizons by providing more "patient" capital than conventional hedge fund financing. For that reason, the fourth phase should last for an extendable predefined period (e.g., three years). The longer horizon of Activist SPACs would enable activists to engage in campaigns that include a proxy fight in a company with staggered boards, which may require two years to complete, or the implementation of long-term structural changes that cannot be affected under extant models of activism. The sponsor would incur the expenses related to the campaign in return for the promote she received. To give the sponsor a proper incentive to spend the necessary amount, it is possible to give her restricted shares that she would only be able to sell when the other investors are at the money or even after a certain target rate is reached.[115] However, we believe that the design of optimal incentives should be left to the market and not be prescribed by regulation.

The fifth and last phase is dissolution of the Activist SPAC. As soon as the Activist campaign is over, there is no value in maintaining the Activist SPAC; it is merely a holding company, whose only asset is the shares of a public company. Thus, at the end of the Activist campaign period, the Activist SPAC ought to distribute the shares of the public company it owns

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114. *See supra* Section II.A.4.

115. This is similar to the promote in the Pershing Square SPAC. *See* Squire, *supra* note 88 ("The truly remarkable departure from SPAC standard terms is that Pershing Square is not taking any founders shares . . . . Pershing Square's sole compensation for founding and capitalizing the SPAC and sourcing, negotiating and closing a $10B+ acquisition will be a 6.21% promote after the investors have already received a 20% return.").

as an in-kind dividend after providing the sponsor with the compensation she is entitled to, and dissolve. An Activist SPAC would be able to obtain additional time (say, beyond three years) in appropriate cases by a vote of a majority excluding the sponsor. The possibility to extend the period of operation would enable the Activist SPAC to have a longer investment horizon than conventional activist hedge funds, and adopt long-term strategies that may bear fruit only over a time span of several years.

III. The Potential Impact of Activist SPACs

A. The World of Activism with Activist SPACs

The main rationale for the Activist SPAC form is its ability to enhance the impact of activism in financial markets. As we will show in the subsequent discussion, the introduction of Activist SPACs has the potential to transform the scope and nature of activism, as we know it. Not only can Activist SPACs dramatically increase the resources available to activists, but they would give the public an opportunity to use activism for environmental, social, and governance investing (ESG) purposes or to support managements of corporations.

1. Forming a Market for Activism: Improving the Functioning of Activism

Currently, large-scale activism is dominated by activist hedge funds. The structure of hedge funds influences and even dictates the form of activism. Introducing a new structure for activism will facilitate the entrance of new players and new voices to the activist arena. The diversification and thickening of the activist arena will contribute to the perfecting of the market for activism and fortify its ability to self-correct its flaws.

There exists an extensive debate regarding the impact of activist hedge funds on the market. Many scholars and commentators point to its positive impact in addressing agency problems, disciplining management, and generating higher value for shareholders.[116] Yet, there are other scholars who are more skeptical of the positive value of activism. The main concern of the skeptics is that, while activist engagements generate value in the short run, they harm firms in the long run. Hedge funds aim at investing in companies that generate *alpha*—above market return. As a result, their investment in targets is limited to the period in which their surgical strategic operation is executed, which is relatively short.[117] As hedge funds are incorporated as partnerships, the general partner (the hedge fund's manager)

116. *See supra* notes 26–30 and accompanying text.
117. Sullivan & Cromwell LLP, *supra* note 15.

has complete control of both the decision to enter the investment and to terminate it. Thus, all investors in a hedge fund have the same horizon for their investment.

The Activist SPAC may fundamentally change the investors' time horizon and, as consequence, the engagement strategy of the manager. Unlike a hedge fund, the Activist SPAC is incorporated as a corporation and the manager has control only of the entry decision—i.e., which company to engage and when to do it. Activist SPAC Investors can maintain their position in the target as long as they want, because they can sell the Activist SPAC shares on a stock exchange, allowing new shareholders to buy into the activism campaign. Additionally, the shareholders of the Activist SPAC may hold on to the shares of the target even after the Activist SPAC dissolves and transfer its holdings in the target to the Activist SPAC shareholders.

For this reason, investors in an Activist SPAC may well care about the long-term performance of the target company and thus be willing to adopt strategies that would bear fruit only over a long period of time. This is in contrast to activist hedge funds, whose investors do not care about the target's performance in the long run if it is not fully reflected in current market prices. In turn, the manager of an Activist SPAC would have to take into account the investment horizons of all its investors, including those who plan on staying invested in the target company well beyond the implementation of the strategic changes in the target company. An additional reason why Activist SPACs may generate more "patient" capital than that of hedge funds is that the exit option will alleviate the pressure on hedge funds' managers to show positive results to the investors who locked their money in the hedge fund for several years. Since investors in the Activist SPAC have an exit option, they will exert less pressure on the managers to show immediate positive results.

An additional dimension in which Activist SPACs could impact the functioning and nature of activism is by enabling it to function as "validation" capital.[118] This concept has been developed in a recent paper by Alon Brav, Dorothy Lund, and Edward Rock. Activists are typically expected to change the course of the target. Brav, Lund, and Rock point to another function activists can perform: instead of utilizing their block of shares to pressure management to make changes, they can utilize their block of shares to "protect" the current course of management from pressures by other market actors.[119] It should be noted that Brav, Lund and Rock were

118. Alon Brav, Dorothy S. Lund & Edward B. Rock, *Validation Capital*, 99 TEX. L. REV. 1247 (2020). In recent years, almost half of the campaigns of activists were aimed at pushing for an M&A deal—47% in the Q1 2021, 41% in 2020 and 47% in 2019. *See* LAZARD, *supra* note 53, at 12.

