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Systemic Stewardship with Tradeoffs*

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Abstract

Many have started to look to the corporate sector to control carbon emissions, mitigate climate change, and redress other problems. But any serious effort to control carbon emissions (or other problems) will have winners and losers: companies that will benefit from reduction; and companies that will bear the brunt of mitigation efforts. In particular, concentrated carbon emitters such as oil exploration and production companies are likely to suffer. If so, who will force the carbon emitters to cut their carbon output? Who will be the agents of change in the corporate sector?

In recent years, the proponents of a corporate focused strategy have started to look to "universal owners" – the asset managers and owners that hold a significant swath of many public companies. Some commentators have argued that universal owners should use their influence in portfolio companies to maximize the value of the overall portfolio, rather than the value of any particular company. For some, this means that universal owners should adopt "systemic stewardship" that would push for market wide initiatives to reduce environmental externalities and control systemic risk (e.g., standardized climate risk disclosure). According to others, universal owners should pursue a more ambitious agenda and take affirmative steps to mitigate the risks of climate change to the long-term value of the portfolio by, for example, pushing carbon emitters to cut output, whether or not that promotes individual firm value.

But shareholders, even universal owners, do not manage companies. Rather, the business and affairs of a corporation are managed by full time senior management teams under the general oversight of a board of directors, within a framework created by corporate law. In this article, we analyze the extent to which universal owners can and should be expected to sacrifice single firm value even when doing so increases the value of the overall portfolio. We are quite pessimistic about the potential of systemic stewardship that entails substantial tradeoffs among portfolio companies.

This is for three principal reasons. First, universal owners would have to take into account the possibility that inducing some firms to reduce environmental externalities and mitigate risk will generate a competitive response that will eliminate the benefits from these actions for their other portfolio companies. If that were to happen, universal owners would be stuck with the losses without receiving any corresponding gains. Second, corporate law, as it currently stands, has a strong "single firm focus" ("SFF") that stands in sharp contrast to the potential "multi-firm focus" ("MFF") of large portfolio investors. If universal owners were to work individually or together to protect their overall portfolios from systemic risk, it would clash with corporate law in a fundamental way that could create significant risks of liability. Third, universal owners typically manage a wide variety of different portfolios for different clients each of whom is owed fiduciary duties. A "tradeoff" strategy that would benefit some portfolios at the expense of other portfolios would conflict with these fiduciary duties as well as with the core multi-client multi-portfolio business model. As a result, we expect that universal owners will not act in concert and will not openly pursue a MFF strategy. Rather, they will act unilaterally and under cloak of promoting single firm value. But because any serious effort to mitigate climate change will involve tradeoffs, we do not expect universal owners to be effective in controlling carbon emissions.

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Introduction

If you manage a "universal owner" – an asset owner or manager that holds a wide swath of public companies – should you look at each of your portfolio companies separately, and ask what is best for that company, or should you take a portfolio-wide approach? Should you focus your efforts on controlling systematic risks that can doom your whole portfolio (and the world) or try to rectify firm-specific problems that are already mitigated by wide diversification?[1] Should you care if one company's actions have adverse effects on other companies that you own? And if you and other universal owners collectively hold enough stock to exert substantial influence, should you use that influence with a company to reduce negative externalities and systematic risks to benefit your portfolio even if doing so reduces the value of that company? Should we expect – or demand – universal owners to become agents of change in the corporate sector, to force individual companies to make sacrifices for the benefit of the long term value of their portfolios and society as a whole?

Universal owners collectively hold a significant percentage of the shares of public companies, often with substantial holdings in individual portfolio firms.[2] Some commentators have argued that universal owners should use their influence in portfolio companies to maximize the value of their overall portfolio, rather than the value of any particular company.[3] For some, this means that universal owners should adopt "systemic stewardship" that would push for market-wide initiatives to control systematic risks (e.g., standardized climate risk disclosure, board diversity targets, etc.).[4] Others think universal owners should pursue a more ambitious agenda and take affirmative steps to mitigate risks to the long term

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[1] Jan Fichtner and Eelke Heemsker, The New Permanent Universal Owners, 49 Economy and Society 493, 495 (2020) ("We thus call BlackRock, Vanguard and State Street the 'New Permanent Universal Owners' as they are invested indefinitely in thousands of firms that are members of international stock indexes; they only divest when the composition of an index changes."); see also, James Hawley and Andrew Williams, The Emergence of Universal Owners, 43 Challenge 43 (2000); PRI, Universal Ownership: Why environmental externalities matter to institutional investors, https://www.unepfi.org/fileadmin/documents/universal_ownership_full.pdf ("Large institutional investors are, in effect, "Universal Owners", as they often have highly-diversified and long-term portfolios that are representative of global capital markets."). Matthew J. Kiernan, Universal Owners and ESG: Leaving Money on the Table?. Corporate Governance: An International Review, Vol. 15, No. 3, pp. 478-485, May 2007, Available at SSRN: https://ssrn.com/abstract=984340 or http://dx.doi.org/10.1111/j.1467-8683.2007.00580.

As will be discussed in more detail below, the entities to which commentators refer as "universal owners" – the large asset managers and owners who invest in many or most public companies – are, in fact, not really universal owners.

[2] For recent data, see Lucian Bebchuk & Scott Hirst, The Specter of the Giant Three, 99 B.U. L. Rev. 721 (2019).

[3] Frederick H. Alexander, The Benefit Stance: Responsible Ownership in the Twenty-First Century, 36 Oxford Review of Economic Policy 341, 356 (2020); Jeffrey N. Gordon, Systematic Stewardship (February 14, 2021). Columbia Law and Economics Working Paper No. 640, European Corporate Governance Institute - Law Working Paper No. 566/2021, Available at SSRN: https://ssrn.com/abstract=3782814; Madison Condon, Externalities and the Common Owner, 95 Washington L. Rev. 1 (2020); Majority Action, Climate in the Boardroom: How Asset Manager Voting Shaped Corporate Climate Action in 2019 https://www.majorityaction.us/asset-manager-report#:~:text=In%202019%2C%20the%20world's%20largest,climate%20and%20their%20irresponsible%20lobbying ; Trucost, Universal Ownership: Why environmental externalities matter to institutional investors (2011), https://www.unepfi.org/fileadmin/documents/universal_ownership_full.pdf.

[4] Gordon, Systematic Stewardship, supra note 3.

value of the portfolio, such as the risk of climate change, by pushing firms that emit carbon to cut output, whether or not doing so promotes the value of these firms.[5]

In this article, we analyze the extent to which universal owners can and should be expected to induce a firm to sacrifice itself in order to increase a universal owner's overall portfolio value. We are quite pessimistic that universal owners have the ability and inclination to do so. This is for three reasons. First, universal owners would have to take into account the possibility that inducing some firms to mitigate risk or reduce externalities will generate a competitive response that will eliminate the benefits from these actions for their other portfolio companies. If that were to happen, universal owners would be stuck with the losses without receiving any corresponding gains.

Second, shareholders, even universal owners, do not manage companies. Rather, the business and affairs of a corporation are managed by a full time senior management team under the general oversight of the board of directors, within a framework created by corporate law. But corporate law, as it currently exists, has a strong "single firm focus" ("SFF") that stands in sharp contrast to the potential "multi-firm focus" ("MFF") of large portfolio investors. If universal owners were to work individually or collectively to protect their overall portfolios from systemic risk, it would clash with corporate law in a fundamental way that could create risks of liability. Indeed, the more effective universal owners are in collectively constraining portfolio companies, the greater the legal risk.

Third, the largest and most important universal owners are asset managers – entities such as BlackRock, Vanguard, and Fidelity – that manage a wide variety of different portfolios for different clients and owe fiduciary duties to all of them. A centrally executed "tradeoff" strategy that would benefit some firms at the expense of others – and hence, in all likelihood, some portfolios at the expense of other portfolios – would conflict with the core multi-client multi-portfolio business model as well as with these fiduciary duties.[6] As a result, we expect that universal owners will not openly pursue a MFF strategy. Rather, if at all, they will act under the cloak of promoting single firm value. But because making substantial inroads on controlling systematic risks and reducing externalities involves tradeoffs that cannot be ignored while pretending to further single firm value, we do not expect universal owners to have much impact.

I. The Potential Benefits of "Systemic Stewardship"

a. Universal Owners and Externalities

Universal owners are larger than ever. Often, the largest asset owners and managers, firms such as BlackRock, BNY Mellon, CalPERS, CalSTRS, Capital Group, Fidelity, Norges Bank, State Street and Vanguard, will collectively hold more than 30% of the shares of even the biggest public companies. Because of their huge scale combined and market wide diversification, large universal owners, in principle, have financial incentives to induce firms to internalize intra-portfolio externalities – the effects

[5] See, e.g., Condon, supra note 3; Alexander, supra note 3.

[6] Similarly, universal owners that own assets – such as CalPERS and other pension funds – typically hold those assets in different segregated funds for different sets of beneficiaries and utilize a variety of investing strategies over a variety of asset classes. A "tradeoff" strategy that would advantage some funds or strategies at the expense of others would raise both legal and political issues.

of the actions by one firm on the value of other portfolio holdings – including environmental externalities.[7]

Rick Alexander, who was instrumental in developing benefit corporations and is the founder of "The Shareholder Commons" which pushes for systemic stewardship, argues that universal owners should take seriously the cost of externalities generated by portfolio companies:

> For example, because the first interest of UOs [universal owners] is in preserving healthy systems, investment fiduciaries can account for systemic costs when allocating capital or exercising control rights over it. Individual corporations that raid common resource pools or otherwise take actions that exploit social or environmental systems can be disciplined by fiduciaries representing UOs. The UO can be comfortable that if it persuades a portfolio company to act responsibly through engagement, and competitors of that company seek an advantage by continuing to act irresponsibly, the UO's relative returns will be protected by the overlap of its ownership with that of other UOs.[8]

Madison Condon has sharpened this perspective by providing a plausible and concrete hypothetical.[9] ExxonMobil alone is responsible for 1.2% of annual global emissions, while Chevron is responsible for another 0.8%.[10] Given the externalities from climate change to the rest of a market portfolio, she argues, it would make economic sense for universal owners to reduce ExxonMobil's and Chevron's carbon output significantly even at the cost of lowering ExxonMobil's and Chevron's stock price:

> Consider the analysis BlackRock makes when weighing whether or not to intervene to take a measure to curtail production at two firms, Chevron and Exxon. Assume this investor intervention forces each company to reduce its emissions by 40%, and this commitment results in that company's share price falling by 20%. . . If it loses 20% of the value of each of these assets, it will lose $6.3 billion total. . . [B]y intervening to reduce 1% of annual industrial emissions each year, BlackRock could avoid damages to its portfolio with a net present value of $9.7 billion. Because this value of mitigated damages outweighs the loss of share value from diminished expected fossil fuel profits by $3.4 billion, it would be in BlackRock's rational economic interest to pursue this intervention and internalize the intra-portfolio climate externalities.

Condon suggests that universal owners should pursue a true portfolio maximizing strategy by forcing the internalization of climate externalities. By her calculations, universal owners may be leaving huge amounts of money on the table by failing to act. Even more interestingly, she generates this strong

[7] For an early treatment of this perspective with reference to externalities of all sorts, see Robert G. Hansen and John R. Lott, Jr., Externalities and Corporate Objectives in a World with Diverse Shareholder/Consumers, 31 J. Fin. And Quantitative Analysis 43 (1996). The theoretical notion that common ownership may induce firms to internalize the effect of one firm's action on the value of other portfolio companies goes back to at least Daniel P. O'Brien & Steven C. Salop, Competitive Effects of Partial Ownership: Financial Interest and Corporate Control, 67 ANTITRUST L.J. 559 (2000).
[8] Alexander, supra note 3, at 356.
[9] Condon, supra note 3.
[10] Carbon Majors 2017 report cited in Condon, supra note 3, at n. 38.

result within a "shareholder value" paradigm, without considering the effects on other corporate stakeholders or society at large.

Similarly, a universal owner might push for strategies to reduce systematic risks from financial crises. Jeff Gordon explores such strategies in a recent paper and takes as his paradigm the reduction of the risk to the financial system posed by "systemically important financial firms" (SIFIs). A universal owner concerned with such systematic risk might vote "in support of management of a systemically important financial firm in a face-off with activist investors who want the firm to take greater risks to enhance shareholder returns."[11] As Gordon points out, one lesson of the 2007-09 financial crisis is that "the failure of a SIFI can indeed result in losses across an entire portfolio. In deciding whether to support the risk-loving activist, the index-fund advisor ought to consider not only the return proposition at a single firm but the systematic risk effects." In Gordon's account, systemic stewardship is primarily a "reactive" strategy that merely asks shareholders to vote against a "risk loving activist" and hence easier to implement than a "pro-active" strategy to implement a different risk profile, such as the strategy advanced by Condon.

Condon's approach highlights the tradeoffs – in her hypothetical, the values of ExxonMobil and Chevron decline substantially – but similar tradeoffs are present in Gordon's focus on the risks posed by SIFIs as well. A bank taking on "excessive" but legally permissible financial risk – just like ExxonMobil pumping "excessive" amounts of oil – generates a conflict between maximizing firm value and maximizing portfolio value. In both cases, we face the hard question of potential action by universal owners that produces a private and social good – reduction of environmental externalities or financial systemic risk – at the cost of sacrificing value at a portfolio company that is complying with existing regulations.[12]

These arguments about universal owners reducing environmental externalities or systematic risks have interesting parallels with the recent debate about anti-competitive effects from common ownership.[13] The starting premise of both instances is that institutional investors have the incentives and some power to increase the value of their entire investment portfolio even when doing so would reduce the value of some individual companies in their portfolio. In other respects, however, these arguments differ. First,

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[11] Gordon, supra note 3, at 3.

[12] John Armour and Jeff Gordon, in an article focused primarily on systemically important financial institutions, argue that corporate law's SFF results in excessive risk-taking from the perspective of the fully diversified shareholders and argue that this should lead to a change in corporate law fiduciary duties to promote a MFF. John Armour & Jeffrey Gordon, Systemic Harms and Shareholder Value, 6 J. Legal Analysis 35 (2014). Their argument can be extended to the governance of firms that generate climate externalities. Id. at 57.

