HARVARD
BUSINESS LAW
REVIEW

The Illusion of Success: A Critique of Engine No. 1's Proxy Fight at ExxonMobil

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Recommended Citation: Bernard S. Sharfman, *The Illusion of Success: A Critique of Engine No. 1's Proxy Fight at ExxonMobil*, 12 HARV. BUS. L. REV. ONLINE, art. 3, 2021, at 1.

Abstract

With less than $40 million worth of Exxon Mobil Corporation common stock in hand, Engine No. 1 executed a proxy fight that succeeded in getting three of its four nominated directors elected to the board of the company. This victory was viewed as a success by environmentalists and ESG investors. However, this victory was illusionary as a closer look reveals an absence of accomplishment. The hedge fund activism of Engine No. 1 did not provide a roadmap for the company to improve its financial performance or specific recommendations on how it could transition from a global leader in oil and gas production to a global leader in the production of clean energy. Also, there is no evidence that Engine No. 1 has served as a corrective mechanism (correcting managerial inefficiencies) at the company consistent with this Article's theory of hedge fund activism. Moreover, and perhaps most importantly, Engine No. 1 may have created a deadly distraction in our global fight against climate change, a fight that should be taken on by governments all over the world, not hedge fund activists.

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Introduction

With less than $40 million worth of Exxon Mobil Corporation ("ExxonMobil") common stock in hand, but with $30 million to spend,[1] Engine No. 1 executed a proxy fight that succeeded in getting three of its four nominated directors elected to the board of ExxonMobil. This victory was viewed as a success by environmentalists and Environmental, Social, and Governance ("ESG") investors.[2]

To defend itself in the proxy fight, ExxonMobil was estimated to have spent $35 million.[3] However, besides the money, it is not hard to believe that thousands of hours of ExxonMobil management time (board members, executive management, and other managers down the line) were also spent on the effort.

Unfortunately, even after all these resources were expended, this Article finds that nothing was really accomplished. The hedge fund activism of Engine No. 1 did not provide "a roadmap for Exxon[Mobil] to improve its performance or address the difficult questions impeding meaningful progress toward climate objectives."[4] In regard to the latter, Engine No. 1 did not provide the company with specific recommendations on how it could transition from a global leader in oil and gas production to a global leader in the production of clean energy.[5] Also, there is no evidence that Engine No. 1 has served as a *corrective mechanism* (mitigating managerial inefficiencies) at ExxonMobil[6] consistent with this Article's theory of hedge fund activism.[7] Moreover, and perhaps most importantly, Engine No. 1 may have created a *deadly distraction* in our global fight against climate change, a fight that should be taken on by governments all over the world, not hedge fund activists.[8] The only apparent positive result of this activism, at least from the perspective of Engine No. 1, is that the entity got a huge marketing boost in its efforts to raise funds for its exchange-traded funds ("ETFs").[9]

Part I presents a theory of how hedge fund activism creates value. Part II compares the hedge fund activism of Engine No. 1 to the theory discussed in Part I and explains why the fund's

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[1] Scott Deveau, *Exxon Activist Reveals High $30 Million Cost of Boardroom Battle*, BLOOMBERG MARKETS (Mar. 18, 2021, 4:55 PM), https://www.bloomberg.com/news/articles/2021-03-18/exxon-activist-reveals-high-30-million-cost-of-boardroom-battle.

[2] Eric Reguly, *The Little Engine No. 1 That Could: How the Fund That Shook Up Exxon Might Inspire a Wave of Shareholder Activism*, THE GLOBE AND MAIL (June 4, 2021), https://www.theglobeandmail.com/business/commentary/article-the-little-engine-no-1-that-could-how-the-fund-that-shook-up-exxon/.

[3] Deveau, *supra* note 1.

[4] Hemang Desai, Shiv Rajagopal & Sorabh Tomar, *Opinion: Is an Activist Hedge Fund's Climate-Linked Coup of Exxon's Board Simply a Case of 'Greenwashing'?*, MARKETWATCH (June 8, 2021, 1:54 PM), https://www.marketwatch.com/story/is-an-activist-hedge-funds-climate-linked-coup-of-exxons-board-simply-a-case-of-greenwashing-11623103432.

[5] *See infra* Part II.

[6] *See infra* Part II.

[7] *See infra* Part I.

[8] *See infra* Part III.

[9] *See infra* Part II.

activism was unsuccessful. Part III discusses how the activism of Engine No. 1 is just another deadly distraction in our efforts to mitigate climate change.

I. How Hedge Fund Activism Creates Value

This Part presents a theory of hedge fund activism based on Henry Manne's *theory of the market for corporate control* and the role played by the hostile bidder.