119. Brav, Lund & Rock, *supra* note 118, at 1256.

able to report only a handful of cases of "validation" by activists. This is understandable given the current institutional structure of activism under hedge funds: short-term returns sought by activist hedge funds are inconsistent with "validation" strategies, as those strategies are not usually amenable to high short-term returns. On the contrary, "validation" capital protects the company from short-term-oriented market actors and, as such, is more long-term oriented. In sharp contrast, Activist SPACs, as we perceive them, would be designed for investors with *varying* horizons and thus would be more suited for "validation" engagements. Enabling greater implementation of validation campaigns by activists is an additional dimension in which Activist SPACs could change the nature of activism and improve it. Furthermore, enlarging the pool of activist players will improve the outcomes of activism and perverse outcomes will be reduced. If one activist has an inimical activism plan, e.g., to sell the company in the short term in a suboptimal transaction, as the pool of activist actors is larger, it is most likely that other players will emerge and purchase a stake in order to prevent such a suboptimal transaction from occurring.

The introduction of Activist SPACs would also allow retail investors to leave an impact on financial markets. The GameStop rally revealed an extensive interest on the part of retail investors to assume an active role in the stock market.[120] The Activist SPAC would make it possible to tap into this group of interested retail investors, allowing them to join conventional shareholder activism. These investors are currently barred from partaking in the campaigns of activist hedge funds due to the minimum wealth requirements that accompany investment in hedge fund activism. Setting up Activist SPACs would enable these retail investors to join the pool of active investors and leave a lasting mark on the market. The inclusion of retail investors in activism would not be a mere quantitative change, but also a qualitative one: the characteristics of retail investors are different from the typical investors in activist hedge funds. Retail investors are likely to be more open to validation strategies, even if they cannot generate significantly higher value than passive investments. They are also more likely to endorse ESG goals, as we discuss in the next section. Hedge fund investors typically care about pecuniary returns, while retail investors may be more willing to reward companies that promote important societal goals. There are multiple studies that indicate that the public at large, especially Millennials, have a

120. Jill E. Fisch, *GameStop and the Reemergence of the Retail Investor* 34, (Eur. Corp. Governance Inst., Working Paper No. 637/2022, 2022), https://ssrn.com/abstract=4049896 [https://perma.cc/Y9K9-A43R].

different perception of the corporate purpose than traditional Wall Street investors.[121]

To conclude then, Activist SPACs may generate a new form of activism both with respect to its time frame and with respect to the type of goals for which it may strive. Enlarging the variety of any market improves it and bolsters the market dynamic of self-correction of flaws. Consequently, Activist SPACs may receive a warm welcome from regulators, judges, commentators, and scholars who are critical of hedge fund activism.

2. ESG-Oriented Activism

Another virtue of the Activist SPAC lies in its potential to promote ESG objectives. The number of mutual funds with an ESG criterion for purposes of investment selection has nearly doubled in the last four years, reaching over $40 trillion in assets in 2020.[122] The strong preference of investors for ESG investments, reflected in the growth of ESG mutual funds, has trickled down and permeated the backbone of Corporate America. In 2019, the Business Roundtable, a forum consisting of the CEOs of prominent corporate firms and chaired by Jamie Dimon, chair and CEO of JPMorgan Chase & Co., redefined the purpose of a corporation from maximizing shareholders' returns to promoting "an economy that serves all Americans."[123] In this statement, corporate CEOs called for incorporating ESG goals into corporate objectives. Larry Fink, the CEO of BlackRock, the largest mutual fund family, joined the Business Roundtable statement, together with other leaders of institutional investors.[124] Such unity is highly unique and compelling.

121. *Id.* at 34 ("Millennials and Gen-X investors, those who entered the market in the greatest numbers as part of the GameStop frenzy are 'the driving force in the adoption of socially responsible investment strategies.'" (quoting Michal Barzuza, Quinn Curtis & David H. Webber, *Shareholder Value(s): Index Fund ESG Activism and the New Millennial Corporate Governance*, 93 S. CAL. L. REV. 1243, 1294 (2020))); *see also* Barzuza et al., *supra* [hereinafter Barzuza et al., *Shareholder Value(s)*; Michal Barzuza, Quinn Curtis & David H. Webber, The Millennial Corporation (2021) (unpublished working paper), https://scholarship.law.bu.edu/cgi/viewcontent.cgi?article=2171&context=faculty_scholarship [https://perma.cc/8HTU-52T5].

122. Anne-Laure Foubert, *ESG Data Integration by Asset Managers: Targeting Alpha, Fiduciary Duty & Portfolio Risk Analysis*, OPIMAS (June 17, 2020), http://www.opimas.com/research/570/detail/ [https://perma.cc/DY5B-VEMD].

123. *Business Roundtable Redefines the Purpose of a Corporation to Promote 'An Economy That Serves All Americans'*, BUS. ROUNDTABLE (Aug. 19, 2019), https://www.businessroundtable.org/business-roundtable-redefines-the-purpose-of-a-corporation-to-promote-an-economy-that-serves-all-americans [https://perma.cc/H2V9-VUZ4].