[13] In a recent paper, Azar, Schmalz and Tecu present empirical evidence that common ownership of U.S. airlines by widely diversified investors may have resulted in higher ticket prices. Jose Azar, Martin C. Schmalz, and Isabel Tecu, Anticompetitive Effects of Common Ownership, 73 J Fin 1513, 1521-51 (2018). The results by Azar et al. have given rise to a significant body of scholarship, with varying results, on whether common ownership leads to anti-competitive effects. See, e.g., Andrew Koch, Panayides Marios & Thomas Shawn, Common ownership and competition in product markets, 139 Journal of Financial Economics 109 (2020); Mohammad Torshizi & Jennifer Clapp, Price effects of common ownership in the seed sector, 66 Antitrust Bulletin 39–67 (2021). A recent study by Azar and Vives attributes the initial results found by AST to common owners that are less diversified than universal owners. Jose Azar and Xavier Vives, Revisiting the Anticompetitive Effects of Common Ownership, Azar, José and Vives, Xavier, Revisiting the Anticompetitive Effects of Common Ownership (March 15, 2021). IESE Business School Working Paper, Available at SSRN: https://ssrn.com/abstract=3805047 or http://dx.doi.org/10.2139/ssrn.3805047
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universal owners taking steps to reduce environmental externalities or systematic risks would increase social welfare. By contrast, common owners taking steps to reduce competition in an industry – for example, by inducing an airline to cut capacity on certain routes – to generate positive externalities for competing airlines held by these owners (which could then raise their prices) hurts consumers and would reduce social welfare. Relatedly, universal owners embarking on reducing environmental externalities would have to be comparatively *less* concerned that their actions would expose them to certain legal liability (such as liability for violating antitrust laws), would generate an adverse reputational impact, or would prompt governmental regulation or even a break-up.[14] As a result, some of the barriers that may in practice prevent common owners from inducing anti-competitive effects do not apply with equal force in the environmental externalities and systematic risks context.[15] This being said, the true motives of owners may not always be clear. If say, a large asset manager pushed airlines to reduce capacity, or oil companies to reduce output, with the natural effect of increasing prices, it is not always clear whether they are acting to reduce the environmental harm from emissions or to make the industry more profitable.

b. **The Limits on Potential Benefits**

The arguments by Alexander, Condon and Gordon would seem to present grounds for optimism. To lay the groundwork for our analysis, however, it is important to put the incentives created by universal ownership into perspective. As we will explain in this section, universal owners will have incomplete and heterogeneous incentives to induce firms to internalize environmental, systematic risk-based, and other inter-firm externalities. Nevertheless, their incentives are likely to be substantially stronger than those of large undiversified owners or of managers incentivized to maximize firm value.

First, many universal owners like BlackRock and Vanguard are not *owners* at all. Instead, they manage the assets for investors. Indeed, even entities that are technically asset owners like CalPERS or CalSTRS, as distinguished from asset managers, are run by individuals for the benefit of the beneficiaries. As we and others have discussed elsewhere, the incentives of agents managing money are different than the incentives of the beneficiaries of those assets.[16] In particular, institutions like BlackRock and Vanguard do not benefit per se if the value of their portfolio securities increases; they benefit only to the much smaller extent that their management fees increase as a result of such value increase. While the

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[14] C. Scott Hemphill & Marcel Kahan. 129 Yale L.J. 1392, 1434-39 (2020) (detailing costs for common owners inducing portfolio companies to engage in anti-competitive actions). Some legal and reputational risks, however, would remain. For example, universal owners would face the legal risk that their actions breach their fiduciary duties to shareholders in undiversified funds or that politicians less concerned about climate change would push for increased regulation.

[15] Id at 1439-40. An additional difference is that anti-competitive effects of common ownership derive mostly from common ownership within a certain industry or in related industries, while the incentives for systemic stewardship are based on ownership across multiple, often unrelated, industries.

[16] See Edward Rock & Marcel Kahan, Index Funds and Corporate Governance: Let Shareholders be Shareholders, 100 B.U. L. Rev. 1753 (2020); Lucian Bebchuk & Scott Hirst, Index Funds and the Future of Corporate Governance: Theory, Evidence, and Policy, 119 Colum. L. Rev. 2029, 2037 (2019); 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 (2013), Hemphill & Kahan, supra note 14, at 1429-34.

incentives of institutions generally point in the right direction – their fees are based on the value of the portfolio securities they manage – they are much lower in scale and may sometimes be swamped by conflicting incentives.[17]

Second, universal owners are, at most, universal owners of businesses and thus will lack incentives to internalize externalities that fall on individuals. This is true for externalities that directly affect individuals – say, health effects from environmental harms – and for externalities that initially affect businesses but that businesses can transfer to individuals through the pricing mechanism – say, climate-change induced droughts that raise food prices.

Third, universal owners are not really *universal* owners of businesses. While some invest in private equity, private "pre-public" firms, and alternative asset classes like real estate,[18] most are primarily universal owners of *publicly traded* firms.[19] Moreover, U.S. based institutional investors – the most important universal owners for potentially influencing firm behavior – own a significantly greater fraction of U.S. firms than of non-U.S firms. This is due to two factors. First, publicly traded firms play a more significant role in the U.S. than in other countries.[20] Second, U.S. based institutional investors typically own a greater fraction of U.S. publicly traded firms than of non-U.S. publicly traded firms.[21] Institutional investors based in other countries tend to show similar local biases.[22]

Fourth, different universal owners have different allocations across different asset classes that create differing incentives. To start, the allocation of assets between debt and equity varies significantly among universal owners. Debt holdings, for example, are far less exposed than equity to climate change for at least three reasons: creditors get paid before shareholders; debt typically has a fixed return while equity receives a variable return; and debt has a limited, defined term while equity has an indefinite term. Because of these differences, a universal owner with more of its assets in "fixed income" securities will have different incentives regarding climate change than a universal owner mostly invested in equities.

In sum, the degree to which universal owners will have incentives to induce portfolio companies to internalize externalities will vary. It will vary by which industries are affected by the externalities, by whether the externalities are mostly local or global, and by whether the externalities affect individuals or businesses.

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[17] Hemphill & Kahan, supra note 14, at 1429-34 (showing how advisors may benefit from decline in aggregate portfolio value due to differential fees charged to different funds); Rock & Kahan, supra note 16, at 1781-1800, 1809-10 (analyzing incentives to large institutions and pointing to conflicts of interests).

[18] E.g., Blackstone, https://www.blackstone.com/the-firm/ .

[19] E.g., TIAA-CREF. https://www.tiaa.org/public/pdf/2Q21_Mutual_Fund_Capabilities_Overview.pdf.

[20] See, generally, Roberto Tallarita, The Limits of Portfolio Primacy, working paper 2021

[21] Id.

[22] Relatedly, publicly traded companies will account for varying market shares in different industries. For example, in the U.S., four publicly traded companies account for virtually the entire domestic commercial airline industry. By contrast, other industries – accounting services, legal services, restaurants, residential real estate – are dominated by privately held companies. As a result, universal owners would have an interest in promoting the value of industries like airlines— which are dominated by publicly traded firms – at the expense of industries like restaurants – which are not – even if doing so reduces overall business profits.

Nonetheless, universal owners hold highly diversified portfolios, in which each individual firm constitutes only a small fraction. Given the scale of their holdings, even the comparatively small additional fee income from an increase in portfolio value would, as we have shown elsewhere, generate meaningful benefits if a universal owner could reduce the negative externalities that a portfolio firm imposed on other portfolio firms.[23] While their incentives in this regard are not perfect, universal owners have significantly stronger incentives to constrain such externalities than undiversified shareholders of a company generating those externalities or than managers of such a company.

c. Externalities and Competition

The possibility that a given company's reduction of externalities may engender an offsetting competitive response poses a more severe challenge to the argument that universal owners stand to gain from inducing firms to reduce environmental externalities or systematic risks even if that generates tradeoffs. A competitive response can, depending on the circumstances, eliminate or greatly reduce any benefits from such reductions, leaving universal owners with a portfolio loss rather than the gain they had hoped to reap.

To see this, let us return to Condon's hypothetical. Condon posits that, by inducing Chevron and ExxonMobil to reduce their emissions by 40%, BlackRock would increase the value of its other holdings by $9.7 billion, leaving it $3.4 billion net gain even though the value of its stake in Chevron and ExxonMobil would decline by $6.3 billion.

Buried in these numbers is an important assumption: that the actions that Chevron and ExxonMobil take to achieve a 40% reduction in their emissions, which reduction in turn generates benefits for BlackRock's other holdings to the tune of $9.7 billion, will not induce other companies to take actions that *increase* their emissions. Whether this assumption is correct depends on *how* Chevron and ExxonMobil would reduce their emissions and, specifically, whether this opens up competitive opportunities for other companies.

Consider three possibilities. First, ExxonMobil could reduce its emissions by selling assets to other oil companies, as Shell recently did with its Permian Basin assets.[24] While such a sale would reduce carbon emissions at the company level, it is unlikely to affect annual overall emissions as the buyer would likely generate emissions at a level equivalent to those of the selling company.[25] Indeed, a sale to a less environmentally responsible operator could even increase emissions.[26]

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[23] See Kahan & Rock, supra note 16.

[24] Cara Lombardo and Collin Eaton, Shell to Sell Permian Assets to ConocoPhillips for $9.5 Billion, WSJ Sept. 20, 2021. https://www.wsj.com/articles/shell-near-deal-to-sell-permian-assets-to-conocophillips-11632168002?mod=Searchresults_pos13&page=1

[25] Sarah McFarlane, Shell Vows to Speed Up Emissions Cuts in Wake of Court Ruling, WSJ June 9, 2021 at https://www.wsj.com/articles/shell-to-speed-up-emissions-cuts-in-wake-of-court-ruling-11623236932?mod=article_inline

[26] Rachel Adams-Heard, What Happens When an Oil Giant Walks Away, BLOOMBERG (Apr. 15, 2021), https://www.bloomberg.com/graphics/2021-tracking-carbon-emissions-BP-hilcorp/ ("selling assets to less

Second, ExxonMobil may reduce its emissions by reducing production from existing reserves, while retaining ownership of those reserves. By hypothesis, ExxonMobil would have made profits by continuing production. If ExxonMobil cuts production, another oil company with a single firm focus could profitably raise production from one if its existing fields or start producing oil from a new field. And companies with a single firm focus abound in the oil industry. For one, there are many important foreign energy companies – Saudi Aramco, Russia's Rosneft and Gazprom, Kuwait Petroleum Corporation, Petróleos de Venezuela S.A., the Nigerian National Petroleum Corporation and China's Sinopec – that are unlikely to fall under the sway of universal owners because they are state-owned or held by less diversified investors.[27] Even within the U.S., there are about 9,000 independent oil producers[28] who develop 91 percent of the wells and account for 83 percent of U.S. oil and 90 percent of U.S. natural gas production.[29] Moreover, active investors who hold less diversified portfolios than universal owners could accumulate sufficient shares in some of the publicly traded U.S. oil companies to induce them to expand their production or exploratory activities. Similarly, a third party could offer to buy a publicly traded company with the goal of increasing production and making the company more valuable. Over the longer term, the number of independent oil producers would probably increase if public companies forego profit opportunities and other entities do not take up the slack. To the extent ExxonMobil's production cuts engender any of these competitive responses, BlackRock would suffer the $6.3 billion loss, while not obtaining the full, or maybe any, portfolio benefits from a decline in annual industrial emissions.

Whether such competitive responses would fully offset ExxonMobil's reduction depends on the extent to which ExxonMobil enjoys competitive advantages in producing oil. ExxonMobil's costs may be lower than those of its competitors, for example because of the location of the field reduces transportation costs or because the terrain of the field reduces extraction costs. At the price for crude oil prevailing before ExxonMobil's cut, it would then be unprofitable for some competitors to produce oil – otherwise they would have done so before ExxonMobil cut its emissions. ExxonMobil's cut could thus generate an increase in price and a corresponding increase in production by ExxonMobil competitors, albeit an increase by less than the initial ExxonMobil cut.[30] To that extent, there would be a net decline of emissions, but a smaller decline than ExxonMobil's reduction in emissions, and a correspondingly smaller benefit to BlackRock's other holdings. On the other hand, Saudi Arabia, a dominant oil producer, may try to manage the global supply and increase production to make up for ExxonMobil's cut

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scrupulous operators, you're not going to get overall emissions reductions", quoting Dan Gardiner, London School of Economics).

[27] See, e.g., Clifford Krauss, As Western Oil Giants Cut Production, State-Owned Companies Step Up, Oct. 14, 2021 NY Times https://www.nytimes.com/2021/10/14/business/energy-environment/oil-production-state-owned-companies.html?smid=em-share.

[28] The U.S. Internal Revenue Code section 613A(d) defines an independent producer as a producer who does not have more than $5 million in retail sales of oil and gas in a year or who does not refine more than an average of 75,000 barrels per day of crude oil during a given year.

[29] https://www.ipaa.org/independent-producers/.

[30] One study estimated the substitution at around 50%. Peter Erickson & Michael Lazarus, Would constraining US fossil fuel production affect global CO2 emissions? A case study of US leading policy, Climactic Change 150, 29-42 at p. 35 (2018), https://link.springer.com/article/10.1007%2Fs10584-018-2152-z

at the oil price prevailing before the cut. To that extent, ExxonMobil's actions, while reducing its emissions and its value, would have no effect on annual industrial emissions.