A. The Market for Corporate Control

The market for corporate control refers to the buying and selling of shares by which acquirers gain voting control of "target" companies, whether privately held or publicly traded.[10] Changes in control may occur through merger, tender offer, proxy contest, or some combination thereof.[11] According to Michael Jensen and Richard Ruback, *the market for corporate control* is "a market in which alternative managerial teams compete for the rights to manage corporate resources."[12]

Henry Manne was the first to use the term *market for corporate control*.[13] He was also the first to propose a *theory of the market for corporate control*[14] that provided a compelling argument for the existence of a vibrant hostile takeover market.[15] His theory was that "the control of corporations may constitute a valuable asset" if the acquirer takes control with the expectation of correcting managerial inefficiencies.[16] Manne's theory proceeds on the premise that there is "a high positive correlation between corporate managerial efficiency and the market price of shares of that company."[17] Such a premise means that the price of a public company's stock will in part reflect managerial performance. Moreover, assuming the existence of a liquid stock market where potential acquirers could assess the price of the stock versus what the price

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[10] Ronald J. Gilson & Andrew Schwartz, *An Efficiency Analysis of Defensive Tactics*, 11 HARV. BUS. L. REV. 1, 2 (2021) ("The 'market for corporate control' is the market in which companies or investment vehicles such as private equity firms search for other companies to buy. The companies that search are called 'acquirers'; the companies that are searched for are called 'targets.'"). *See also* Edward B. Rock, *Antitrust and the Market for Corporate Control*, 77 CALIF. L. REV. 1365, 1370, n.9 (1989) ("[T]he very commodity that is traded in the 'market for corporate control' [is] the corporation . . ." (quoting CTS Corp. v. Dynamics Corp. of Am., 481 U.S. 69, 94 (1987))).

[11] Michael C. Jensen & Richard S. Ruback, *The Market for Corporate Control: The Scientific Evidence*, 11 J. FIN. ECON. 5, 6 (1983).

[12] *Id.*

[13] According to William Carney, the phrase *the market for corporate control* was first introduced into the corporate law literature by Manne in Manne's article, Henry G. Manne, *Some Theoretical Aspects of Share Voting: An Essay in Honor of Adolf A. Berle*, 64 COLUM. L. REV. 1427, 1430–31 (1964). *See* William J. Carney, *The Legacy of "The Market for Corporate Control" and the Origins of the Theory of the Firm*, 50 CASE W. RES. U. L. REV. 215, 234 (1999). *See also* BRIAN CHEFFINS, THE PUBLIC COMPANY TRANSFORMED 79 (2018).

[14] Henry G. Manne, *Mergers and the Market for Corporate Control*, 73 J. POL. ECON. 110 (1965).

[15] *See* CHEFFINS, *supra* note 13, at 79.

[16] Manne, *supra* note 14, at 112.

[17] *Id.*

could be with better management,[18] these expected gains in efficiency can be quantified by evaluating how the share price of the company changed as a result of a takeover bid.[19]

Acquirers who participate in the market for corporate control, i.e., those who are motivated at least in part by the profits that can be earned by correcting managerial inefficiencies, can be categorized as a very special subset of what Zohar Goshen and Gideon Parchomovsky call "information traders."[20] These traders trade in the financial markets based on non-public research and analysis and "are willing and able to devote resources to gathering and analyzing information as a basis for their investment decisions."[21] "[I]nformation traders [look for differences] between value and price based on the information they possess . . . [t]hen trade to capture the value of their informational advantage."[22] Information traders move security prices toward their fundamental values and are in essence "the agents who render markets efficient."[23]

In the market for corporate control, an important process by which managerial inefficiencies can be corrected is through a hostile takeover. The lead actor in a hostile takeover, the hostile bidder, assuming it is an information trader seeking to correct managerial inefficiencies, may act as a *corrective mechanism* in corporate governance. A *corrective mechanism* is defined as a stakeholder, including shareholders, or potential stakeholders "of a public company, other than the [current] Board or executive management, which may have, from time to time, superior decision-making skills in the making of major corporate decisions."[24]

In the context of the theory of the market for control, Manne describes how the hostile bidder would operate:

> [I]f an existing corporation with publicly traded shares is poorly managed, holders of those shares will respond by selling. This will drive the price down to the point indicated by the quality of management which the corporation is receiving. As the price of securities of any corporation is thought to be low relative to the price that would be generated by more efficient managers, the stage is set for the critical functioning of the market for corporate control. Outsiders, whether we call them "raiders"[25] or more polite names, will respond to the

[18] *Id.* at 113 ("Share price, or that part reflecting managerial efficiency, also measures the potential capital gain inherent in the corporate stock.").

[19] Fred S. McChesney, *Manne, Mergers, and the Market for Corporate Control*, 50 CASE W. RES. U. L. REV. 245, 252 (1999).

[20] Bernard S. Sharfman, *A Theory of Shareholder Activism and Its Place in Corporate Law*, 82 TENN. L. REV. 791, 797–98 (2015).

[21] Zohar Goshen & Gideon Parchomovsky, *The Essential Role of Securities Regulation*, 55 DUKE L.J. 711, 723 (2006).

[22] *Id.* at 726.

[23] *Id.* at 719.

[24] Bernard S. Sharfman, *The Tension Between Hedge Fund Activism and Corporate Law*, 12 J. L. ECON. & POL. 251, 258 (2016) (alteration in original).