124. Hugh Grove, John Holcomb, Mac Clouse & Tracy Xu, *Analyzing the Business Roundtable Statement on the Purpose of a Corporation and Linking It to Corporate Governance*, CORP. BD.: ROLE, DUTIES AND COMPOSITION, 2020, at 19, 20 ("The world's two largest asset managers also signed this

While ESG goals seem to gain traction among investors, many commentators claim that these goals have not yet become an integral component in real-life corporate agendas.[125] Our explanation of the limited impact of ESG aspirations on the corporate sphere is the lack of innovative vehicles that would enable investors to exert influence over management and boards. Mutual Funds are guided by ESG targets in their support of shareholder proposals that address ESG matters, such as gender diversity, employee welfare, and environmental sustainability of the corporation's activity.[126] They may even object to the nomination of directors suggested by management, based on the ESG principles incorporated into their guidelines.[127] However, they are barred from employing more aggressive techniques, such as initiation of a proxy fight with their own candidate for the board and actively campaigning for strategic changes in the course of the company. As John Morley has shown, mutual funds cannot plausibly execute these more aggressive means: the regulatory price for such actions would be too high.[128] Commentators have argued that the limited means employed by mutual funds bar them from exerting stronger influence on corporate managements and boards in the promotion of ESG goals.[129]

Other commentators have argued that ESG mutual funds are not actually guided by ESG considerations, even in their investment decisions, and that their stated ESG objectives are essentially "greenwash."[130] There is no

Statement: Laurence Fink, CEO of Blackrock with $6.4 trillion of assets under management with offices in 30 countries and clients in over 100 countries, and Mortimer Buckley, CEO of Vanguard with $5.3 trillion of assets under management.").

125. *See* Lucian A. Bebchuk, Kobi Kastiel & Roberto Tallarita, *For Whom Corporate Leaders Bargain*, 94 S. CAL. L. REV. 1467 (2021).

126. Barzuza et al., *Shareholder Value(s)*, *supra* note 121, at 1265–68.

127. Asaf Eckstein, *The Rise of Corporate Guidelines in the Unites [sic] States, 2005–2021: Theory and Evidence*, 98 IND. L.J. (forthcoming 2022), https://papers.ssrn.com/sol3/papers.cfm?abstract_id=3705140 [https://perma.cc/X3RK-EMJJ] (explaining the efficacy of the utilization of guidelines by for the monitoring of portfolio companies by institutional investors).

128. *See* Morley, *supra* note 3, at 1422–23.

129. One study even found that there is no difference between the voting pattern of many of the ESG funds to that of other funds in respect to ESG matters. *See* Gita R. Rao, *A Surprise About Some ESG Funds—They Actually Vote Against Environmental and Socially Conscious Resolutions*, MARKETWATCH (Dec. 18, 2020, 10:40 AM), https://www.marketwatch.com/story/a-surprise-about-some-esg-funds-they-actually-vote-against-environmental-and-socially-conscious-resolutions-11608306020 [https://perma.cc/C8G8-LPHD]. *But see* Quinn Curtis, Jill E. Fisch & Adriana Z. Robertson, *Do ESG Mutual Funds Deliver on Their Promises?* 120 MICH. L. REV. 393, 435 (2021) (finding that ESG Mutual Funds vote their share differently than non-ESG funds, with greater tendency to support ESG proposals).

130. *See, e.g.*, Rachel Evans, *How Socially Responsible Investing Lost Its Soul*, BLOOMBERG, (Dec. 18, 2018, 4:00 AM), https://www.bloomberg.com/news/articles/2018-12-18/exxon-great-marlboros-awesome-how-esg-investing-lost-its-way?leadSource=uverify%20wall [https://perma.cc/8MJB-93WX]; Zachary Barker, *Socially Accountable Investing: Applying* Gartenberg v. Merril Lynch Asset Management*'s Fiduciary Standard to Socially Responsible Investment Funds*, 53 COLUM. J.L. SOC. PROBS. 283, 286 (2020). This concern has also seemed to trouble the chair of the SEC, who is considering greater regulation for ESG funds, especially mandating greater disclosure by the

effective monitoring of investors on the numerous investments comprising the portfolio of the mutual fund. Investors cannot even make use of an external ESG index to monitor and compare the investment of their ESG mutual fund due to the numerous conflicting indexes for measuring ESG.[131]

In contrast to mutual funds, activist hedge funds can employ more aggressive mechanisms to achieve ESG goals, such as engaging in proxy fights and proposing their own board candidates in order to promote their desired objectives. Recently, this possibility became reality when the "Engine No. 1" hedge fund led a successful proxy fight against the management of Exxon Mobil and succeeded in nominating directors who supported shifting Exxon's activity toward renewable energy at the expense of drilling.[132] Yet, such a campaign by a hedge fund is the exception, rather than the rule. Ordinarily, hedge funds do not pursue ESG goals directed at benefitting the wider public. Rather, they focus on the attainment of narrow financial goals that have a quick impact on the company's shares, such as spin-offs of company assets, slashing R&D expenses, or altering the compensation structure of management. As we already explained, hedge funds' structure, as partnerships with a defined horizon and illiquid investment of the limited partners, as well as high powered financial incentives of their general partners, direct them to enhance share value of the companies in which they invest as quickly as possible.[133] They are