Third, ExxonMobil could reduce its emissions in ways that are unlikely to engender a competitive response. Rather than reducing its output, it could, for example, make its own production more energy efficient through changes in its operations. To illustrate with a trivial example, suppose that ExxonMobil chooses to reduce carbon output by installing energy efficient windows in its offices. [31] If these windows are not cost justified on their own, installing them would lower ExxonMobil's profits, but would not, at least in the short term, create competitive opportunities for other firms.[32]

That a company's actions designed to reduce externalities – ExxonMobil's emissions cut in our example – may engender a competitive response that eliminates the gain from such a reduction for universal owners affects their incentives in two ways. First, to the extent that it is easy to predict how competitors would respond and to evaluate the response, universal owners would have incentives to induce a reduction in externalities only in the subset of cases when such a reduction does not elicit a strong competitive response. Thus, in our example and using Condon's numbers, it would no longer make business sense for BlackRock to push for a 40% emissions reduction if competitive responses reduced portfolio gains by more than 35%.

Second, to the extent that it is not easy to predict how competitors would respond or to evaluate the response, the task that universal owners like BlackRock face is far more complicated than Condon's hypothetical suggests. It would require not only a valuation of the economic benefit generated by a reduction in emissions for BlackRock's portfolio companies and the economic costs to ExxonMobil and Chevron. It would also require an understanding of the ways in which ExxonMobil and Chevron would cut emissions, the competitive dynamics in the oil industry, the cost structure under which ExxonMobil, Chevron and its competitors operate, and the extent to which competitive opportunities would be exploited by publicly held companies in which BlackRock holds a stake or other entities.

By contrast, strategies that cut emissions without reducing profits pose far fewer problems. To vary Condon's hypothetical, assume that ExxonMobil cutting emissions by 4% would have no effect on its profits or even raise profits by a small amount (e.g. because the projects cut are not profitable at the margin) while at the same time increasing the value of other BlackRock's holdings by $0.97 billion. Since ExxonMobil's value would not decline, it would not be necessary to evaluate whether its emissions cut would engender a competitive response. Even though the emissions cut would have no significant effect on ExxonMobil's profits, it could benefit BlackRock.

Universal owners thus have clear-cut incentives to induce portfolio companies to take actions that have no material impact on their value (or increase their value) but reduce negative externalities for other portfolio companies. Importantly, this task would be much easier than a tradeoff strategy for two reasons. First, and more obviously, they would have to assess only the direction, but not the magnitude,

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[31] To be sure, other firms may not follow ExxonMobil's footsteps by installing energy efficient windows. If they do not, while other firms may be more profitable than ExxonMobil, they would not make even more money by installing even less energy efficient windows that before. Over the long term, ExxonMobil's reduced profitability may make ExxonMobil non-competitive and force it to scale down and ExxonMobil may be replaced by another firm. This may not happen for a long time, if it ever happens.

[32] Even this response may generate lower benefits. ExxonMobil's actions, for example, could lead to an increase in the price of energy efficient windows which would, in turn, induce others not to install energy efficient windows.

of externalities to determine whether the action is in their interests. Second, they would not have to worry about competitive reactions. But, of course, merely inducing companies to refrain from environmentally damaging actions that are not profitable offers far less potential for substantial reductions in environmental or other externalities.

II. The Deep Architecture of Corporate Law

Alexander, Condon, and Gordon each argue that an investor with a diversified portfolio has financial incentives to adopt a portfolio-wide or multi-firm focus, including when significant tradeoffs are required. Even when true, such an MFF is in tension with traditional corporate law principles in a variety of ways. These tensions are likely to inhibit universal owners from pursuing an MFF approach and to make that approach, if pursued, less effective.

In this part, we first describe corporate law's single firm focus. We then discuss how corporate law understands the interests of shareholders as the interests in a particular firm, unrelated to their extraneous interests, including interests derived from other holdings. Next, we summarize the board's obligation to manage for the benefit of *all* the shareholders and not just the most powerful ones. Finally, we review shareholders' general right to vote their shares selfishly and the traditional limits to that right. The single firm focus that emerges from these principles stands in the way of implementing systemic stewardship with tradeoffs.

a. Corporate Law's Single Firm Focus

The traditional description of the properties of the corporate form is that "the objective of a corporation is to promote the value of the corporation, within the boundaries of law, for the benefit of the corporation's shareholders."[33] This description includes two key aspects: first, the objective of a corporation is to promote the value of *this particular corporation*; second, promoting the value of this corporation is for the benefit of *all* its shareholders. The SFF of corporate law has not received nearly as much attention as the issue of whether corporations are managed for the benefit of the shareholders (sometimes referred to as "shareholder primacy") or for some broader group of stakeholders ("stakeholderism"), possibly because the SFF is so fundamental to corporate law and corporate governance that it is hardly noticed.

Here we describe just some of the ways in which SFF is a fundamental principle in corporate law. First, the critically important business judgment rule – the commitment that courts will not second-guess business judgments – is entirely SFF. As the Delaware Supreme Court explained in *Aronson v. Lewis*, the business judgment rule creates a "presumption that in making a business decision, the directors of a corporation acted on an informed basis [i.e., with due care], in good faith and in the honest belief that the action taken was *in the best interest of the company*."[34]

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[33] See ALI, Restatement of the Law, Corporate Governance, § 2.01(a) (ALI Council Draft No. 1, September 7, 2021).

[34] Aronson v. Lewis, Del. Supr., 473 A.2d 805, 812 (1984)(emphasis added). As discussed below, the best interest of the company intrinsically includes the interests of shareholders qua shareholders (or, from a stakeholder perspective, the interest of other stakeholders, qua stakeholders), but does not include the extraneous interests of shareholders.

Fiduciary duties are likewise single firm focused. As expressed in numerous decisions, "directors owe fiduciary duties to the corporation and its shareholders."[35] Similarly, the classic language from *Guth v. Loft, Inc.*[36] has a clear SFF:

> A public policy, existing through the years, and derived from a profound knowledge of human characteristics and motives, has established a rule that demands of a corporate officer or director, peremptorily and inexorably, the most scrupulous observance of his duty, not only affirmatively to protect the interests of the corporation committed to his charge, but also to refrain from doing anything that would work injury to the corporation, or to deprive it of profit or advantage which his skill and ability might properly bring to it, or to enable it to make in the reasonable and lawful exercise of its powers. The rule that requires an undivided and unselfish loyalty to the corporation demands that there shall be no conflict between duty and self-interest.

The fiduciary duty of loyalty has been summarized as mandating "that the best interest of the corporation and its shareholders take[] precedence over any interest possessed by a director, officer or controlling shareholder and not shared by the stockholders generally."[37] Indeed, the very definition of what counts as an "interested" director or controller distinguishes between the interest of a specific corporation and a fiduciary's extraneous interests. Generally, a director or controller is "interested" in a transaction or conduct involving a corporation if the director or controller is a party to the transaction or conduct or if the director or controller receives a benefit as a result of the transaction or conduct that is not shared pro rata according to the number of shares held. "Interest" is thus relative to a particular corporation, with interests derived from other portfolio holdings – which could generate benefits to a director or controller that is not shared pro rata according to the number of shares – rendering a director or controller not disinterested.

Definitions of "good faith" and the related concept of "bad faith" are also SFF. In Chancellor Chandler's detailed exploration of Delaware precedent in *In re Walt Disney Co. Derivative Lit.*,[38] he captured this SFF:

- "Bad faith has been defined as authorizing a transaction 'for some purpose other than a genuine attempt to advance corporate welfare . . .'"[39]
- "Bad faith (or lack of good faith) is when a director acts in a manner 'unrelated to a pursuit of the corporation's best interests.' It makes no difference the reason why the director intentionally fails to pursue the best interests of the corporation."[40]

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[35] See, e.g., Mills Acquisition Co. v. MacMillan, Inc., 559 A.2d 1261, 1280 (Del. 1988).

[36] Guth v. Loft, Inc., 5 A.2d 503, 510 (Del. 1939).

[37] Cede & Co. v. Technicolor, 634 A.2d 345, 361 (Del. 1992 (citing Pogostin v. Rice, 480 A.2d 619, 624 (Del. 1984)), cited in In re Walt Disney Co. Derivative Litigation, 907 A.2d 693, 751 n. 434 (Del. Ch. 2005).

[38] 907 A.2d 693, 753 (Del. Ch. 2005)

[39] Id. at 753 citing Gagliardi, 683 A.2d at 1051 n.2 (citing Miller v. AT&T, 507 F.2d 759 (3d Cir. 1974), emphasis in original).

[40] Id. at 754 (footnotes and citations omitted).

- "To act in good faith, a director must act at all times with an honesty of purpose and in the best interests and welfare of the corporation."[41]
- "The good faith required of a corporate fiduciary includes not simply the duties of care and loyalty . . . but all actions required by a true faithfulness and devotion to the interests of the corporation and its shareholders."[42]

The outrage with which courts view fiduciaries with conflicting interests is another indication of the SFF of fiduciary duties. As the Delaware Supreme Court thundered in *Weinberger v. UOP*, "there is no 'safe harbor' for . . . divided loyalties in Delaware. . . There is no dilution of this obligation where one holds dual or multiple directorships . . . "[43]

Finally, in the Delaware court's review of defensive tactics in control contests under the *Unocal/Unitrin* standard, there is a clear SFF. The board's power to act in response to a tender offer "derives from its fundamental duty and obligation to protect the corporate enterprise, which includes stockholders, from harm reasonably perceived, irrespective of its source."[44] When responding to a pending takeover bid, the board "has an obligation to determine whether the offer is in the best interests of the corporation and its shareholders." Given the "omnipresent specter that a board may be acting primarily in its own interests, rather than those of the corporation and its shareholders," the court announced a threshold examination before the business judgment rule would attach. In this examination, the first step is the identification of a "danger to corporate policy and effectiveness."[45]

The limit case – a company with wholly owned subsidiaries – highlights the single firm focus of the normal case. Wholly owned subsidiaries present a special case because, by construction, there are no possible conflicts of interests among shareholders. While the law is clear that the directors of a solvent wholly owned subsidiary should pursue the interests of the parent company,[46] in all other cases (e.g., a partially owned subsidiary), the directors must pursue the interests of the subsidiary itself.[47] Put differently, extraneous interests of shareholders – as to which shareholder interests may conflict – are problematic except in the special case in which there is no potential for conflicts of interest among shareholders because the company has only a single shareholder.

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[41] Id. at 755.
[42] Id. at 755.
[43] Weinberger v. UOP, 457 A.2d 701, 710 (1983).
[44] Unocal Corp. v. Mesa Petroleum Corp., 495 A.2d 946, 954 (Del. 1985) citations omitted.
[45] Indeed, the *Unocal* court's explicit rejection of Frank Easterbrook and Dan Fischel's "passivity" thesis (see Frank H. Easterbrook and Daniel R. Fischel, The Proper Role of a Target's Management in Responding to a Tender Offer, 94 Harv. L. Rev. 1161, 1175-80 (1981)) is, in significant degree, a rejection of the MFF that formed the foundation of their argument. As they argued, the increased merger premium that defensive measures might secure was unimportant as it was largely a transfer among fully diversified shareholders, while the threat of hostile tender offers would increase the value of their overall portfolios.
[46] Trenwick American Litigation Trust v. Ernst & Young, LLP, 906 A.2d 168, 201 (Del. Ch. 2006), citing Anadarko Petro. Corp., 545 A.2d at 1174 (citing Sinclair Oil Corp. v. Levien, 280 A.2d 717, 720 (Del. 1971)). See also Quadrant Structured Prods. Co. v. Vertin, 102 A.3d 155, 184 (Del. Ch. 2014).
[47] For an interesting discussion of these SFF principles as applied to directors appointed by a particular shareholder or group of shareholders, see Travis Laster & John Mark Zeberkiewicz, The Rights and Duties of Blockholder Directors, 70 Bus. Law. 33 (2015).

b. Single Firm Focus, Shareholder Primacy and Stakeholderism

As noted above, in the traditional formulation, the corporation is managed "for the benefit of shareholders" and the articulation of various duties often talks about "the corporation and its shareholders." This raises two important issues. First, how does corporate law understand shareholders' interests. Second, how does SFF relate to the ongoing debate over whether corporate law does, and should, enshrine "shareholder primacy:" the principle that the corporation should be managed for the principal benefit of its shareholders, rather than for the benefit of multiple constituencies, such as employees and customers.[48]

In the traditional understanding, the focus is on shareholders *qua* shareholders of a particular firm, taking into account their interests only insofar as the interests relate to shareholders' relationship with the company and, importantly, ignoring their "extraneous" or outside interests, including their portfolio interests.

The focus on shareholders *qua* shareholders of a given corporation – to the exclusion of shareholders' extraneous interests – is best illustrated by *Revlon.*[49] *Revlon* involved a bidding contest for Revlon between Forstmann and Pantry Pride, a company owned by Ronald Perelman. In the contest, the board of Revlon had accepted a bid by Forstmann that entailed a lockup and cancellation fee for the benefit of Forstmann valued at $125 to $200 million.[50] In exchange, Forstmann had promised to support the par value of Revlon's Senior Subordinated Notes, that had declined in value after the Revlon board agreed to waive certain note covenants.[51] The court's opinion criticized the board's attempt for secure benefits for Revlon's noteholders, holding that "concern for non-stockholder interests is inappropriate" when a company is sold for cash.[52]

While *Revlon's* holding is often cited as an endorsement of shareholder primacy,[53] its significance extends further. The Senior Subordinated Notes that Forstmann had promised to support had been issued by Revlon only one month earlier pursuant to an exchange offer for its own shares in which 87% of Revlon's shareholders participated.[54] When the exchange offer closed, the vast majority of Revlon's shareholders also became noteholders, and all noteholders were also Revlon shareholders. In all likelihood, this picture had not changed fundamentally by the following month. As Revlon Senior Subordinated Noteholders were largely Revlon shareholders, supporting the price of the notes would have benefitted these shareholders. Nevertheless, the Delaware Supreme Court was clear that this type of benefit – which derives from shareholders' extraneous interests (the ownership of Senior

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[48] For some recent contributions to this debate, see, e.g., Donald C Langevoort, The Effects of Shareholder Primacy, Publicness, and "Privateness" on Corporate Cultures. Berle XI: Law and Corporate Culture. 43 Seattle U. L. Rev. 377 (2020); Jeff Schwartz, De Facto Shareholder Primacy. 79 Md. L. Rev. 652 (2020); Ramsi A. Woodcock, The Antitrust Case for Consumer Primacy in Corporate Governance. 10 UC Irvine L. Rev. 1395 (2020);

[49] Revlon, Inc. v. MacAndrews & Forbes Holdings, Inc., 506 A.2d 173 (Del. 1985).

