ACTIVISM ON HOLD: THE LEGAL BARRIERS TO SHAREHOLDER IMPACT LITIGATION

Dennis Ronel*

In recent years, shareholder activism in the United States has surged, driven by the rise of Environmental, Social, and Governance (ESG) policies and heightened corporate stewardship. This Column examines the challenges shareholder activists face when seeking to hold managers accountable through litigation, highlighting three key obstacles: the entrenched shareholder primacy doctrine, the protective nature of the business judgment rule, and the stringent evidentiary requirements under Delaware law. Despite the push for a broader stakeholder governance perspective, Delaware courts have historically favored management's authority, limiting the effectiveness of legal actions aimed at promoting progressive corporate change. I argue that, given these barriers, shareholder activists should reconsider their reliance on litigation and instead focus on reshaping corporate governance norms from within. There are indeed effective avenues for promoting corporate change, but this Column posits that litigation is not one of them.

* Dennis Ronel is a second-year student at Harvard Law School and serves as a Senior Editor and Columnist for the *Harvard Business Law Review*. He would like to thank Christopher Kies, Louis Noirault, and Professor Mariana Pargendler for their guidance and support in shaping the ideas for this paper.

Table of Contents

Introduction

In recent years, shareholder activism in the United States has surged, driven by the growing significance of ESG policies, the human capital management movement, and an enhanced emphasis on corporate stewardship. Shareholder activism seeks to minimize agency costs between shareholders and managers of widely held public companies. It does so by attempting to mitigate the negative consequences of managers prioritizing their own interests over shareholder values and the overall success of the corporation.[1]

How can shareholder activists effectively hold managers accountable and drive corporate change? The obvious answer would be to go to the courts. Delaware courts have erected the legal pillars that frame today's corporate governance discourse, interjecting a plethora of perspectives on the rights of shareholders and the prerogatives of managers.[2] However, since the 1980s, Delaware courts have persisted in hollowing out, in important ways, the scope of these pillars that shaped all manner of corporate discourse.[3] There is an argument to be made that such developments have weakened shareholder monitoring of corporate management and potentially increased the incidence of director misconduct.[4] While judicial review of corporate action may still limit egregious acts of corporate misconduct, it is unlikely that Delaware courts will prove effective in promoting today's shareholder activists' aspirational, progressive objectives.

Shareholder activists face many challenges in achieving their goals through litigation, thanks in large part to the cultural norms of American corporate governance. U.S. corporate law often favors the authority of management, which can result in leadership that is resistant to change. Courts tend to defer to management decisions, making it hard for shareholder activists to succeed in litigation aimed at altering corporate practices.[5] In addition, as opposed to EU countries and Brazil, which lean towards a concentrated ownership structure and tend to focus on long-term portfolios, the U.S. prioritizes dispersed ownership and short-term performance.[6]

Since American corporate governance typically prioritizes managerial authority, courts are unlikely to recognize the interests of shareholder activists

---

[1] Katelouzou, Dionysia, *The Foundations and Anatomy of Shareholder Activism*, 11 J. Corp. L. Stud., 551 (2011).

[2] James D. Cox & Randall S. Thomas, *Delaware's Retreat: Exploring Developing Fissures and Tectonic Shifts in Delaware Corporate Law*, 42 Del. J. Corp. L. 323, 324 (2018).

[3] *Id.* at 326.

[4] *See generally* Joel Edan Friedlander, *Vindicating the Duty of Loyalty: Using Data Points of Successful Litigation as a Tool for Reform*, 72 Bus. Law. 623 (2017) (recognizing that stockholder class actions challenging corporate transactions are often unproductive).

[5] David G. Yosifon & Brett H. McDonnell, *Will the Real Shareholder Primacy Please Stand Up?,* 137 Harv. L. Rev. 1584, 1588 (July 1, 2023), [https://perma.cc/W97M-BMA5].

[6] John C. Coffee, Jr., *The Rise of Dispersed Ownership: The Roles of Law and the State in the Separation of Ownership and Control*, 111 Yale L.J. 1, 8 (2001).

until those interests align with those of corporate management. American courts tend to be reactive; judges do not initiate changes to corporate social norms but rather respond to the established practices of corporate directors, incorporating them into the common law. For these reasons, as of right now, shareholder activists should cease reliance on litigation to drive corporate social change.