ESG regarding their ESG strategy and its execution. *See* Elad L. Roisman, Commissioner, U.S. Sec. & Exch. Comm'n, Keynote Speech at the Society for Corporate Governance National Conference, (July 7, 2020), (transcript available at https://www.sec.gov/news/speech/roisman-keynote-society-corporate-governance-national-conference-2020 [https://perma.cc/TNZ6-PJH7]); Allison Herren Lee, Commissioner, U.S. Sec. & Exch. Comm'n, Playing the Long Game: The Intersection of Climate Change Risk and Financial Regulation, (Nov. 5, 2020) (transcript available at https://www.sec.gov/news/speech/lee-playing-long-game-110520 [https://perma.cc/6GGV-SP5N]). For a critique of this argument, finding a significant difference between the investment pattern of ESG mutual funds and non-ESG mutual funds, see Curtis et al., *supra* note 129, at 26–51.

131. For example, in some ESG rankings, Tesla scores the highest score in the MCSI ESG rating, and lowest from the FTSE ESG rating. *See* James Mackintosh, *Is Tesla or Exxon More Sustainable? It Depends Whom You Ask*, WALL. ST. J. (Sept. 17, 2018, 11:58 AM), https://www.wsj.com/articles/is-tesla-or-exxon-more-sustainable-it-depends-whom-you-ask-1537199931 [https://perma.cc/9K7D-GMX5]. For a systematic study of the variation among ESG ratings, and the problem that is poses for monitoring ESG mutual funds, see Florian Berg, Julian F. Kölbel & Roberto Rigobon, *Aggregate Confusion: The Divergence of ESG Ratings*, 26 REV. FIN. 1315 (2022), https://academic.oup.com/rof/advance-article/doi/10.1093/rof/rfac033/6590670 [https://perma.cc/5DSB-KQMD] (comparing ratings from six prominent agencies and reporting substantial differences); Feifei Li & Ari Polychronopoulos, *What a Difference an ESG Ratings Provider Makes!*, RSCH. AFFILIATES, (Jan. 2020), https://www.researchaffiliates.com/publications/ articles/what-a-difference-an-esg-ratings-provider-makes [https://perma.cc/S4VK-KPE7]; Dana Brakman Reiser & Anne Tucker, *Buyer Beware: Variation and Opacity in ESG and ESG Index Funds*, 41 CARDOZO L. REV. 1921, 2003–05 (2020).

132. *See supra* note 39; Levine, *supra* note 41.

133. *See supra* notes 34–39 and accompanying text.

hardly the best candidates to pursue ESG goals that often require very long investment horizons and even sacrifice of returns for a greater cause.

The Activist SPAC may fill the void that currently exists in the realm of ESG activism. Unlike mutual funds, Activist SPACs are not barred from employing aggressive measures to achieve their goals. Unlike hedge funds, Activist SPACs do not require investors to forgo liquidity. Consequently, Activist SPACs do not have to adopt the high-powered and short-term-focused incentives that characterize hedge funds. This combination may enable Activist SPACs to serve as an ideal investment vehicle for investors interested in promoting ESG objectives, and we expect that Activist SPACs, which emphasize ESG goals at the stage of their IPO, will draw much attention from investors who are inclined toward these purposes. Such Activist SPACs could utilize aggressive measures for promoting ESG objectives with less pressure from investors to show immediate profitability. An investor who is skeptical about the desirability of the Activist SPAC's ESG strategy can exit by selling her shares.[134] In addition, unlike mutual funds, Activist SPACs enable investors to monitor their ESG strategy more easily and effectively, given that Activist SPACs cannot hold a portfolio of many companies, but must focus on an engagement in one company.[135] The Activist SPAC must notify its investors of the target it chose and the strategy it is planning to employ, which makes it easier for a retail investor to evaluate whether the strategy promotes her preferred ESG goals. If not, she would be able to redeem her shares, and thereby communicate both to the Activist SPAC management and the market that it is not the type of ESG strategy that she had envisioned.

3. *Activist SPACs' Impact on the Scope of Activism: Widening the Scope of Activism*

Even among supporters of activism, there are doubts about its actual impact. Activism in its current form has a limited scope. As we noted, the $16.1 billion invested by hedge fund activists in 2020 constituted a mere 0.0322% of the aggregate market cap of all U.S. firms.[136] There are a few

134. The skepticism does not have to arise regarding the normative desirability of the changes in the company for which the hedge fund is pushing. As Max M. Schanzenbach & Robert H. Sitkoff have noted, one should distinguish between "collateral benefits ESG"—directed to benefiting third parties based on the ethical views of the trustee—and "risk-return ESG" in which ESG is a strategy for obtaining superior risk-adjusted return based on the premise that there is a correlation between the two. *See* Max M. Schanzenbach & Robert H. Sitkoff, *Reconciling Fiduciary Duty and Social Conscience: The Law and Economics of ESG Investing by a Trustee*, 72 STAN. L. REV. 381, 397–98 (2020). Based on their distinction, a risk-return ESG oriented investor may object to a certain ESG investment not on ethical grounds—that it does not coincide with her ethical preferences—but that it will not generate superior returns.