[50] Id. at 178.

[51] Id. at 179.

[52] Id. at 182.

[53] See, e.g., Matthew T. Bodie, AOL Time Warner and the False God of Shareholder Primacy, 31 J. Corp. L. 975, 979 (2006) ("The clearest victory for shareholder primacy in the law of mergers and acquisitions is Revlon, Inc. v. MacAndrews & Forbes Holdings, Inc.").

[54] 506 A.2d at 177.

Subordinated Notes by persons who also happen to be Revlon shareholders) rather than their interests *qua* shareholders – should have been ignored.

While stakeholderism expands the range of interests that count to include non-shareholder constituencies, the single firm focus remains. In a stakeholder jurisdiction, the board is typically given permission to consider non-shareholder interests (e.g., the interests of employees or creditors), but the permission is in the context of "considering the best interests of the corporation."[55] This clear SFF implies that only the interests of shareholders *qua* shareholders of this company, the interests of employees *qua* employees of this company, or the interests of creditors *qua* creditors of this company, should enter the company's calculus. Indeed, given the variety of extraneous interests that can arise as one considers additional stakeholders, a stakeholder approach may be even more SFF than a shareholder primacy view. As a result, the shareholder versus stakeholder debate is largely orthogonal to our concerns here: both approaches incorporate a deep SFF.

Because shareholder primacy remains the dominant framework under which most corporations operate, the discussion in this paper is mostly premised on shareholder primacy. However, it bears noting that the arguments advanced by Alexander, Condon and Gordon are weaker under stakeholderism than in a shareholder primacy setting. Their arguments rely on the existence of large, highly diversified *shareholders* with huge extraneous portfolio interests that swamp their interest in any particular firm. For example, BlackRock's holdings in ExxonMobil account for less than 0.5% of its $3.6 trillion domestic equity portfolio.[56] Other corporate constituents – employees in particular – are not equally diversified and therefore hold comparatively smaller extraneous interests. A decision by ExxonMobil to cut its emissions by 40% – raising the prospect that many employees would lose their jobs or that the company would buy less from some of its major suppliers – may well not be in the interests of ExxonMobil's stakeholders even if it benefitted ExxonMobil's universal shareholders.

c. Corporate Law's "Egalitarian" Focus: for *all* the shareholders

When it is said that a corporation is managed "for the benefit of the shareholders," what exactly does that mean? For the benefit of which shareholders?

If shareholder interests are understood as the interests of shareholders *qua* shareholders of a given company – abstracting from the interests of the actual shareholders who will often have "extraneous" interests – then the principal focus is on the interest that all shareholders have in common, namely, maximizing the value of the company. This results in a highly stylized conception of shareholders' interests that often departs from shareholders' actual interests, and, in doing so, avoids all of the complex issues that arise in reconciling heterogeneous interests and preferences.[57]

Shareholders, of course, may have different views on *how* a company should go about in maximizing its value. From the beginning, corporate law has embraced indirect majority rule, providing for the election

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[55] 15 Pa. Consol. Stat. § 1715.

[56] BlackRock Inc. Form 13F, Sep. 30, 2021, available at https://www.sec.gov/Archives/edgar/data/0001364742/000108636421000104/xslForm13F_X01/primary_doc.xml . Form 13F excludes most debt securities and foreign equity securities.

[57] See, generally, Henry Hansmann, The Ownership of Enterprise (2000).

of directors by a majority or plurality of the shares voting, while tasking directors with the management of the company.

Giving power to holders of a majority of shares, however, generates a problem. Holders of a majority of shares may use their power not merely to resolve differences of opinion on how to maximize the value of the corporation for shareholders at large, but to pursue their extraneous self-interest. This problem is most acute if there is a single shareholder, or a group of affiliated shareholders, who own a majority of the shares or otherwise control the corporation.

One way to constrain this abuse was to require that the majority's power to decide be deployed for the benefit of *all the shareholders*. Thus, in *East Rome Town Co. v. Nagle*,[58] a court blocked the attempt of a majority shareholder to convert a toll bridge owned by the corporation into a free bridge (which would have advantaged the majority shareholder) on the grounds that the corporation must use the bridge franchise for the profit of the corporation, and thus for all shareholders ratably. Similarly, in *Ervin v. Oregon Railway & Navigation Co.*,[59] the court recognized the power of the majority to dissolve the corporation, but then required that the majority account to the minority for the fair value of the assets sold.[60]

This principle also has deep roots in Delaware corporate law. In *Allied Chem. & Dye Corp. v. Steel & Tube Co. of Am.*, a seminal decision on the fiduciary duties of a controlling stockholder, the court stated that:

> The same considerations of fundamental justice which impose a fiduciary character upon the relationship of the directors to the stockholders will also impose, in a proper case, a like character upon the relationship which the majority of the stockholders bear to the minority. When, in the conduct of the corporate business, a majority of the voting power in the corporation join hands in imposing its policy upon all, it is beyond all reason and contrary, it seems to me, to the plainest dictates of what is just and right, to take any view other than that they are to be regarded as having placed upon themselves the same sort of fiduciary character which the law impresses upon the directors in their relation to all the stockholders. Ordinarily the directors speak for and determine the policy of the corporation. When the majority of stockholders do this, they are, for the moment, the corporation. Unless the majority in such case are to be regarded as owing a duty to the minority such as is owed by the directors to all, then the minority are in a situation that exposes them to the grossest frauds and subjects them to most outrageous wrongs. [61]

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[58] 58 Ga. 474 (1877).

[59] 27 F. 625, 630 (S.D.N.Y. 1886).

[60] As Gordon Smith points out, this principle is the origin for what we now think of as the shareholder primacy norm. Gordon Smith, The Shareholder Primacy Norm, 23 J. Corp. Law 277, 279 (1998)("Nevertheless, when early courts employed rules requiring directors to act in the interests of all shareholders – not just the majority shareholders – they were creating the shareholder primacy norm.")

[61] 120 A. 486, 491 (Del. Ch. 1923) (collecting authorities); accord Epstein v. Celotex Corp., 238 A.2d 843, 847 (Del. Ch. 1968); see 18 C.J.S. Corporations § 394 ("When a stockholder exercises control over the corporation by directing its actions, the stockholder assumes the same fiduciary duties as those owed by a director to the corporation."). Cited and discussed by VC Laster in Firefighters' Pension System of the City of Kansas City, Missouri Trust v. Presidio, Inc., 2021 Del. Ch. LEXIS 15 at *81-82.

The board's obligation to manage the corporation for the benefit of all the shareholders has, over time, extended to imposing limited fiduciary duties on controlling shareholders. Unlike officers and directors, shareholders do not automatically owe fiduciary duties to the corporation. Rather, shareholders take on fiduciary duties when they become controllers, whether as a result of owning a majority of the corporation's shares or as a result of exercising actual control. Corporate transactions or conduct in which a controller has an interest that is different from the general shareholder interest hence trigger the duty of loyalty. Thus, for example, when a controller freezes out non-controlling shareholders in a going-private transaction, the controller must establish the fairness of the transaction unless it adopts procedures that cleanse the transaction of the taint of self-dealing.[62]

The use of majority power to oppress minority shareholders in closely held corporations developed into the "minority oppression" remedy,[63] but the underlying principle remains the same: the corporation must be managed for the benefit of all the shareholders and not just the majority shareholder.[64]

d. **Shareholders' Limited Duties: Selfish Voting**

There are two respects in which corporate law bows to the right of shareholders to pursue their extraneous self-interest: any shareholder, including a controller, may generally vote and sell shares selfishly. In the leading Delaware case, *Bershad v. Curtiss-Wright*, the plaintiff argued that the majority

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[62] Kahn v. M & F Worldwide Corp., 88 A.3d 635 (Del. 2014). But controllers' duties *may* extend further. As Chancellor William T. Allen explained, "when a shareholder, who achieves power through the ownership of stock, exercises that power by directing the actions of the corporation, he assumes the duties of care and loyalty of a director of a corporation." Cinerama, Inc. v. Technicolor, Inc., 1991 WL 111134, at *19 (Del.Ch.)(Allen, C.), aff'd in part, rev'd on other grounds sub nom, 634 A.2d 345 (Del.1993), cited and quoted with approval in Pfeffer v. Redstone, 965 A.2d 676, n. 52 (Del. 2009). See also, Harris v. Carter, 582 A.2d 222, 234 (Del. Ch. 1990) (Allen, C.) (citing Sterling v. Mayflower Hotel Corp., 93 A.2d 107, 109–10 (Del. 1952)("when a shareholder presumes to exercise control over a corporation, to direct its actions, that shareholder assumes a fiduciary duty of the same kind as that owed by a director to the corporation."). Here, Chancellor Allen explained, the protective device of fiduciary duties substitutes for the "protection that a corporation or its shareholders ordinarily receives from the business judgment of the men and women who comprise the company's board of directors." Id.

[63] Gordon Smith, supra note 60, at 310-22.

[64] The U.K. cases reflect a similar "abuse of majority" principle according to which majorities must use their power over the corporation for the benefit of all, at least in some circumstances. In the leading 1900 case of *Allen v. Gold Reefs of West Africa Ltd*, [1900] 1 Ch 656 at 671, [1900–3] All ER Rep 746 at 749 - 750, the court held, in relation to a power conferred on the majority of shareholders to alter the articles of association, that:

> The power thus conferred on companies to alter their articles is limited only by the provisions contained in the statue and the conditions contained in the company's memorandum of association. Wide, however, as the language of s. 50 [of the Companies Act 1862] is, the power conferred by it must, like all other powers, be exercised subject to those general principles of law and equity which are applicable to all powers conferred on majorities and enabling them to bind minorities. It must be exercised, not only in the manner required by law, but also bona fide for the benefit of the company as a whole, and it must not be exceeded. These conditions are always implied, and are seldom, if ever, expressed.

See, also, the discussion of this principle in connection with bond exit consents in Asseinagon v. Irish Bank. While the development of this principle in U.K. company law is complex (for reasons explored below), and the decisions to which it applies remain unclear, the core concern with minority oppression remains alive and important. Indeed, the key phrase from *Allen v. Gold Reefs* – "bona fide for the benefit of the company as a whole" – captures both of the aspects we have been discussing. The actions must be bona fide for the benefit of *this* company, and for the benefit of this company *as a whole* (and not just for the benefit of the majority).

shareholder's policy against selling its controlled subsidiary breached its fiduciary duties. Rejecting this claim, the Delaware Supreme Court provided the iconic statement that is typically cited for the proposition that shareholders, including controlling shareholders, may vote selfishly:

> Stockholders in Delaware corporations have a right to control and vote their shares in their own interest. They are limited only by any fiduciary duty owed to other stockholders. It is not objectionable that their motives may be for personal profit, or determined by whim or caprice, so long as they violate no duty owed other shareholders.[65]

In our context, what is so interesting about this statement is its limitations, "so long as they violate no duty owed to other shareholders." When applied to controllers, this imports the case law imposing duties to other shareholders when acting through the board.

The right to vote selfishly is conceptually most important when shareholders vote on board proposals *other than* the election of directors. Thus, shareholders are legally free to oppose and defeat a merger or a charter amendment for extraneous self-interested reasons, even if they acknowledge that the measure would be valuable for the company. To be sure, shareholders may also cast votes for directors "for personal profit." But directors are not permitted to further the personal profits of some shareholders and at least controlling shareholders could be subject to personal liability if directors did so. While fiduciary duty law in these respects is surely not perfectly enforced, it imposes substantial constraints on the ability of most shareholders to benefit from selfish votes in director elections and practical limits on how shareholders and directors campaign for elections. By contrast, when a controlling shareholder intervenes in the governance directly and not in response to a board proposal– e.g., through the enactment of a bylaw – the limitation on *Bershad's* permission to vote selfishly becomes relevant: a shareholder adopted bylaw may be held void if adopted for an inequitable purpose.[66]

Shareholders are also free to vote in their self-interest on precatory shareholder resolutions. Votes on precatory shareholder resolutions fall between votes on director elections and votes on bylaw amendments. On one hand, these resolutions are not self-effecting but are addressed to the board. And the board, of course, has to consider its own fiduciary duties in deciding whether to heed them. On the other hand, directors themselves are not directly involved in these resolutions. This dual nature means that shareholders may sometimes campaign openly in favor of resolutions on the basis of goals other than the best interest of the corporation. But if such a resolution then obtains majority support, such campaigning would make it harder for directors to implement the resolution.

III. Implementing Climate Stewardship

Let us assume that Condon is correct that ExxonMobil and Chevron, by reducing their carbon production by 40%, would substantially increase the value of the portfolios of universal owners despite the fact that ExxonMobil's and Chevron's stock price would decline by 20%. How might universal owners induce ExxonMobil and Chevron to cut their carbon emissions? What legal and political risks would it entail?

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65 Bershad v. Curtiss-Wright, 535 A.2d 840, 845 (Del. 1986).

66 Hollinger Int'l v. Black, 844 A.2d 1022, 1080-82 (Del. Ch. 2004), affirmed 872 A.2d 559 (Del. 2005) (bylaw adopted by controlling shareholder void because adopted for inequitable purpose).

Are there alternative strategies with less legal risk? Would those alternative strategies significantly reduce carbon emissions?

a. **Embracing the Hypo with Enthusiasm: a hypothetical campaign**

Suppose that BlackRock, Vanguard and State Street ("BVS"), the three largest universal owners, were to team up explicitly to elect new boards at ExxonMobil and Chevron committed to reducing their carbon output by 40%, despite clear evidence that doing so would substantially reduce their stock prices.[67] Let us suppose, for instance, that they enter into a shareholders' agreement committing themselves to vote together for a jointly selected slate, jointly retain a proxy solicitor and other professionals, and campaign for their slate based on the portfolio benefits an emissions cut would generate. What regulatory or corporate law obstacles and risks would they run?