In this Column I outline three significant obstacles that shareholder activist plaintiffs encounter when pursuing their objectives through litigation: the prevailing shareholder primacy doctrine, the protective nature of the business judgment rule, and the stringent evidentiary requirements surrounding Delaware's books and records access. Section II explores how the shareholder primacy doctrine fundamentally clashes with the aspirational goals of shareholder activists. Section III analyzes the limitations of the business judgment rule, highlighting its inadequacy as a standard for holding boards accountable for misconduct. Section IV illustrates how the evidentiary barriers imposed by Delaware law hinder shareholder activists from even initiating their claims.

While these issues are critical, they are not exhaustive; they reflect broader concerns about the viability of litigation as a tool for driving corporate social change. I do not suggest that litigation will never facilitate shareholder activism; however, I argue that, at this juncture, shareholder activists should shift their focus away from litigation and work to reshape corporate governance norms from within the boardroom. There are indeed effective avenues for promoting corporate change, but this article posits that litigation is not one of them.

I. Incompatible Goals: The Shareholder Primacy Doctrine's Limitations

Litigation is generally not conducive to advancing shareholder activist objectives in the U.S because American corporate jurisprudence can best be described as promoting "stockholder primacy," also known as shareholder primacy.[7] This school of thought argues that the ends of corporate governance should be in the best interests of shareholders and that other stakeholders like employees, consumers, creditors, and society should primarily look to contracts and statutes for protection.[8] However, many of today's corporate social activists attempt to push courts to adopt a school of thought known

[7] Leo E. Strine, Jr., *Good Corporate Citizenship We Can All Get Behind? Toward a Principled, Non-Ideological Approach to Making Money the Right Way*, 78 Bus. Law. 329, 341 (2023).

[8] *Id.* at 341-342

as "stakeholder governance."[9] In their view, corporations have a plethora of stakeholders, of which shareholders are just one.[10] While shareholders are empowered to make many of the decisions within the corporation, boards are not obligated to subordinate stakeholder interests to those of shareholders.[11] Rather, corporations are to treat workers, consumers, or communities as an equal end of for-profit governance.[12]

Delaware corporate law clearly supports the shareholder primacy approach to corporate governance, a concept exemplified in the recent case *McRitchie v. Zuckerberg*. In this case, plaintiff James McRitchie argued that the directors of Meta breached their fiduciary duties to their diversified shareholders by prioritizing "firm-specific" value while neglecting the effects on other companies and the broader economy.[13] The directors admitted to this approach, justifying their actions by asserting that Delaware corporate law requires them to manage Meta solely in its own interests.[14] *McRitchie* represents an instance of strategic litigation, aiming not only for a favorable outcome in this case but also for broader societal change through legal avenues.[15]

Unsurprisingly, the Court dismissed McRitchie's case for failure to state a claim. This ruling is significant because it establishes for the first time that directors must prioritize the interests of firm-specific investors over those of diversified investors. However, the Court downplayed its significance, stating that the principle is so fundamental that it hasn't required explicit mention in previous Delaware decisions: "Fish don't talk about water."[16] The Court further clarified that the duties of corporate directors to "stockholders" refer to firm-specific stockholders, rather than to diversified investors, employees, customers, suppliers, or creditors.[17]

---

[9] *Id*. at 343.
[10] *Id*.
[11] *Id*.
[12] *Id*.
[13] Andrew A. Schwartz, *McRitchie v. Zuckerberg: Fiduciary Duties are Firm-Specific*, CLS Blue Sky Blog (May 31, 2024), [https://perma.cc/3287-G9H3].
[14] *Id*.
[15] While the plaintiff's claim (that directors' fiduciary duties extend to stockholders as diversified investors, aimed at maximizing the overall value of their portfolios) seems hopeless at first glance, it is helpful to understand that Mr. McRitchie is an ardent corporate activist, advancing numerous claims each year in the Delaware Chancery. On his organization's website, aptly titled "Corporations are not Democratic-Free Zones," Mr. McRitchie outlines his mission to "help shareholders enhance the production of wealth by acting as long-term shareowners." He refers to his audience as the "corporate governance industrial complex" and notes on LinkedIn that he "files 40-90 shareholder proposals each year and teaches online classes on increasing corporate accountability."; CorpGov.net, *CorpGov.net: Corporations are not Democratic-Free Zones*, *CorpGov.net* (last visited Dec. 23, 2024), [https://perma.cc/83CP-7MDZ]; James McRitchie, LinkedIn, [https://perma.cc/2DA8-TPB9].
[16] McRitchie v. Zuckerberg, 315 A.3d 518, 527 (Del. Ch. 2024).
[17] *Id*. at 548.