135. This is due to the legal restrictions of the Investment Company Act. *See infra* note 151 and accompanying text.

136. *See supra* note 5.

factors that cause the impact of the hedge fund activism to loom larger than its proportional market share. First, activist hedge funds often cooperate with other large actors, such as institutional investors. As they obtain only a relatively small block of shares of the companies that they engage, activist hedge funds need support from other actors to achieve their goals. In many cases, institutional investors are happy to cooperate as they stand to benefit from successful engagements without incurring the same costs. Second, the impact of activist hedge funds is not limited to the companies they engage. Activist hedge funds have a broad disciplining effect—even on companies they do not engage. The mere threat of an engagement is likely to improve how firms are being run. Fearing that an activist engagement would lead to their replacement, managements of under-performing companies strive to avoid an activist campaign against them. An effective way to achieve this goal to improve firm performance and thus make it a less lucrative target for activists.

While it is true that the impact of activist hedge funds is greater than the effect one would expect to see given the limited resources of funds, activism in its current form falls short of realizing its potential. Even with the help of institutional investors, activist hedge funds managed to engage only 80 of the 3,500 publicly traded companies (with a market value above $500 million) in the United States in 2020.[137] While we openly acknowledge that the salutary effect of activist hedge fund engagements goes beyond the targets, it cannot reach, in its current scope, all publicly traded companies—or even the majority. Presently, the probability of engagement is quite low and stands at 2.3%. With such low probability, the deterrent effect of hedge funds is very modest. An increase in the number of engagements will also increase the deterrence effect of hedge funds and can have a significant market-wide impact.

B. Activist SPAC as the "Poor Man's" Activist Hedge Fund

Introducing Activist SPACs would not only change the nature of activism but would also have a distributive impact. Traditionally, exposure to activist hedge fund activity has been limited to certain institutional investors, private equity funds and affluent individuals. These limitations are driven primarily by regulation.[138]

137. *See supra* note 2 and accompanying text.

138. A non-public company is limited to thirty-five individuals, unless they are "accredited investors." The definition of "accredited individuals" is individuals with a net worth of at least $1 million or a minimum income of $200,000. *See* 17 C.F.R. § 230.501(5)–(6) (2022). If they are accredited, there could be up to ninety-nine investors in the fund. *See* Investment Company Act of 1940, 15 U.S.C. § 80a-

Most retail investors are not qualified to participate in hedge fund activism and thus do not get to share in the benefits it produces. In 2020, activist hedge funds gained 17.75%, on average.[139] For comparison's sake, the return on investing in the S&P 500 index for 2020 was 16.26%.[140] Relative to investment in the S&P 500 index, investors in activist hedge funds had generated returns that were almost 10% higher than the returns on market benchmark, such as the S&P 500. The average retail investor cannot get this abnormal return, however. Furthermore, activist hedge funds offer another advantage to their investors: relative insularity to market risk. The returns of activist hedge funds are primarily derived from improving companies, and thus can be generated even in a bear market.[141]

The introduction of Activist SPACs would improve the current state of retail investors in three respects. First, investment in Activist SPACs would be open to *all* retail investors. It would not be conditioned on individual wealth. Second, because Activist SPACs would only buy shares in public companies, and because the Activist SPAC's own shares are traded on the exchange, the retail investors' holdings will be highly liquid. This means that retail investors can liquidate their shares at any time. Hedge funds, by contrast, are illiquid. Hedge funds are structured as partnerships and the funds invested in them are locked in for a period of seven to ten years. Consequently, even wealthy individuals may be reluctant to join activist hedge fund campaigns. Locking a considerable portion of one's wealth for an extended period involves a high opportunity cost.[142] Third, the proliferation of Activist SPACs would provide retail investors with the opportunity to diversify their activism portfolio. The fact that Activist SPACs could take any amount of money would enable retail investors to invest in multiple Activist SPACs as well as any other investment. Doing

3(c)(1). If all investors are qualified purchasers—with a liquid net worth of $5 million or less as defined in 15 U.S.C. § 80a-2(a)(51)—the fund can qualify as a section 3(c)(7) company and consist of up to 2,000 investors. *See id.* § 3(c)(7); Matthew Speiser, Kate Bridge, Maria LoPreiato-Bergan & Jim Tomczyk, *Accredited Investors vs. Qualified Purchasers: What You Need to Know*, ANGELLIST, https://learn.angellist.com/articles/accredited-investors-vs-qualified-purchasers#:~:text=3(c)(7)%20funds%20can%20accept%20up%20to%202%2C000,(c) (1)%20funds [https://perma.cc/T5BD-RLWN] (last visited Dec. 29, 2022). The reason for this limitation is that hedge funds, in contrast to mutual funds, are not regulated. The risk of unregulated activity is higher and thus the regulatory approach is to limit exposure to the risk only to individuals who can bear the cost of the risk should it materialize.

139. *Hedge Fund Performance Update: December 2020*, PREQIN (Jan. 20, 2021), https://www.preqin.com/insights/research/factsheets/hedge-fund-performance-update-december-2020 [https://perma.cc/6XNP-WQR7].

140*See S&P Historical Annual Returns*, MACROTRENDS, https://www.macrotrends.net/2526/ sp-500-historical-annual-returns [https://perma.cc/6A46-ARXC] (last visited Dec. 14, 2022).