First, having formed a "group" for the purpose of voting their shares, they would no longer qualify to file Schedule 13G but would now have to file a joint Schedule 13D disclosing their holdings and amend that filing when holdings or intentions changed. While filing a Schedule 13D would not, itself, be particularly burdensome, amendments would add to the burden and filing a Schedule 13D would necessitate a fundamental change in practice, as each adviser currently files only Schedule 13Gs.

Second, this group of universal owners collectively holding more than 10% would likely find itself subject to Section 16 of the Securities Exchange Act.[68] Section 16(b) requires the disgorgements of any "short swing" profit made or loss avoided from "any purchase and sale, or any sale and purchase" within six months.[69] This would be very burdensome for BlackRock, Vanguard and State Street as they constantly buy and sell shares as money flows into and out of their funds and thus engage in substantial short swing trading.

Third, having shifted from being "passive" holders to being "active" holders, the Hart-Scott-Rodino Act would impose advanced notice and pre-clearance requirements on additional purchase of shares of either company.[70] In periods when additional funds are flowing into their index funds, this would increase tracking error and expenses.

Even more concerning would be the risks under Delaware corporate law. Let us assume that BVS's campaign is successful, their slate of directors is elected, and the boards of ExxonMobil and Chevron

[67] The actual calculation required by Condon's hypothetical, with its tradeoff over various margins, is complex. It is unclear whether universal owners, as currently configured, have the expertise to calculate such tradeoffs accurately. Were this to become a major strategy, however, they could acquire the expertise.

[68] Section 16 incorporates the Section 13(d) concepts of beneficial ownership. Rule 16a-1(a)(1); CSX v. TCI, 654 F.3d 276, 290-94 (2d Cir. 2011)(Winter, concurring). See also, Rubenstein v. International Value Advisers LLC, 959 F.3d 541 (2d Cir. 2020). The filing of a Schedule 13D by BVS would likely disqualify BVS from relying on the 13G Institution exemption from 16(b) under Rule 16a-1. SEC, Ownership Reports and Trading by Officers, Directors and Principal Security Holders, SEC Release No. 27148, 24942, 17112, 34-27148, , 54 FR 35667, 1989 WL 1093497 (1989).

[69] Securities Exchange Act § 16(b), 15 U.S.C. § 78p.

[70] On the limitations that the Hart-Scott-Rodino exemption of purchases "solely for the purpose of investment" imposes on active engagement by the largest institutional investors, see Edward Rock, Comments on 16 CFR parts 801-803: Hart-Scott-Rodino Coverage, Exemption, and Transmittal Rules; Project No. P110014 (January 28, 2021) available at https://www.regulations.gov/comment/FTC-2020-0085-0005

commit to implementing a 40% emission cut, resulting in an immediate 20% drop in the stock price. In the wake of the boards' decision and the drop in the stock price, litigation is brought on behalf of ExxonMobil and Chevron shareholders against the directors of each company and against BlackRock, Vanguard and State Street both as a collective "controlling shareholder" and for "aiding and abetting" the directors' breaches of their fiduciary duties. The lawsuit alleges, with detailed support, that the decision to cut carbon emissions was made to benefit the extraneous interests of the universal owners of the companies rather than ExxonMobil and Chevron.

In this robust form of climate change activism – in which universal owners team up to elect a new board committed to a strategy with substantial tradeoffs – these would be very substantial claims. We will briefly work through the steps.

First, while the claims would be derivative – the harm to shareholders derives from the reduction in the value of ExxonMobil and Chevron by virtue of adopting BVS's low carbon emissions strategy[71] – demand would clearly be excused: by hypothesis, a majority of the directors intentionally pursued a strategy that reduces company value for the extraneous benefit of a group of shareholders and, we will show, faces potential liability.[72]

Second, on the merits, the claims against the directors would be strong. This extreme hypothetical, unrealistically, comes close to a confession of disloyalty. After all, the BVS campaign, by its terms, seeks portfolio benefits for BVS while acknowledging that it will harm ExxonMobil and Chevron. With respect to the directors, corporate law's fundamental principles described above – the SFF and the "egalitarian" commitment to managing the corporation for the benefit of all the shareholders and not just the most powerful – would both condemn the conduct. The goal of benefiting the portfolio interests of powerful shareholders over the interests of the corporation is improper. Benefiting those powerful shareholders at the expense of the other shareholders is likewise off-limits. Similarly, the fact that some other, smaller shareholders may share BVS's interests would be of no avail. Such conduct by directors would, under Delaware case law, constitute lack of "good faith" and, in doing so, would violate the duty of loyalty and expose directors to the risk of personal liability.[73]

The claims against BVS are more complicated. After all, none of BlackRock, Vanguard and State Street individually has sufficient power to control ExxonMobil or Chevron. Their liability, then, would depend on whether a court would find that they, together, constitute a "controller."

Delaware law recognizes that "multiple stockholders together can constitute a control group exercising majority or effective control, with each member subject to the fiduciary duties of a controller."[74] To establish group control, the shareholders must be:

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[71] Tooley v. Donaldson, Lufkin & Jenrette, Inc., 845 A.2d 1031 (Del. 2004).

[72] United Food and Commercial Workers Union v. Zuckerberg, ___ A.3d ___, ___ (Del. 2021) (holding that demand is excused where majority of the demand board faces prospect of liability on claim).

[73] While Delaware law permits companies to exculpate directors from monetary liability for breach of fiduciary duties by charter provision, that provision may not eliminate or limit liability "for any breach of the director's duty of loyalty to the corporation or its stockholders" or "for acts or omissions not in good faith." Del. GCL § 102(b)(7). For a similar argument, see J. Travis Laster, Fiduciary Duties in Activist Situations, 13 Va. L. & Bus. REV. 75 (2019).

[74] Sheldon v. Pinto Tech. Ventures, L.P., 220 A.3d 245, 251 (Del. 2019) (citing cases).

"'connected in some legally significant way'—such as 'by contract, common ownership, agreement, or other arrangement—to work together toward a shared goal.'" To show a "legally significant" connection, [one] must allege that there was more than a "mere concurrence of self-interest among certain stockholders." Rather, "there must be some indication of an actual agreement," although it need not be formal or written.[75]

Here, of course, the hypo's explicit agreement between BVS – memorialized in a shareholders' agreement – presumably establishes the requisite "legally significant connection."

If BVS constituted a group, there could be a decent argument that the group had effective control over the companies, depending on the relationship between BVS and the directors who they nominated. For example, nominees who are all employees of BlackRock, Vanguard or State Street would be strong evidence of control. Similarly, if the nominees, while not BVS employees, nonetheless had committed to implement the "low carbon" strategy as part of their agreement to be nominated to the board, that would also be some evidence that BVS were pulling the strings, at least as to the "low carbon" initiative. While a collective ownership of around 20-25% is at the bottom end of what is typically held to be sufficient to become a controller,[76] it could suffice when combined with control over the board of directors.

Even if a court were unconvinced that BVS jointly controlled ExxonMobil and Chevron, and BVS thus did not have fiduciary duties as controllers, they could still face liability for "aiding and abetting" the directors' breaches of fiduciary duties. To establish "aiding and abetting" liability, one must show (i) the existence of a fiduciary relationship, (ii) a breach of the fiduciary's duty, (iii) knowing participation in the breach by a non-fiduciary defendant and (iv) damages proximately caused by the breach.[77] Here, the relevant fiduciary relationship would be that of the directors. The fiduciary's alleged breach would be the directors' breach of their duty of loyalty in pursuing a goal other than ExxonMobil's, or Chevron's interests. "Knowing participation" in a fiduciary's breach requires that the alleged aider and abettor "act with the knowledge that the conduct advocated or assisted constitutes such a breach."[78] On the facts of the hypothetical, BVS formulated the low carbon emission strategy and ran a proxy contests to have directors elected who would implement it. Plaintiffs would have a strong case that, in doing so, they induced the board to make the decision at issue.[79] Finally, the resulting 20% decline in the stock price would be damages proximately caused by the breach.

b. Pursuing a Condon "tradeoff" strategy would conflict with Universal Owners' business model and legal obligations to clients.

"Universal owners" are, in fact, not real owners but managers of money for the benefit of clients. The plausibility of universal owners pursuing an active climate risk mitigation strategy depends on these firms' businesses and legal obligations to these clients. BlackRock, for example, describes its business as follows:

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[75] Id. at 251-52 (citations omitted).

[76] Tornetta v. Musk, 250 A.3d 793 (Del. Ch. 2019)

[77] Malpiede v. Townson, 780 A.2d 1075, 1096 (Del. 2001); Firefighters' Pension Sys. v. Presidio, Inc., 2021 Del. Ch. LEXIS 15 at *103. See, also, Restatement (Second) of Torts, § 876.

[78] Malpiede, 780 A.2d at 1097.

[79] Id. at 1098.

> BlackRock, Inc. (together, with its subsidiaries, unless the context otherwise indicates, "BlackRock" or the "Company") is a leading publicly traded investment management firm with $8.68 trillion of assets under management ("AUM") at December 31, 2020. With approximately 16,500 employees in more than 30 countries who serve clients in over 100 countries across the globe, BlackRock provides a broad range of investment management and technology services to institutional and retail clients worldwide.
>
> BlackRock's diverse platform of alpha-seeking active, index and cash management investment strategies across asset classes enables the Company to tailor investment outcomes and asset allocation solutions for clients. Product offerings include single- and multi-asset portfolios investing in equities, fixed income, alternatives and money market instruments. Products are offered directly and through intermediaries in a variety of vehicles, including open-end and closed-end mutual funds, *iShares®* exchange-traded funds ("ETFs"), separate accounts, collective trust funds and other pooled investment vehicles. ... The Company is highly regulated and manages its clients' assets as a fiduciary. ...
>
> BlackRock serves a diverse mix of institutional and retail clients across the globe. Clients include tax-exempt institutions, such as defined benefit and defined contribution pension plans, charities, foundations and endowments; official institutions, such as central banks, sovereign wealth funds, supranationals and other government entities; taxable institutions, including insurance companies, financial institutions, corporations and third-party fund sponsors, and retail intermediaries.[80]

While Vanguard pursues a different, consumer focused strategy that emphasizes low costs, it too is a highly regulated fiduciary that runs dozens of different mutual funds, including both equity and fixed income products, with different goals and targeted to different customers.

Any sort of "tradeoff" strategy of the sort proposed by Condon would wreak havoc on universal owners' business model.[81] While the "low carbon" strategy might be optimal for the investors in an S&P 500 index fund, as Condon argues, it will not be optimal for investors in an energy ETF in which ExxonMobil and Chevron are significant holdings. For example, a decline of 20% in the stock price of ExxonMobil and Chevron would be devastating to the investors in BlackRock's $2.6 billion U.S. Energy ETF (holdings: ExxonMobil 23.64%; Chevron 17.92%),[82] or Vanguard's $6.2 billion Energy ETF (holdings: ExxonMobil 21.37%; Chevron 17.26%).[83] The strategy could also negatively impact actively managed portfolios that are overweight in these companies. How would BlackRock or Vanguard explain to the current or prospective investors in the Energy ETFs or other funds heavily invested in ExxonMobil and Chevron why they supported a strategy that sacrificed ExxonMobil and Chevron for the benefit of their index fund

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[80] BlackRock, Inc., Annual Report on Form 10-K (Feb. 25, 2021), available at https://d18rn0p25nwr6d.cloudfront.net/CIK-0001364742/c7a7c1bc-6afa-4e2a-929e-aa2af777caeb.pdf

[81] John Morley, Too Big to Be Activist, 92 S. Cal. L. Rev. 1407 (2019).

[82] https://www.ishares.com/us/products/239507/ishares-us-energy-etf

[83] https://etfdb.com/etf/VDE/#holdings; https://investor.vanguard.com/etf/profile/portfolio/vde

investors? Indeed, a business model that prioritized the interests of index fund investors over other funds would likely doom those other funds, as competitors would offer competing products that pledged loyalty to fund investors.

A tradeoff strategy would also present a significant risk of fiduciary liability to clients.[84] As BlackRock explicitly says in its securities filings, "[t]he Company is highly regulated and manages its clients' assets as a fiduciary."[85] Just as corporate law incorporates a SFF in mandating that directors owe fiduciary duties to "their" corporation for the benefit of "their" corporation's shareholders, so, too, trust law's duty of loyalty has a similar, narrow, focus.[86] Under the traditional "sole interest" rule, a trustee must "administer the trust *solely* in the interest of the beneficiaries."[87] As Max Schanzenbach and Robert Sitkoff point out,

> Under this rule, "the trustee has a duty to the beneficiaries not to be influenced by the interest of any third person or by motives other than the accomplishment of the purposes of the trust." "The trustee," in other words, "is under a duty to the beneficiary in administering the trust not to be guided by the interest of any third person." Acting with mixed motives triggers "an irrebuttable presumption of wrongdoing," full stop.[88]

As they discuss in detail, "the 'sole interest' rule is mandatory under ERISA and is the default in trust law."[89] But even the somewhat more permissive "best interest" standard applicable when the "sole interest" standard is waived – a standard roughly equivalent to corporate law's "entire fairness" test – would not permit any tradeoff strategy precisely because it involves sacrificing the interests of the beneficiaries for the benefit of some third party to that relationship.[90]

Given these fiduciary obligations, combined with business considerations, universal owners like BlackRock, Vanguard and State Street simply could not embrace a tradeoff strategy of the sort suggested by Condon.

c. Controlling Legal Risk: Less Robust Strategies

The "enthusiastic" version of the hypo, analyzed above, is obviously unrealistic. In the real world, because of the substantial legal risk under both federal and state law, no one would proceed in such an explicit way.