While the outcome may seem unremarkable, as the Court suggested, the Court's opinion carries considerable weight. It strongly reinforces the shareholder primacy perspective, indicating that as long as directors uphold their duties of loyalty and care to stockholders in their firm-specific capacity, the Court will not intervene to ensure that directors address the needs of workers, consumers, or communities. This suggests that such matters are better suited to labor or antitrust law. More importantly, it implies that shareholder activists like James McRitchie may find greater success outside the realm of corporate litigation.

II. The Business Judgment Rule's Protective Veil

The courts' frequent invocation of the business judgment rule, which protects corporate directors and officers from being held liable for decisions they make in good faith is another reason why shareholder activists often fail to achieve their goals through litigation. As a standard of review, the business judgment rule often contradicts the aspirational goals of shareholder activists regarding corporate governance.

Let's consider a hypothetical company—Company X—whose board of directors transcends the typical "shareholder primacy" model by embracing a broader perspective on corporate governance known as "stakeholder governance." This approach may require shareholders to accept reduced returns to align with the company's core principles. Now, imagine that the stakeholders of Company X support the election of a specific candidate or believe a particular political party should dominate the legislature. What if these stakeholders pressure Company X to announce a particular political stance? Alternatively, consider a scenario where stakeholders wish to boycott a state due to policies the board disapproves of, even if those policies do not directly impact Company X's business. These are the kinds of concerns that shareholder activists often address.

By filing lawsuits against directors for failing to pursue these matters, shareholder activists aim to compel the board to allocate resources to political and social causes, even though most other shareholders typically have a shared interest in a good return on their investment and may not agree with using corporate resources for such purposes.[18] However, the business judgment rule directs courts not to question decisions made by boards that lack any intent to harm the corporation.[19] While the political and social issues raised by shareholder activists may be important, they typically do not indicate that the board intends to harm the company. As a result, these issues often prove too idealistic for the business judgment rule to address effectively in a legal

[18] Strine, *supra* note 7, at 343.
[19] *Id.* at 337.

context. Even if these causes could influence shareholder value—though often they do not—courts tend to dismiss them as not aligning with business interests because "shareholders do not sort themselves among companies according to their political preferences."[20]

In addition to a lack of liability for failing to meet aspirational standards of corporate governance, the reality is that directors are also rarely held liable for actions that may negatively impact shareholder value.[21] The standard for finding liability for a lack of director oversight, known as a "*Caremark*" claim, is only met by a showing of "sustained or systematic failure of a director to exercise reasonable oversight."[22] Moreover, liability is not premised on mere negligence, but on a showing that directors were *conscious* of the fact that they were engaged in systematic oversight failures.[23] The Delaware Court of Chancery has stated that even if a judge or jury believes a director's decision was so substantively wrong as to amount to being "stupid," "egregious," or "irrational," there is still no ground for director liability so long as the court determines that the process employed was either rational or employed in a good faith effort to advance corporate interests.[24] Indeed, a showing of bad faith is a necessary predicate to director oversight liability.[25] With *Caremark* claims, the plaintiff faces "the most difficult theory in corporation law upon which a plaintiff might hope to win a judgment."[26]

Thus, even if shareholder activists restrict themselves to bringing cases that solely address shareholder value (cases that do not extend into the more aspirational realm of "stakeholder governance"), it remains difficult to hold directors accountable for potential bad practices.[27] This reality has resulted in several scholars characterizing the business judgment rule's assumption that directors act in good faith not as a standard of liability, but as an abstention doctrine. Under this conception of the business judgment rule, the court will generally avoid examining the substantive merits of directors' conduct unless

---

[20] Lucian A. Bebchuk & Robert J. Jackson Jr., *Shining Light on Corporate Political Spending*, 101 Geo. L.J. 923, 942 (2013).

[21] Claudia A. Restrepo, *The Need for Increased Possibility of Director Liability: Refusal to Dismiss In re Wells Fargo & Co. Shareholder Derivative Litigation, a Step in the Right Direction*, 60 B.C.L. Rev. 1689, 1693 (2019), https://lawdigitalcommons.bc.edu/bclr/vol60/iss6/6.