141. *See* WORLD SCI. PUBL'G CO., HEDGE FUND ALPHA: A FRAMEWORK FOR GENERATING AND UNDERSTANDING INVESTMENT PERFORMANCE 5–6 (John M. Longo ed., 2009) (demonstrating how hedge funds outperformed the market in the bear market of 2000–02).

142. Regarding the high value of liquidity to low socioeconomic individuals who require an especially high liquidity premium, see Adi Libson, *Confronting the Retirement Savings Problem: Redesigning the Saver's Credit*, 54 HARV. J ON. LEGIS. 207, 233–34 (2017).

so would allow them to hedge their bets and not lose their capital if a particular Activist SPAC fails.

IV. POTENTIAL OBJECTIONS

In this Part, we discuss three potential objections that may be raised against our proposal. The first objection we discuss maintains that if Activist SPACs were as useful as we claim, they would exist already. The present absence of Activist SPACs, so the argument goes, indicates that there is no need for the new corporate form we propose. The second objection is that the introduction of Activist SPACs might threaten the protection granted to investors under the Investor Advisor Act by allowing mutual funds to pass themselves off as Activist SPACs. The third objection is that there is too much activism already and therefore Activist SPACs are not needed. We will address these objections in turn.

A. Why Doesn't the Market Generate Activist SPACs?

A classic objection that might be raised against our proposal is: why has the market not generated Activist SPACs on its own? This objection is known in academic circles as "the Chicago School objection." The assumption underlying the objection is that, if there were market demand for a new activism tool, it would exist already. Academic theorizing, clever as though it may be, is no match for the creativity of markets—especially financial ones. Thus, any academic proposal that presumes to improve the operation of markets is suspect. If Activist SPACs present the myriad advantages we discussed, and may improve Activist campaigns, why has the market not generated this corporate form on its own? Sophisticated investors should have discerned the potential of this corporate form and employed it to their benefit. It is implausible that academics have detected an investment pattern that has eluded many sophisticated investors with high-powered incentives.

Although this objection typically poses a challenge to innovative academic proposals and, ordinarily, should be taken seriously, it misses the mark in our case. The answer to the question "why are there no Activist SPACs?" is simple: regulation. As we explained throughout this Essay, under current regulations, the formation of an Activist SPAC or a similar investment structure is not possible. Rule 419 requires a blank check company to inform investors of the identity of its potential target *before* it acquires it.[143] This requirement precludes investment instruments akin to

143. 17 C.F.R. § 230.419 (2022).

the Activist SPAC. The basic feature of activist strategy is to form a block of shares under the market's radar in order to purchase the shares of the target cheaply and benefit from the increase in the company's value as a result of the engagement. Disclosing the activist's potential target will likely cause an increase in the target's share price. Such an increase before the activist's formation of its block of shares might render the planned campaign unprofitable and thereby prevent it from occurring. Without regulatory reform, the investment strategy on which activist SPACs are predicated cannot be executed. Hence, it is not surprising that Activist SPACs are presently missing from the market.

One may also query whether there is a need for a blank check company that uses public funds for activism. What precludes managers of mutual funds from deploying the funds they have at their disposal to promote activism? After all, the assets managed by mutual funds originate with the public at large. Allegedly, activism by mutual funds will be very similar to that of Activist SPACs.

The reply to this argument is twofold. First, legal requirements de facto bar managers of institutional investors from playing a direct role in activism. John Morley has provided a convincing account of the many legal barriers that prevent mutual funds from acting like activists.[144]

For one, mutual funds disclose their holdings by filing a Schedule 13G form, instead of a 13D form, when crossing the 5% ownership threshold.[145] Form 13G is meant for passive holders and sidesteps the expansive disclosure requirements mandated by Schedule 13D, which includes a report of all trade in the 45-day period that preceded a change of its block by 1% or more.[146] Such disclosure is extremely burdensome for mutual funds that engage in frequent trades of the shares of their portfolio companies. Because no such reporting is required under Schedule 13G, reporting under Schedule 13G, rather than 13D, is crucial for institutional investors. However, only passive investors that have no intention to influence the strategy of the corporation are allowed to use the lenient Schedule 13G.

The second and more well-known explanation for why mutual funds do not engage in activism is their regulated fee structure that limits their incentives to engage in activism.[147] The Investment Advisers Act of 1940, which regulates the fee structure of all investment advisers registered with the SEC, including all mutual funds, precludes them from utilizing an

144. *See* Morley, *supra* note 3.

145. *Schedules 13D and 13G*, INVESTOR.GOV, https://www.investor.gov/introduction-investing/investing-basics/glossary/schedules-13d-and-13g [https://perma.cc/5WBH-SJP3] (last visited Dec. 14, 2022).

146. 17 C.F.R. § 240.13d-2(a) (2022).

147. For additional explanation on the lack of activism by mutual funds and other traditional institutional investors, see Gilson & Gordon, *supra* note 18, at 891–95.

aggressive success-based fee in order to protect the investments of ordinary mom-and-pop investors from excessive risk.[148] Due to the low sensitivity of mutual funds to increases in the value of their portfolio companies and their strict focus on offering low fees to investors, they are disinclined to engage in activism.[149] While the Investment Advisory Act provides an answer to the question why mutual funds do not provide a solution for retail investors who wish to engage in activism, it gives rise to a second objection to our proposal: isn't the Activist SPAC in conflict with the Investment Advisory Act? We turn to this question next.