But that is part of our point: each step away from an explicit joint campaign comes at a price of effectiveness. Indeed, because of the clash between universal owners' MFF and corporate law's SFF,

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[84] Morley, supra note 81.
[85] See BlackRock Annual Report, supra note 80.
[86] Max Schanzenbach & Robert Sitkoff, Reconciling Fiduciary Duty and Social Conscience, 72 Stan. L. Rev. 381, 399-425 (2020).
[87] Id. at 400 citing 3 RESTATEMENT (THIRD) OF TRUSTS § 78(1) (emphasis added); see also UNIF. TRUST CODE § 802(a) (UNIF. LAW COMM'N 2000).
[88] Id. at 400-01, extensive citations omitted.
[89] Id.
[90] Id. at 401-02.

there will be nearly a direct relationship between how effective a strategy is for MFF purposes and how much legal risk it entails. Because the success of even the explicit MFF tradeoff strategy is hardly assured – shareholders could easily vote down the BVS slate of directors, either because they had different financial interests or because they did not trust BVS's directors to run the company well – more legally defensible (and less effective) approaches are unlikely to result in significantly lower carbon emissions.

First, BlackRock, Vanguard and State Street would never explicitly form a group because of the legal risks we describe above. In the real world, BlackRock, Vanguard and State Street do not nominate directors, run proxy contests, or coordinate, or even discuss, their positions at specific firms. Instead, they allow others to launch proxy contests and then independently decide whether to support a slate in full or in part.

Second, because of corporate law's SFF – with directors owing fiduciary duties to their corporation and not to their investors' portfolios – campaigns will typically be framed in SFF terms. As long as a campaign is framed in SFF terms, climate-aware directors of carbon emitters would have great latitude under the business judgment rule to reduce a firm's own carbon emissions, even if doing so turns out to reduce the company's stock price. For an individual firm, substantial unilateral reductions in carbon emissions can be justified as rationally related to the long term success of the firm either because of reputational concerns, as a way of re-positioning the firm for a post-carbon economy, or because of a judgment that current investments in production are unlikely to be profitable due to anticipated changes in either demand or regulation. A board that chooses to reduce carbon emissions for one of these reasons would thus be unlikely to face any significant legal risk.

Finally, at the fund family level, because of the differing interests of different funds, voting on issues that potentially affect different funds differently will often be pushed down to the fund level, with a fund's portfolio manager casting the votes.

While each of these steps will reduce legal risk, they will also make accomplishing the MFF outcome of Condon's hypo less likely. Without coordinating with each other and with the other universal owners, coming up with a jointly acceptable MFF "low carbon" strategy will become far more difficult. Given the complexities of the calculation that Condon's hypo demands, different investors will likely come to different conclusions and, without coordination, those different conclusions will result in different voting decisions.

Similarly, nominating or, more likely, supporting climate-concerned but independent board nominees will be far less effective than nominating a slate of candidates committed to a given low-carbon strategy, especially when that strategy sacrifices the interests of ExxonMobil and Chevron for universal owners' portfolio interests.

Further, the need to push decisions on potential tradeoffs to the fund level will both reduce the universal owners' voting power and make it less likely that they will support proposals that involve tradeoffs necessitating this more complex procedure.

Fifteen years of hedge fund activism has demonstrated the challenges of forming a consensus around a strategy for increasing single firm value. Forming a shareholder consensus around a tradeoff strategy is

an even more daunting challenge. Indeed, to date, we cannot identify a single campaign that has proposed a tradeoff strategy, much less succeeded.[91]

d. What you may (or may not) get instead: Engine No. 1 at ExxonMobil

As Condon discusses, ExxonMobil is an ideal target for climate-driven activism. As the largest publicly traded oil company, ExxonMobil's products comprise a significant proportion of carbon emissions on both a current and historical basis. According to one study, ExxonMobil's cumulative 1988-2015 share of global industrial greenhouse gas emissions is 2.0%, while its emissions in 2015 were 1.4% of global totals.[92] Currently, it is responsible for approximately 1.2% of annual global emissions.[93]

Moreover, ExxonMobil's financial performance over the last five years has been poor in absolute and comparative terms. Total returns pre-Covid were –18.9% (1 year), –15.9% (3 years) and –17.5% (5 years).[94] Comparatively, ExxonMobil substantially trailed its peers over the same time periods by –12.5% (1 year), –31.7% (3 years), and –45.2% (5 years). As an article in the Wall Street Journal put it in September 2020, when ExxonMobil was removed from the Dow Jones Industrial Index: "It has been a stunning fall from grace for Exxon Mobil Corp. Just seven years ago, ExxonMobil was the biggest U.S. company by market capitalization. It has since lost roughly 60% of its value, with its market cap now at around $160 billion, after the pandemic crushed demand for fossil fuels."[95]

A sense that it had not been listening to its biggest shareholders made ExxonMobil even more vulnerable. Already in 2017, BlackRock and Vanguard had both made it clear to ExxonMobil that it was moving too slowly in assessing climate risk.[96] And in 2020, BlackRock voted against two ExxonMobil directors and in favor of separating the chair and CEO positions.[97]

Against this backdrop, Engine No. 1, a newly formed hedge fund, launched a proxy contest to elect four directors at ExxonMobil's 2021 annual meeting. Engine No. 1's campaign was framed entirely in SFF terms.[98] In the summary slide, the investment thesis was simple: "The industry is evolving, and so must ExxonMobil," with four key elements (all quoted from Engine No. 1's PowerPoint presentation):

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[91] On the other hand, some high-profile battles over the approval of mergers may provide examples of MFF investors *defeating* a SFF campaign. When HP and Compaq agreed to merge, Walter Hewlett, with a large holding in HP, opposed the merger inter alia because he thought the exchange ratio disfavored HP shareholders. By contrast, for an investor like an S&P 500 index fund with equal shares of each company, the exchange ratio was irrelevant; all that mattered was whether the companies were worth more together than apart. Hewlett's campaign against the merger – a SFF campaign – failed at least in part because of the support for the merger by MFF investors. See, also, Gordon, supra note 3 (arguing that a MFF investor in a financial institution would have a portfolio interest in opposing a hedge fund seeking to increase leverage because of the portfolio effects of systemic financial risk).

[92] Paul Griffith, The Carbon Majors Report at Appendix I-II (pp. 14-15). Other estimates are higher. Friends of the Earth, Exxon's Climate Footprint at5 (January 2004) (1882-2002: 5% of total emissions).

[93] Condon, supra note 3, at 10.

[94] ExxonMobil 2021 proxy statement at 51; ExxonMobil 2020 Annual Report at 124.

[95] Christopher Matthews, Exxon's Bet on Oil, Gas Drags Down U.S. Titan, WSJ September 14, 2020 at A1.

[96] Bradley Olson, Sarah Krouse & Sarah Kent, Big Investors Weigh Rebuking Exxon on Climate, Wall St. J., May 26, 2017 at B5.

[97] Christopher Matthews, Exxon vows to reduce its carbon footprint, Wall St. J., Dec. 15, 2020 at B1.

[98] Engine No. 1, Reenergize ExxonMobil//Investor Presentation (April 2021).

- ExxonMobil has significantly underperformed and has failed to adjust its strategy to enhance long-term value.
- A focus on chasing production growth over value has resulted in an undisciplined capital allocation strategy and has destroyed value even during periods of higher oil and gas prices.
- A refusal to accept that fossil fuel demand may decline in decades to come has led to a failure to take even initial steps towards evolution, and to obfuscating rather than addressing long-term business risk.
- A lack of successful and transformative energy experience on the Board has left ExxonMobil unprepared and threatens continued long-term value destruction.[99]

Having "diagnosed" the "problem," Engine No. 1 then made the case for its four board nominees. In the course of doing so, it explicitly disclaimed a tradeoff strategy. As one slide pointed out, "Not just a climate issue – a valuation issue for all long-term investors."[100] This theme continued as it focused on ExxonMobil's "lack of capital allocation discipline,"[101] with a series of supporting points, including:

- Returns on upstream projects (~75% of capex) have been falling for years, even during times of higher prices.[102]
- Rising costs and falling capital productivity have fundamentally changed return profile.[103]
- ExxonMobil and peers are far more exposed to risk of declining demand than National Oil Companies (NOCs).
- ExxonMobil's capital expenditures have outgrown cash generation, despite declining returns.
- Despite these dynamics, ExxonMobil has repeatedly committed to more aggressive spending than the industry.

Engine No. 1's campaign was remarkably effective and three of its four nominees were elected. They received support from the major index funds, most actively managed funds, large state pension funds and both of the major proxy advisers (ISS and Glass Lewis).[104] Vanguard and State Street supported two of Engine No. 1's four nominees, while BlackRock supported three.[105] CalPERS and CalSTRS publicly supported Engine No. 1 prior to the vote. Indeed, Aeisha Mastagni, head of corporate engagement in CalSTRS's sustainable investment and stewardship strategies unit, provided active support from the outset, coming close to jointly sponsoring the initiative.[106] Engine No. 1's victory likely sent a signal that shareholders will not tolerate poorly performing management that ignores investors' concerns with the

[99] Engine No. 1 ppt at 8.
[100] Id. at 23.
[101] Id. at 37.
[102] Id. at 38.
[103] Id. at 39.
[104] Evercore, The New World of Shareholders (slide deck, June 2021) at 2, on file with authors.
[105] https://www.blackrock.com/corporate/literature/press-release/blk-vote-bulletin-exxon-may-2021.pdf
[106] Leslie Kaufman & Saijel Kishan, CalSTRS's crucial phone call eased path for activist's Exxon win, Bloomberg June 18, 2021, available at https://finance.yahoo.com/news/calstrs-crucial-phone-call-eased-090009091.html

risks posed by climate change. Certainly, this is how activist-defense advisors have interpreted the victory.[107]

But despite the fact that Engine No. 1's campaign was framed in traditional single firm "total shareholder value" terms, it could constitute a disguised example of Condon's tradeoff hypothetical. ExxonMobil tried to characterize it that way. Its "deck" accused Engine No. 1 of being motivated by climate concerns rather that value concerns and claimed that Engine No. 1 had backpedaled from earlier positions that aggressively pushed for a reduction in oil and gas investment, increased investment in wind and solar, and a "wind-down" strategy.[108] And regardless of Engine No. 1's intentions, diversified owners of ExxonMobil stock may have thought that electing Engine No. 1's nominees could reduce ExxonMobil's carbon emissions with beneficial effects for their other portfolio holdings. Thus, even if the Engine No. 1 strategy was framed as a SFF strategy, their nominees may have been elected by a coalition of shareholders with MFF concerns.

So is Engine No. 1's campaign at ExxonMobil a paradigm for a viable strategy to achieve the aims of Condon's hypothetical? Will activists conduct successful campaign that are nominally SFF and hence entail low legal risks but hold an MFF appeal to universal holders?

Even if that is what happened at ExxonMobil – and we do not know that it is – it is not clear that a similar approach would succeed in other companies, even ones with poor performance similar to ExxonMobil's. An investor's view of a tradeoff strategy like Condon's will depend, among other things, on the share of an investor's portfolio represented by the target firm. Condon's calculation assumes an investor that pursues an indexing strategy. Extending her analysis, an investor that is "overweight" will give greater weight to the effects on the target, and less to the benefits of reducing emissions, than an indexed investor. On the other hand, an investor that is "underweight" will give *less* weight to the effects on the target and *more* weight to the effects on the rest of its portfolio than an indexed investor. More generally, as a first approximation, investors that are overweight (underweight) will be more (less) SFF than investors that hold the market portfolio.[109] Because universal owners must create a winning coalition to implement a tradeoff strategy, the composition of the shareholder base will thus be important.

In order to provide a sense of the intra-shareholder politics at ExxonMobil, Table 1 below looks at the votes of the 30 largest ExxonMobil shareholders that together controlled 34% of the vote in ExxonMobil. Due to the complex regulatory scheme that governs disclosure of investor ownership and voting, figuring out how the top thirty holders of ExxonMobil stock voted is a non-trivial task. Table 1 contains data prepared for us by Proxy Analytics LLC, a new firm that provides data analytics and consulting services on matters relating to ESG trends and shareholder voting practices.[110] Each year, Proxy

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[107] Evercore, supra note 104, on file with authors.

[108] ExxonMobil, Growing Shareholder Value in a Lower-Carbon Future (April 2021) at 68 available at https://ir.exxonmobil.com/static-files/b4970581-bc73-409e-a658-49f05a369e25

[109] Whether an investor is overweight or underweight in a given stock, without considering an investor's full portfolio, is an imperfect proxy for an investor's SFF v. MFF incentives.

[110] https://www.proxy-analytics.com.

Analytics captures and analyzes nearly 20M voting records that were gathered from SEC (Form N-PX) and web-based disclosures in order to generate profiles on how institutional investors vote. It then performs additional analysis to develop a deeper understanding of the factors that influence voting decisions. Information on beneficial holding and estimated voting authority was derived from quarterly 13F filings as of March 31, 2021 and then adjusted by Proxy Analytics using its proprietary methodology.[111]

Table 1 also provides, for each holder, information on the value of ExxonMobil common stock as a percentage of the total value of the holder's 13F securities. This percentage reflects the extent to which a holder is invested in ExxonMobil relative to the market. For comparison, ExxonMobil stock at the time accounted for approximately 0.59% of the capitalization of the all the companies in the Russell 3000 index.

There are several notable features. First, among the 30 largest holders, many more seem to be underweight in ExxonMobil (relative to the Russell 3000 index) than overweight. Thus, for example, ExxonMobil stock represents more than 1.18% of the value of 13F securities (twice the Russell 3000 percentage) for only 2 holders, while it represents less than 0.29% (half the Russell 3000 percentage) for 4 holders. This is particularly noteworthy as being underweight in ExxonMobil makes it less likely for a holder to be included in the list of top 30 holders. Ordinarily, one would have expected that the largest holders of a firm are holders that are overweight in that firm.

[111] The record date for the shareholder vote was March 29, 2021. As of March 31, 2021, ExxonMobil constituted about 0.586% of the capitalization of all Russell 3000 companies. Column [] of the table then calculates, for each institutional investor, the ratio of the (x) percentage of the value of that holders 13F securities accounted for by ExxonMobil stock to (y) 0.586%. A ratio of above 1 would indicate that the holder is overweight is ExxonMobil stock; a ratio below 1 would indicate that the holder is underweight. Since 13F securities include securities beyond stock of the Russell 3000, these figures are likely to overstate somewhat the degree to which investors are overweight in ExxonMobil.