[22] In re Caremark Int'l Inc. Derivative Litig., 698 A.2d 959, 971 (Del. Ch. 1996) [hereinafter Caremark].

[23] Guttman v. Huang, 823 A.2d 492, 506 (Del. Ch. 2003).

[24] Caremark 698 A.2d at 967-968 (explaining that the business judgment rule is process oriented and informed by a deep respect for all *good faith* board decisions).

[25] In re Citigroup Inc. S'holder Derivative Litig., 964 A.2d 106, 123 (Del. Ch. 2009) [hereinafter In re Citigroup Inc. S'holder Derivative Litig].

[26] Caremark 698 A.2d at 967.

[27] *See* In re Citigroup Inc. S'holder Derivative Litig., (declining to impose liability for failure to properly anticipate business risk in subprime lending market, even for a claim framed in a *Caremark* context); In re Walt Disney Co. Derivative Litig., 731 A.2d 342 (Del. Ch. 1998) (holding that a court will not apply 20/20 hindsight to second guess a board of director's business decision, except in rare cases where a transaction may be so egregious on its face that board approval cannot meet the test of business judgment).

there exists clear, indisputable evidence against them.[28] And unfortunately for many shareholder activists, accessing such evidence even when it may exist is no easy feat.

III. Caught in a Catch-22: The Evidence Challenge

We have determined that the ambitious goals of shareholder activists—such as prioritizing the environment, the workforce, diverse investors, and other stakeholders—are unlikely to achieve results through litigation. However, many shareholder activists, as previously discussed in relation to the business judgment rule, tend to focus more narrowly on issues that directly affect the value of a specific company.

In order to prove directorial mismanagement that affects firm-specific value, shareholders must provide evidence. To obtain this evidence, shareholders must gain access to the corporation's books and records under Delaware General Corporate Law § 220. Yet, the Delaware Supreme Court has held that shareholders making a books and records demand for purposes of investigating alleged wrongdoing must provide a "credible basis" for their claims—simply speculating is not enough.[29] Simply disagreeing with a business decision, without evidence that could lead the court to infer a potential breach of fiduciary duty, does not meet the credible basis standard.[30]

There's an ironic catch-22 in this evidentiary requirement. Imagine you're a major shareholder in a fictional motorcycle company called Vroom. Over the past two years, Vroom has consistently missed its sales targets and is losing value. The company claims that these shortfalls are due to temporary supply chain issues and insists there's still consumer demand. However, you and other shareholders are doubtful. You know that the entire motorcycle industry is struggling because consumers are shifting to more environmentally friendly transportation options, like regular bikes and scooters. You suspect that Vroom's directors are misleading shareholders about the temporary nature of this downturn, so you decide to take action and request to inspect Vroom's books and records.

If those records show that the board has been dishonest, you plan to sue them for breach of fiduciary duty. However, the court denies your request for access to the books and records, stating that your suspicions alone don't meet the "credible basis" standard needed to imply that the board is lying. The irony is that you need evidence to investigate the board's actions, but you can

---

[28] *See* Stephen M. Bainbridge, *The Business Judgment Rule as Abstention Doctrine*, 57 Vand. L. Rev. 83, 90 (2004).; Lyman Johnson, *The Modest Business Judgment Rule*, 55 Bus. Law. 625, 632 (2000).

[29] Joseph O. Larkin & Rupal Joshi, *Guidance on "Credible Basis" Standard for Obtaining Books*, 31 Insights 6, 26 (June 2017).

[30] Seinfeld v. Verizon Commc'ns, Inc., 909 A.2d 117, 120 (Del. 2006).

only obtain that evidence by inspecting the very records you're restricted from having access to. In essence, to uncover what you suspect, you need access to information you currently don't have.

This catch-22 in the evidentiary requirement is a key reason why shareholder activists often struggle to hold boards accountable, even for actual misconduct under the shareholder primacy model.[31] This is not to say that shareholder activists can never rely on § 220 to inspect a company's books and records. In fact, in recent years, plaintiffs have seen greater success in *Caremark* shareholder litigation. This success is largely due to plaintiffs effectively utilizing their inspection rights.[32] Delaware courts have actually broadened their interpretation of § 220, permitting shareholders greater access to internal documents, including informal electronic communications such as emails and private messages.[33] However, the *Caremark* shareholder litigation that has been more successful has typically centered on significant public safety issues and emergencies, including food safety crises and criminal medical malpractice cases.[34] In these cases, the evidence of corporate mismanagement went beyond the company's internal records, manifesting in observable injuries, fatalities, and criminal charges, making the consequences clear and detectable. Because these situations presented a higher likelihood of detecting such issues, oversight and compliance were more effectively enforced by the