B. Does the Activist SPAC Conflict with the Investors Advisors Act and the Investment Company Act?

The Activist SPAC structure, as we designed it, provides remuneration to the Activist SPAC's management for identifying a target for activism and successfully executing an activist campaign. These activities require expertise, sophistication, and investment of considerable resources. As we have noted, the compensation would come in the form of a share of the profits from the campaign. We did not set the precise percentage of shares management would receive. Instead, we left it to the market to determine the appropriate level of compensation. Although we cannot predict the manager's cut, it may possibly reach 20% of the profits—similar to the carried interest compensation of activist hedge funds' managers.

The compensation structure of the Activist SPAC conflicts with the Investment Advisers Act of 1940, which prohibits registered investment advisors from charging a share of the capital appreciation of the funds.[150] Creating an entity such as an Activist SPAC and exempting it from the Investment Advisory Act prohibition runs the risk of undermining the

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148. Investment Advisers Act of 1940, 15 U.S.C. § 80b-5(a). So called "fulcrum fee" structures are allowed, but those provide only lame incentives. As such performance-based fee structures reward managers with a component of the fund's excess return over a prespecified benchmark, it symmetrically imposes a monetary "fine" in case of underperformance with respect to said benchmark. *See* Juan Sotes-Paladino & Fernando Zapatero, *Carrot* and *Stick: A Role for Benchmark-Adjusted Compensation in Active Fund Management*, 52 J. FIN. INTERMEDIATION (forthcoming Oct. 2022).

149. Gilson & Gordon, *supra* note 18 at 889–95. *But see* Marcel Kahan & Edward B. Rock, *Index Funds and Corporate Governance: Let Shareholders be Shareholders*, 100 B.U. L. REV. 1771, 1776 (2020) (claiming that the passive functioning of institutional shareholders is not a bug but a feature of institutional investors: "In this Article, we argue that these criticisms rest on a flawed understanding of the current corporate governance landscape and of the nature of institutional investing.").

150. Investment Advisers Act of 1940, 15 U.S.C. § 80b-5(a)(1) ("No investment advisor registered or required to be registered with the Commission shall enter into, extend, or renew any investment advisory contract, or in any way perform any investment advisory contract entered into, extended, or renewed on or after November 1, 1940, if such contract—(1) provides for compensation to the investment adviser on the basis of a share of capital gains upon or capital appreciation of the funds or any portion of the funds of the client . . . .").

protection the Act provides to common investors. Funds could define themselves as Activist SPACs in order to circumvent the success-based fee prohibition. There does not seem to be a clear-cut mark which distinguishes the function of an Activist SPAC and other mutual funds. It is true that Activist SPACs actively engage with the company in which they invest, but funds could easily feign active engagements by sending a letter to the management regarding a suggested reform or voting against the directors proposed by management. These actions by themselves are not costly—the main cost element they implicate is the strategic planning behind them, which is much harder to discern. Similar to the claim that many active mutual funds are actually "closet" passive funds (which index their investment, rather than actively engage in stock picking), there may be Activist SPACs which are essentially "closet" mutual funds. The ability of mutual funds to pass themselves off as Activist SPACs, would undermine the regulatory framework of mutual funds intended to protect ordinary investors.

However, there is a critical distinction between Activist SPACs and mutual funds. Activist SPACs, as we envision them, are limited to investment in one company. Mutual funds, by contrast, must invest in multiple companies. This difference is not merely conceptual. It has far-reaching practical implications. First, it would prevent mutual funds from passing themselves off as Activist SPACs. The main service mutual funds provide for their clients is diversification of their investment. As Activist SPACs are limited to investing only in one company, mutual funds will not be able to imitate the business model of Activist SPACs and the protection the Investor Advisors Act grants to investors in mutual funds will not be lost or compromised. The business model of mutual funds is predicated on diversification and, therefore, it is completely antithetical to the defining characteristic of Activist SPACs—investment in a single company. Second, section 3(b)(2) of the Investment Company Act of 1940 grants the SEC the discretion to exclude from the definition of an "investment company" any issuer that "declares to be primarily engaged in a business or businesses other than that of investing, reinvesting, owning, holding, or trading in securities either directly or (A) through majority-owned subsidiaries or (B) through controlled companies conducting similar types of businesses."[151] Importantly, the SEC has adopted a very expansive definition of control in the context of Rule 13D, interpreting the term to include any intervention in a company's strategy. If the same capacious definition were to be adopted also in the context of the Investment Company Act, sponsors of Activist SPACs would be able to receive performance-based compensation. Obviously, we would encourage the SEC to adopt this option not only for

151. Investment Company Act of 1940, 15 U.S.C. § 80a-3(b).

consistency's sake, but also to enable and assure the effective operation of Activist SPACs.[152]

C. Is There a Real Need for Activist SPACs?

The third and final objection goes to one of the core premises underlying our Essay, namely, that the current level of activism is suboptimal. In Part I, we noted that activists only engage 2.3% of publicly traded corporations.[153] Although this figure seems small to us—similarly to many other commentators who question the ability of the limited scope of hedge fund activism to have an impact on the market at large[154]—one might argue that there is no need to enlarge the scope of activism as the current level of activism is optimal, or even excessive.