Table 1

Holder	Percentage Voting	Percentage Investment Power	Percentage of all 13F Securities	Vote
Vanguard	8.25%	8.25%	0.53%	Dissident
BlackRock	5.94%	6.68%	0.47%	Dissident
State Street	5.53%	5.85%	0.79%	Dissident
FMR	1.78%	2.01%	0.41%	Dissident
Geode Capital Management	1.49%	1.49%	0.54%	Management
Northern Trust	1.21%	1.21%	0.53%	Management
Norges Bank	0.92%	1.01%	0.58%	Management
State Farm	0.79%	0.79%	1.99%	No Information
Bank of New York Mellon	0.79%	1.28%	0.62%	Split
Franklin Resources	0.78%	0.83%	0.80%	Dissident
Charles Schwab	0.66%	0.66%	0.58%	Dissident
First Eagle	0.58%	0.61%	3.85%	Management
T Rowe Price	0.48%	0.48%	0.11%	Dissident
Capital World Investors	0.44%	0.44%	0.19%	Dissident
TIAA-CREF	0.43%	0.43%	0.32%	Dissident
Dimensional	0.41%	0.44%	0.35%	Dissident
Bank of America	0.39%	0.82%	0.22%	No Information
Swiss National Bank	0.38%	0.38%	0.61%	No Information
Sumitomo Mitsui	0.32%	0.32%	0.48%	No Information
PNC	0.29%	0.30%	0.84%	No Information
Amundi	0.29%	0.39%	0.71%	Dissident
Legal & General	0.26%	0.54%	0.47%	Dissident
CalPERS	0.23%	0.23%	0.41%	Dissident
APG Asset Management	0.21%	0.21%	0.71%	Dissident
Federated Hermes	0.21%	0.22%	1.01%	Dissident
AllianceBernstein	0.20%	0.21%	0.22%	Dissident
New York State Common Retirement Fund	0.18%	0.18%	0.48%	No Information
California State Teachers Retirement System	0.18%	0.18%	0.58%	Dissident
Fisher	0.17%	0.19%	0.32%	Dissident
Parametric	0.17%	0.22%	0.30%	Dissident

Second, the exposure to ExxonMobil is correlated with the vote of the holder. Thus, all of the four holders who voted for management nominees had a greater than median exposure to ExxonMobil stock. By the same token, active institutional investors that are underweight at a company may be more

attracted to a MFF strategy. The data in Table 1, while very limited, are consistent with the notion that Engine No. 1's campaign found more appeal with investors that had relatively low exposure to ExxonMobil.

In other companies, however, where a larger number of active institutional shareholders are overweight, an (explicit or implicit) MFF strategy may encounter more resistance and could be used to split apart a coalition of shareholders. For active managers, an MFF strategy that comes at the expense of a company in which the investor is overweight may be objectionable for two reasons. First, such a strategy is less likely to enhance overall portfolio value because the loss in the overweight company's stock is less likely to be outweighed by the gains in the rest of the portfolio than for an index investor. Second, even if the MFF tradeoff strategy enhances overall portfolio value, it may lower their fund's relative performance and hence result in fund outflows.[112] In those companies, an MFF tradeoff strategy that requires the support of less diversified actively managed mutual funds will have greater difficulty assembling a winning coalition.

It is unclear whether ExxonMobil shareholders supported Engine No. 1's campaign for SFF or for MFF reasons. For what it is worth, ExxonMobil's stock price barely moved when the results of the proxy vote were announced, suggesting that shareholders did not believe that Engine No. 1's victory would lead to a decline in the stock price (and perhaps that Engine No. 1 was not pursuing a "tradeoff" strategy). To the extent that universal owners perceived that electing the Engine No. 1 nominees to be at least not harmful to the value of ExxonMobil, their decisions to support them would also have been relatively easy and, from a legal perspective, free of risk.

But even if the effect on other portfolio holdings was the reason why many holders of ExxonMobil voted for Engine No. 1's nominees, it is unclear whether Engine No. 1's success can easily be replicated at many companies. At companies in which the shareholder base tilts more strongly to less diversified investors, even a whiff of MFF may undermine the credibility of the activists and harm the campaign.

e. Can Universal Owners Rely on an Intermediary?

One response to the liability risks that arise out of the conflict between universal owners' MFF and corporate law's SFF might be to encourage the emergence of "intermediaries" that can further the collective interests of the universal owners without exposing them to legal liability. Intermediaries in the corporate governance space have already emerged, including the "Investors Forum"[113] and, on

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[112] See, e.g. Richard A. Ippolito, Consumer Reaction to Measures of Poor Quality: Evidence from the Mutual Fund Industry, 35 J.L. & Econ. 45 (1992); Brad M. Barber, Xing Huang & Terrance Odean, Which Factors Matter to Investors? Evidence from Mutual Fund Flows, 29 Rev. Fin. Stud. 2600, 2620 (2016) (estimating that a 1% increase in alpha generates an additional 0.474% in net inflows); Jonathan B. Berk & Richard C. Green, Mutual Fund Flows and Performance in Rational Markets, 112 J. Pol. Econ. 1269, 1274-80 (2004); Jonathan Lewellen & Katharina Lewellen, Institutional Investors and Corporate Governance: The Incentive to Be Engaged, 77 J. Fin. 213 (2022) (examining the effect of performance on net flows for all funds managed by the same adviser).

[113] https://www.investorforum.org.uk/

climate, "Climate Action 100+."[114] According to its website, "Climate Action 100+ is an investor-led initiative to ensure the world's largest corporate greenhouse gas emitters take necessary action on climate change."[115] It claims that more than "570 investors, responsible for over $54 trillion in assets under management" support their initiatives to engage with "companies on improving climate change governance, cutting emissions and strengthening climate-related financial disclosures." Climate Action 100+'s engagement strategy "is spearheaded by a lead investor or investors, who work cooperatively with a number of collaborating investors." Investors also engage on an individual basis but, when they do so, are supposed to "liaise with relevant network staff and/or lead investors to ensure engagement priorities and ambition are aligned with the goals of the initiative, as well as with the overall collaborative approach (as appropriate in each sector)." Importantly, BlackRock, State Street, CalPERS, and CalSTRS are all members.

Climate Action 100+ makes three principal demands of companies: "clear commitments to cut emissions, improve governance and strengthen climate-related financial disclosures." The demands are justified on an MFF basis: "To mitigate investment exposure to climate risk and secure ongoing sustainable returns for their beneficiaries, investors are ensuring the businesses they own cut emissions to help achieve the goals of the Paris Agreement and accelerate the transition to net-zero emissions by 2050 or sooner."

Suppose that Climate Action 100+, concerned that the "supply response" described earlier threatens its carbon reduction strategy, targets *all* the major oil companies in the world, with several of its members spearheading the effort. In keeping with its approach, it strives to act as a coordinator of its members' actions, including their stewardship efforts, voting policies, lobbying and public relations. Suppose, further, that the multi-prong campaign is successful with the result that worldwide production of oil declines, and prices rise.

Two types of legal risk would immediately emerge. First, for U.S. targets, reporting under Schedule 13D would now be a real concern. Climate Action 100+'s website trumpets the cooperative nature of the engagements and their signatories' many successes. Moreover, the broad support of Climate Action 100+ members for the industry-wide output reduction campaign would provide evidence that Climate Action 100+ and its members had formed a group for the purpose of voting, thereby triggering 13D disclosure obligations. While the website's disclaimer, echoing 13D, states that "Climate Action 100+ does not require or seek collective decision-making or action with respect to acquiring, holding, disposing and/or voting of securities," the facts (and Climate Action 100+'s self-promotion) arguably would demonstrate otherwise.

Less obviously, the campaign could raise significant risks under Section 1 of the Sherman Act. An agreement to restrict output, like an agreement to fix prices, is a per se violation of Section 1 and

[114] https://www.ceres.org/initiatives/climate-action-100?gclid=EAIaIQobChMI6YWfobSS8gIViJyzCh3z6gkeEAAYASAAEgJm0vD_BwE.
[115] https://www.climateaction100.org/about/

exposes all members of the conspiracy to treble damages and criminal liability.[116] This is true whether the reduction in output is motivated by a desire to increase prices or for some other reason, such as climate change.[117] One classic scenario in which an "agreement" is formed for the purpose of Section 1 is a trade association representative who organizes the members to work together.[118] One alternative description of the hypothetical Climate Action 100+ campaign is that Climate Action 100+ and its signatories were a "cartel ringmaster" that organized a production cartel (with a resulting increase in prices). Alternatively, one could describe the campaign as a "hub and spokes" conspiracy, with Climate 100+ and its members acting as the "hub" and the individual oil companies as the spokes. Under either description, the more effective the campaign – the greater the reduction in output – the greater the participants' legal risk. At the same time, because oil companies that reduced output in response to Climate Action 100+'s pressure could likewise face liability under Section 1 as members of the conspiracy, the collective nature of the campaign could well *increase* companies' resistance, as their lawyers warn them of the legal risks of any collective action to reduce output.

Like the "enthusiastic" version of Condon's hypo, the legal risks created by an effective intermediary strategy make it unlikely that universal owners would embrace it. Were Climate Action 100+ to embark on such a strategy, universal owners would be well-advised to sever their connections with the group.

f. The Softer Forms of Activism: Shareholder Proposals

Engine No. 1's campaign at ExxonMobil was unprecedented and it is too early to tell how many similar campaigns will be launched and succeed. Much more common are climate-related shareholder proposals and engagement meetings.

During the 2020 proxy season, climate related shareholder proposals did very well. Of the 14 proposals primarily focused on climate change that reached a vote, three received majority support, including one at Chevron.[119] An additional two related proposals received majority support, including a proposal at Phillips 66. Both Chevron and Phillips 66 were targeted by Climate Action 100+, which has taken a leading role. Environmental shareholder proposals garnered even more support during the 2021 proxy season, setting a new record: 13 of the 36 shareholder proposals that reached a vote (most of them relating to climate change) passed. [120]

To what extent do shareholder proposals and engagement meeting push companies in an MFF direction? While Climate Action 100+, as we discuss above, takes an explicitly MFF, BlackRock frames its

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[116] For an extensive discussion of the possibility that shareholder organized industry wide agreements create potential liability under Section 1, see Edward Rock & Daniel Rubinfeld, Common Ownership and Coordinated Effects, 83 Antitrust L. J. 201 (2020).

[117] For an important discussion of the extent to which existing antitrust doctrine constrains corporations' pro-social collaboration, see Amelia Miazad, Prosocial Antitrust, 73 UC Hastings L. Rev.__ (forthcoming 2021).

[118] The classic example is Am. Column & Lumber Co. v. United States, 257 U.S. 377 (1921). Another clear example comes from a recent case from the EU involving a management consultant whose specialty seems to have been organizing cartels. Case C-194/14 P, AC-Treuhand AG v. Comm'n (CJ 2015), ECLI:EU:C:2015:717.

[119] Georgeson 2020 Annual Corporate Governance Review at 34.

[120] Georgeson 2021 Annual Corporate Governance Review at 17-22.

engagement priorities and expectations with a SFF.[121] Between the lines, however, BlackRock may well be motivated by MFF concerns. Specifically, when it comes to emissions, BlackRock is quite demanding:

> Specifically, we expect companies to disclose scope 1 and scope 2 emissions and accompanying GHG reduction targets. Companies in carbon-intensive industries should also disclose scope 3 emissions. A significant portion of the transition to a low-carbon economy hinges on the eventual retirement of fossil fuels, and it is particularly important for investors to understand the scope 3 emissions profile of oil, gas, and coal companies as the primary source of fuel transitions from carbon-intensive solutions to cleaner alternatives. The viability of these fuel sources will also become diminished as companies within the transportation and energy value chain, such as original equipment manufacturers, auto-makers, and utilities, accelerate the design of battery, electric, and hydrogen powertrains to further mitigate emissions and prioritize clean energy use.

Increased disclosure on emissions can always be justified as aiding investors' ability to price securities. But what about "GHG *reduction* targets" which, the statement implies, are desirable for all companies? At least some companies may find it in their interests to maintain or even emissions (within legal limits). If fossil fuels will be regulated out of the energy sector, oil companies, for example, may want to increase production now before their reserves become valueless and coal-fired power plant operators would not want to upgrade their soon-to-be-mothballed facilities by installing filters.[122] While BlackRock never says outright that it favors emission targets even if they reduce profits of the company setting the targets, and while its statements are vague enough for BlackRock to walk away from this implication, its references to GHG reduction targets is much more compatible with an MFF than a SFF.

BlackRock's memo on "Climate risk and the transition to a low-carbon economy" is consistent with this interpretation. There BlackRock explain that:

> Underlying our desire for greater disclosure on emissions baselines, GHG reduction targets, and transition plans, is our conviction that climate risk is investment risk. Solutions to climate change and the transition to a low carbon economy require concerted effort on the part of companies, including assessing their operations and adapting their businesses to remain resilient.

It is, of course, entirely legitimate for BlackRock to take a portfolio perspective in its investment strategy given BlackRock's duties to its clients with diversified portfolios "to deliver sustainable long-term financial returns." From a portfolio perspective, obtaining information on emissions and transition plans that helps BlackRock to evaluate a particular investment's climate risk, and even pushing companies to reduce their *exposure to* climate risk is sensible and consistent with an SFF.[123] But again, GHG reduction targets would seem to affect climate risk principally by lowering the climate-based *negative externalities*

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[121] https://www.blackrock.com/corporate/about-us/investment-stewardship

[122] https://www.power-technology.com/features/feature104857/

[123] It would be consistent with an SFF since market participants may generally be concerned about the amount of systematic risk (including climate risk that is systematic) a particular investment contributes to a portfolio and since therefore a reduction in risk may increase the value of a company. Richard Brealey & Stewart Myers, Principles of Corporate Finance.

generated by emissions, rather than by reducing the climate risk facing the emitting firm. Favoring GHG reduction targets because of a concern with climate risk – rather than, say, because reducing emissions is a good strategy for fending off more onerous regulation – thus indicates an MFF orientation.