---

[31] *See id.* (denying stockholder's request for access to Verizon's books and records to investigate alleged mismanagement and corporate waste related to executive compensation, as the stockholder's concerns about the large compensation amounts lacked a "credible basis" for claims of mismanagement); Haque v. Tesla Motors, Inc., No. CV 12651-VCS, 2017 WL 448594 (Del. Ch. Feb. 2, 2017) (denying plaintiff's demand to inspect Tesla's books and records to identify if Tesla had fabricated certain information regarding its sales misses because "merely offering a suspicion of wrongdoing is not enough to justify a Section 220 demand"); Se. Pennsylvania Transportation Auth. v. Abbvie Inc., No. CV 10374-VCG, 2015 WL 1753033 (Del. Ch. Apr. 15, 2015) (holding that a stockholder does not have a credible basis to investigate mismanagement or wrongdoing where the only identified use by the stockholder for the inspection was to help plead a later claim in litigation); Beatrice Corwin Living Irrevocable Tr. v. Pfizer, Inc., No. CV 10425-JL, 2016 WL 4548101 (Del. Ch. Aug. 31, 2016) (finding that plaintiffs failed to establish a credible basis from which the court could infer that the board utterly failed to implement an oversight system because plaintiffs could not access evidence focused on the board's compliance with its oversight duties to support the credible basis standard).

[32] *See* Roy Shapira, *A New Caremark Era: Causes and Consequences*, 98 WASH. U. L. REV. 1857, 1861 (2021).

[33] *Id.* at 1867, (citing KT4 Partners LLC v. Palantir Techs. Inc., 203 A.3d 738 (Del. 2019)).

[34] *See* Marchand v. Barnhill, 212 A.3d 805 (Del. 2019) (denying the defendant's motion to dismiss shareholders' claim of oversight failure following a listeria contamination in ice cream products that resulted in three deaths and a major recall); In re Clovis Oncology, Inc. Derivative Litig., No. 2017-0222-JRS, 2019 WL 4850188 (Del. Ch. Oct. 1, 2019) (denying pharmaceutical company's motion to dismiss shareholders' oversight claim when company failed to accurately report to the regulator and the market the true efficacy of a lung cancer therapy drug); *See* Teamsters Local 443 Health Services & Insurance Plan v. Chou, No. 2019-0816-SG, 2020 WL 5028065 (Del. Ch. Aug. 24, 2020) (finding sufficient pleading-stage evidence of multiple red flags overlooked by a drug company whose subsidiaries were involved in a criminal investigation for pooling oncology vial overfills not intended for patient use and repackaging them into syringes in a cancer drug repackaging scheme).

courts.[35] In addition, these particular cases may have been more successful because there may have been compelling public policy reasons to permit books and records inspections to ensure compliance. However, cases that provide clear evidence and raise significant public policy concerns are quite rare. The majority of shareholder activist plaintiffs do not have so much observable evidence and thus, the majority of these plaintiffs still face a very high threshold to prove failure of oversight. Without access to a company's books and records, it remains difficult for these plaintiffs to show that the directors consciously disregarded their duties in bad faith.[36]

Conclusion

While shareholder activism has gained momentum in addressing critical social and environmental issues, the landscape of American corporate governance presents significant obstacles to effecting meaningful change through litigation. Primarily, the entrenched shareholder primacy perspective prioritizes the interests of stockholders above all else, often sidelining broader stakeholder concerns. Additionally, the business judgment rule offers robust protection to directors, making it difficult for shareholder activists to challenge management decisions, even when those decisions may conflict with shareholder values. Compounding these challenges is the stringent evidence requirement, which demands a "credible basis" for claims, often leaving shareholder activists unable to access crucial information needed to hold directors accountable. Given these barriers, shareholder activists must shift their strategies away from litigation and towards initiatives that promote cultural change within corporations. This includes utilizing the universal proxy and engaging high-net-worth individuals to effect change from within, while also advocating for collaboration with other stakeholders to align management practices with the evolving expectations of a diverse array of constituents.

[35] *See* Shapira, *supra* note 32 at 1892 (noting that oversight compliance is better enforced by courts when there is a higher probability of detecting the problem).

[36] *See id.*