Given current data, it is impossible to determine the optimal level of activism with any degree of certainty. However, we do not believe that the uncertainty regarding the optimal level of activism stands to bar the adoption of our proposal. The reason is simple: we do not intend to force financial actors to adopt our model. We merely call for the addition of the Activist SPAC to the activist toolkit. Adding another option to the menu of activism comes at no real cost to society. The implementation of our proposal necessitates a change of SEC Rule 419 to allow Activist SPACs to disclose the identity of the target a short while after it acquires a block of shares in the target. This change is necessary to enable the successful operation of Activist SPACs. In essence, the introduction of Activist SPACs requires a simple act of deregulation, whose cost is minimal. Thereafter, activists would be free to use Activist SPACs, but nothing would compel them to do so. The success or failure of the Activist SPAC would be left to the market. Currently, there is no way of knowing whether we have reached the right level of activism. The only way to determine the optimal level of activism is by removing all barriers to new models of activism and allowing the market to operate. We argue that Activist SPACs present a strong prima facie case for market experimentation. Even if in the short run, the introduction of Activist SPACs would generate too much activism, in the long run, after generating low returns, Activist SPACs would become unpopular, and investors would stop using them. In contrast, if Activist SPACs continue to be suppressed from the market, the cost is likely to be

152. Naturally, even if the SEC chooses not to adopt such a wide interpretation for control in the context of the Investment Company Act, Congress could nevertheless legislate such an interpretation.

153. *See supra* note 2 and accompanying text.

154. *See, e.g.*, Robin Greenwood & Michael Schor, *Investor Activism and Takeovers*, 92 J. FIN. ECON. 362, 374 (2009) ("One implication of our work is that the scope for hedge fund activism to have pervasive effects on corporate governance is limited.").

high: if the current level of activism is too low, agency costs in public companies would persist to the detriment of the public.

Furthermore, at present, the market for activism is based on a single model—that of activist hedge funds. Startlingly, there is no competition in the market for activism, which is puzzling in and of itself. The addition of Activist SPACs would not only foster competition in the market for activism, but would have two additional desirable effects. First, it would allow the public to partake in the world of activism. Currently, the public at large has no foothold in the activist realm. Retail investors who would like to share in the gains arising from activism have no ability to do so. It is true that activism carries risks with it and not all activist engagements are successful. Yet, the design of Activist SPACs offers a high degree of protection to lay investors, while allowing them to participate in the upside of activism.

Second, Activist SPACs portend a new kind of activism—one with longer horizons and without locked-in capital. We believe that the unique features of the Activist SPAC would attract new money to the world of activism. Numerous scholars have criticized the impatient and short-term nature of activism by activist hedge funds.[155] The different structure of the Activist SPAC would provide an alternate path for activism. As Activist SPACs enable investors to exit more easily from their investment by selling their shares in the Activist SPACs in public, the more "patient" capital it provides may impact the pattern of activism. This, in turn, would enable investors in Activist SPACs to implement activist strategies that require longer engagements and give good management an opportunity to engage in strategic planning that benefits companies in the long haul. Hence, activism of Activist SPAC may be able to address agency problems that the quickly exiting hedge fund activists do not address. The ability of Activist SPACs to introduce a new kind of activism should allay the concerns of the critics who maintain that we already have enough activism. As we demonstrated time and again, the analysis cannot be strictly quantitative by focusing exclusively on the level of activism on the market and must, instead, incorporate a qualitative dimension by looking at the types, or models, of activism the market offers.

CONCLUSION

In this Essay, we offered a new corporate structure that can transform the market for corporate activism. Currently, only sophisticated, wealthy investors can partake in the advantages of Activist investments. Retail investors are excluded from the scene, notwithstanding their clearly

155. *See supra* notes 31–32.

manifested desire to have a voice in the corporate world.[156] The exclusion of retail investors from the domain of activism harms not only the investors themselves, but also the quality of corporate governance across the board. The existing model enables activists to engage only 2.3% of public corporations. The limited scope of activism is due to three interlocking reasons: (a) the exclusive reliance on the funds of sophisticated investors, primarily activist hedge funds; (b) regulation that prevents retail investors from entering the world of activism, and (c) the dearth of corporate forms suitable for activism.

All three hurdles can be overcome by the introduction of the Activist SPAC. The Activist SPAC is uniquely designed to give the public a foothold in the domain of activism, on the one hand, while providing it with maximal protection against abuse on the other. Adoption of our proposal can not only improve corporate governance by enhancing dramatically the scope of activism, but also by changing its nature. As we showed throughout this Essay, Activist SPACs are especially attractive to patient investors with long horizons. Likewise, Activist SPACs are conducive to the advancements of ESG goals. Therefore, Activist SPACs provide an effective tool for effectuating the preferences of the American public with respect to how corporations should be managed and the goals they are supposed to promote. We also demonstrated that the introduction of Activist SPACs requires minimal (yet necessary) changes in the existing regulatory framework and imposes no other costs. Considering this fact, our Essay establishes a strong prima facie case for permitting Activist SPACs, at least as a market experiment. The potential benefits of Activist SPACs are significant, while the risk is small. Financial markets have always prided themselves on innovation; the introduction of Activist SPACs can be a meaningful step forward along that path.

156. *See* Barzuza et al., *Shareholder Value(s)*, *supra* note 121, at 1250.