As discussed, BlackRock and other shareholders may legally adopt an MFF perspective in voting on precatory shareholder resolution. Indeed, as investment fiduciaries, they may even be required to do so. The problem is that the board has a different set of duties and, under directors' duty of loyalty, must consider whether the actions proposed by a resolution are in the best interest of the company. The more a precatory resolution is premised on MFF, the harder it will be for the board to act in accordance with the resolution.

But BlackRock and other shareholders taking an MFF perspective in their engagement meetings with a company's directors and executives raises additional issues. Urging a board in such meetings to take actions that are in the shareholders' extraneous interest, but not in the company's interest, carries a somewhat higher legal risk than a mere vote in favor of a precatory resolution. At some point, if directors heed these demands, the shareholder may be exposed to claims for aiding and abetting a breach of fiduciary duties.

However, whatever BlackRock proclaims in its public materials, we do not know what BlackRock actually says to board members and executives in engagement meetings. BlackRock may spend little time discussing emissions, focus on disclosure rather than GHG reduction targets, or push for reduction targets only in situations where such targets can be justified as enhancing firm value. BlackRock's engagement team is well aware that the board has a fiduciary duty to act in the best interest of the corporation, and we doubt that it would ask the board in an engagement meeting to take an action that reduces company value in order to enhance the value of other portfolio securities owned by BlackRock.

Thus, both shareholder resolutions and engagement meetings entail a tradeoff: the more openly one advocates for board action on an MFF basis, the more risk is created that a board will violate its fiduciary duties if it undertakes the action, and hence decide not to take it. We would expect BlackRock to at least pretend that the course it advocates benefits the company. Just as BlackRock understands the fiduciary duty constraints under which the board is operating, the board understands that BlackRock has substantial extraneous interests. While the board may thus be skeptical of BlackRock's SFF arguments, it also has an interest in maintaining good relationships with its large shareholders. As long as both BlackRock and the board can maintain the facade that the objective is to maximize company value, the board is more likely to heed BlackRock's requests.

The recent ExxonMobil vote provides some evidence of such a kabuki theatre. In addition to voting on the contested director election, shareholders were asked to vote on a proposal by BNP Paribas Asset Management that asked the company to issue a report within the next year "describing if, and how, ExxonMobil's lobbying activities (direct and through trade associations) align with the goal of limiting average global warming to well below 2 degrees Celsius (the Paris Climate Agreement's goal)."[124] The evident purpose of this proposal, in our view, was to induce ExxonMobil to stop lobbying against the

[124] WLRK memo, July 22, 2021
[https://engagements.ceres.org/ceres_engagementdetailpage?recID=a0l1H00000CjqZOQAZ]

Paris Climate Agreement, with the ultimate goal of facilitating implementation of the accord for the benefit of the public and the benefit of other companies. But BlackRock, which supported the proposal, explained that it was concerned about "the reputational risk to the company of misalignment in public positions on key strategic policy issues" – a pure SFF rationale for the vote.[125] Indeed, the BNP Paribas proposal also asked the company to assess "the risks presented by any misaligned lobbying and the company's plans, if any, to mitigate these risks" – an addition that gave some surface plausibility to BlackRock's explanation.

In short, one can interpret many of BlackRock's statements and actions as promoting MFF under the cloak of SFF. While expressed in terms of a SFF, BlackRock's goal, we surmise, is at least partially based on a MFF because, as a sophisticated universal owner, any other strategy would be irrational.

But the need to articulate a plausible SFF basis for proposals, even if these proposals are truly meant to further MFF goals, places significant constraints on universal holders. Returning to Condon's hypothetical, we do not think that it is possible for a universal owner to make a sufficiently plausible case that it is in ExxonMobil's interest to cut its emission by 40% when doing so would result in 20% drop in the company's value. Having to talk the SFF talk, thus, makes it harder to walk to the MFF walk.

IV. Can Corporate Law's SFF be Changed to promote a MFF?

Madison Condon and Rick Alexander have advanced intriguing proposals for robust systemic stewardship. Universal owners have better incentives than most to pursue policies that force the internalization of carbon externalities even (or especially) when doing so requires sacrificing highly polluting companies for the benefit of their overall portfolios. If current corporate law and practice interfere with pursuing these economically and socially rational goals, then perhaps corporate law and practice should change.[126] Is doing so politically plausible?

We think the answer is no. An MFF approach remains a second-best to direct governmental regulation. Direct governmental regulation would be more beneficial for the environment as it would apply not just to publicly traded companies with powerful universal owners but also to other business entities. As a result of the broader scope, direct governmental regulation would also reduce the risk of a competitive response that would reduce or eliminate the benefits from actions by individual companies. Indeed, adopting an effective MFF approach for public companies without direct regulation would, over time, lead to a change in industry composition from public to private companies, especially in industries such as energy that would be the prime targets of an MFF approach. Thus, the longer-term benefits from a MFF approach would be limited.[127]

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[125] Id.

[126] See Armour & Gordon, supra note 12, at 50-56.

[127] An MFF approach that did not affect private companies would also generate less political opposition than direct governmental regulation. But because an MFF approach is less effective due to competitive responses and shift in industry composition, it is likely to have a stronger effects on the degree of support than to the degree of opposition.

Second, while there would be powerful political forces and interests that may favor a move to an MFF approach, a move to a MFF would also garner substantial opposition. Employees and managers of carbon emitting firms that would be sacrificed under such an approach would stand to lose a lot and would likely be strongly opposed. The media responses to Engine No.1's SFF campaign provide a taste of what an explicit "tradeoff" campaign would attract. In an editorial immediately after the ExxonMobil shareholders meeting, the Wall Street Journal viewed Engine No. 1's victory as "a reflection of the enormous political pressure and financial leverage of government pension funds, proxy advisers and asset managers like BlackRock that want to be seen as virtuous to the progressives who are now in power."[128] Moreover, the Journal characterized the campaign's goal: "Make the biggest U.S. oil and gas company 'transition' out of its legacy business." Its columnist Holman Jenkins, Jr., was similarly unimpressed: "When you've failed to convince consumers to stop consuming oil, when you've failed to sway politicians to ban or even disincentivize its production, that's when you go to oil company boards and insist that they voluntarily refrain from producing a legal product for which there is huge and inelastic demand."[129]

Third, an MFF approach entails adverse collateral consequences. Empowering universal owners to cooperate for privately and socially beneficial goals like reduction in carbon emissions can also empower them to cooperate for privately beneficial but socially harmful goals like raising airline ticket prices.[130] Line drawing between these goals would be difficult since achieving them often entails the same type of actions – a reduction in output – and since owners may have mixed motivations. Whether common ownership has already resulted in anti-competitive effects is the subject of an on-going debate. But as the barriers against an MFF approach are eroded, the potential for such anti-competitive effects increases.

At the federal level, we see no reason why a push to change the SFF focus of corporate law would succeed when the push for direct climate regulation has failed. In light of the strenuous opposition that a shift to MFF would engender, the superiority of dealing with environmental and risk-based externalities through direct regulation, and the potential anti-competitive effects of embracing MFF, any coalition that stood a chance of succeeding would prefer to put its efforts into direct regulation.

Corporate law is, of course, state law, so any legal change could also occur at the state level. But shifting to an MFF approach would not appeal to Delaware, the most important corporate law jurisdiction, given the extent to which a SFF is fundamental to the deep structure of Delaware corporate law. As discussed above, shifting to a MFF would require a wholesale re-configuration of corporate law. The prospect that doing so would intellectually appeal to Delaware's judiciary or bar are remote.

Nor would a shift to MFF be in Delaware's economic interest: the interest of the Delaware fisc in franchise taxes from companies incorporated in Delaware and the interest of the Delaware bar in revenues from representing Delaware companies and litigating in Delaware courts.[131] To maximize franchise fees and lawyers' revenues, Delaware wants to attract public incorporations and thus has an

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[128] The Proxy Coup at Exxon, WSJ May 26, 2021.

[129] Holman Jenkins, Jr., The Climate Yawns at Exxon "Coup", WSJ June 2, 2021 at A13.

[130] See Azar et al., supra note 13.

[131] See generally Marcel Kahan and Edud Kamar, The Myth of State Competition in Corporate Law," 55 Stan. L. Rev. 679 (2002) (detailing Delaware's economic benefits from incorporations).

interest in satisfying directors and shareholders, who jointly control where companies incorporate.[132] While managers would tend to be opposed to shifting to an MFF, shareholders would be split with the large and growing segment of highly diversified universal owners favoring an MFF. While the interests of current shareholders and managers may create some basis for relaxing its SFF, looking at the interests of current shareholders and managers is too narrow an approach. Delaware cares not only about where the existing stock of public corporations is domiciled but also about how attractive it is to become – and remain – a public corporation. Facilitating an MFF would make it substantially less appealing to be a publicly traded company, under pressure from its universal owners to sacrifice its profits for the good of others, than a privately held company, which will face no such pressure, but still be able to free-ride on sacrifices of others.[133] From that perspective, Delaware's long-term interests are inconsistent with MFF.[134] We thus see little chance that corporate law's deep seated SFF will be changed either at the federal or at the state level.

Conclusion

In the face of the arguments that universal owners, through systemic stewardship and other means, should induce firms to reduce externalities and curtail systematic risks even if doing do lowers firm value, it is worth reviewing the normative foundations for the traditional single firm focus that is so deeply entrenched in corporate law, and that poses substantial obstacles to strategies that impose material tradeoffs.

The traditional defense of a SFF and, within that, a focus on shareholder value, is that it ultimately leads to greater social welfare. This traditional approach assumes adequate regulation: effective antitrust to maintain competitive markets; environmental regulation to force the internalization of externalities; employment law to protect workers; and so on. With that assumption, corporate managers face a constrained optimization task: maximize firm value consistent with meeting regulatory obligations. Within this framework, corporate law has a narrow scope: create the corporate form; define its terms and ground rules; and constrain agency costs.

When markets are competitive and other areas of the law carry out their missions, maximizing single firm value will benefit shareholders and increase social welfare. On the other hand, under conditions of monopoly, shareholders may not agree on single firm profit maximization because they have

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[132] Marcel Kahan and Ehud Kamar, Price Discrimination in the Market for Corporate Law," 86 Cornell L. Rev. 1205 (2001) (showing that the bulk of Delaware's benefits derive from incorporations by publicly traded companies).

[133] Similarly, if Delaware adopted an MFF, some other state, intent on getting a slice of the incorporation business, could offer as a differentiated product a commitment to SFF. Public companies, at the IPO stage or when still held by undiversified owners, could incorporate in such a state with provisions (such as high voting requirements) that would it difficult to reincorporate in to Delaware once it shareholder profile changes and it becomes dominated by universal shareholders.

[134] In addition, were Delaware to shift to an MFF, some other state, intent on getting a slice of the incorporation business, could offer a commitment of SFF as a differentiated product. Public companies, at the IPO stage or when still held by undiversified owners, could incorporate in such a state with provisions (such as high voting requirements) that would make it difficult to reincorporate in to Delaware once its shareholder profile changes and it becomes dominated by universal shareholders.

heterogeneous interests.[135] This implies that one cannot simultaneously achieve complete portfolio diversification, management that implements shareholders' preferences, and competitive markets.[136]

Even in a world of substantial portfolio diversification, the advantages of this traditional framework are many. First, by fixing the goal at SFF, it avoids the instability and indeterminacy that heterogeneous shareholder interests can produce, with a benefit to competition. Second, corporate governance's narrow lane avoids confrontation with political forces. Firms need not take any position on social policy and need not engage in social and political tradeoffs. Third, the narrow focus promotes accountability of management to shareholders.

The push for *systemic* stewardship starts with a critique of the traditional model. In fact, proponents of systemic stewardship and more aggressive strategies argue, other areas of the law do not carry out their missions: financial regulation does not adequately control systemic financial risk; antitrust law does not adequately protect competition; environmental law does not force the internalization of the social cost of carbon; employment law does not adequately protect employees. Moreover, political dysfunction in the face of climate change threatens investors' entire portfolios (and life on the planet) and creates an imperative to respond.

From this perspective, systemic stewardship is a clear second best to well-implemented SFF. The substantial political obstacles to changing the status quo, outlined above, raise fundamental questions. If there is the political will to change corporate law's SFF to permit universal owners to intervene to address climate change risk on a portfolio basis, why isn't there sufficient political will to enact a carbon tax or some other regulatory intervention to force internalization? Absent political will to control or mitigate climate change, will universal owners pursuing MFF have any material welfare effect?

On the other hand, an optimist might note, getting universal owners – among the most powerful forces in the capital markets – to take climate change seriously enough to change their corporate governance strategies may be the most effective way *to develop* the broad political consensus necessary to enact adequate regulation. This could be true in two different ways. First, if elites become convinced that climate change poses an existential threat, they may succeed in convincing governments to act. From this perspective, a variety of environmental initiatives – from recycling to electric vehicles to carbon offsets – may be "ideologically" important even if they do not, in fact, reduce emissions, energy use or waste or achieve any of the other stated goals.

Second, inducing change at a firm level, even (or perhaps especially) if it engenders a competitive response, may transform the political landscape in ways that could be far more important than the direct economic effect. Suppose that, under shareholder pressure, ExxonMobil and Chevron are forced to factor the social cost of carbon in their exploration and production decisions, with the result that their production drops substantially along with their stock price while competitors pump more oil. This would give ExxonMobil and Chevron powerful incentives to lobby Congress to enact legislation that would force their competitors to do the same thing. Indeed, it is hard to imagine a more significant change in the political landscape than ExxonMobil and Chevron becoming active supporters of, say, a carbon tax. The recent embrace of a carbon tax by the American Petroleum Institute provides some

[135] Jose Azar, The Common Ownership Trilemma 87 U. Chi. L. Rev. 263, 273 (2020).
[136] Id.

evidence that this process is already underway.[137] The best argument in favor of systemic stewardship may thus be that it could act as a catalyst for political change.

[137] https://www.api.org/news-policy-and-issues/news/2021/03/24/climate-action-framework (March 25, 2021).