[25] Undoubtedly, Manne is referring here to hostile bidders. However, Manne did not limit the definition of an acquirer to a corporate raider or hostile bidder. *See* Manne, *supra* note 14, at 117. The friendly acquisition is a perfectly acceptable way of gaining control for purposes of implementing efficiencies, even though Manne suggested that some sort of side payment to the target's management was usually involved in order to get their sign-off. *See id.* at 118. According to Coffee, "Manne's focus was not specifically on hostile tender offers, which were then just beginning to become highly visible, but rather on acquisitions, mergers, and control contests generally."

> opportunity to make substantial capital gains (not necessarily in the tax sense) by buying control, managing the company efficiently, and then perhaps disposing of the shares. It is not necessary that they remain permanently to manage the business.[26]

For the hostile bidder, the weapon of choice has always been the tender offer. Empirically, both here in the United States and in the United Kingdom, the tender offer has allowed target shareholders to reap significant gains.[27] In both countries hostile tender offers have tended to produce statistically significant abnormal positive returns for target shareholders, which in general have not been offset by corresponding losses to bidder shareholders.[28] This empirical work provides significant support for the efficiency enhancing role that the hostile bidder plays in the *market for corporate control*.

However, unsuccessful hostile tender offers did not yield positive abnormal returns. Moreover, when unsuccessful tender offers did not ultimately result in a change in control, target shareholders suffered significant losses.[29] This implies that the use of aggressive defensive measures is inconsistent with shareholder welfare. And, although empirical studies show that returns to shareholders of bidders from acquisitions have generally been negligible, it is nevertheless very clear that the aggregate combined value of targets and acquirers from these transactions increased relative to their stand-alone values.[30]

Unfortunately, while a vibrant hostile takeover market did exist in the United States during the 1960s, 70s, and 80s,[31] this has not been the case for many years.[32] In the early 80s the use and success of a particular kind of tender offer—the front-end loaded, two-tier tender offer to acquire the majority of voting stock of a target company despite the target board's opposition—led to a slew of antitakeover statutes and the development of shark repellents such as the poison pill, which greatly damaged the vibrancy of this market.[33] Without a vibrant hostile takeover market

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John C. Coffee Jr., *Regulating the Market for Corporate Control: A Critical Assessment of the Tender Offer's Role in Corporate Governance*, 84 COLUM. L. REV. 1145, 1153 (1984). Moreover, those entities who may be in the best position to evaluate a company's managerial strengths and weaknesses may include competitors, customers, and suppliers. Manne, *supra* note 14, at 118–19. These are the kind of companies that constantly interact with the target and may have unique insights into the managerial inefficiencies that need correcting. *See id.*

[26] Henry G. Manne, *Cash Tender Offers for Shares – A Reply to Chairman Cohen*, 1967 DUKE L.J. 231, 236 (1967) (footnotes omitted).

[27] For a summary of empirical studies on tender offers, including hostile tender offers, both in the U.S. and the U.K., *see generally* Bernard S. Sharfman & Marc T. Moore, *Liberating the Market for Corporate Control*, 18 BERKELEY BUS. L.J. 1, 42–3 (2021) (https://lawcat.berkeley.edu/record/1207307?ln=en).

[28] *Id.*

[29] *Id.*

[30] *Id.*

[31] *See* Matthew D. Cain et al., *Do Takeover Laws Matter? Evidence from Five Decades of Hostile Takeovers*, 124 J. FIN. ECON. 464, 479 (2017).

[32] *See id.* at 465.

[33] For a detailed discussion of the hostile takeover market in the 1960s, 70s, and 80s, and the legal impediments, including the use of the poison pill, placed in the way of hostile bidders, *see generally* Sharfman & Moore, *supra* note 27 (manuscript at 9–16).

in place, the most significant *corrective mechanism* in terms of correcting managerial inefficiencies has been lost.[34]

B. A Theory of Hedge Fund Activism

Even though we no longer have a vibrant hostile takeover market in the U.S., we do have another way in which a shareholder or group of shareholders can seek to correct managerial inefficiencies in a public company: *hedge fund activism*.[35] A hedge fund activist seeks to bring about change within a public company *without trying to gain control*. Therefore, hedge fund activism exists in a *market for corporate influence*, not corporate control.[36]

Given the potential for a hedge fund activist to act in the same manner as the hostile bidder, we can extend Manne's *theory of the market for corporate control* to one that applies to hedge fund activism: "In the context of public companies, hedge fund activism may constitute a valuable asset in and of itself if the goal of such activism is to enhance managerial efficiency."[37]

1. Hedge Fund Activism, The Process

Hedge fund activism "typically begins with an unregulated investment fund (the [activist] hedge fund) accumulating a significant amount of a public company's stock, usually around 5% to 10% of the shares outstanding."[38] A large position is necessary in order for the activist hedge fund to earn a large enough return on the expected increase in the stock price to cover the costs of its activism.[39] It also helps in enhancing its voting power, giving it a better chance of eventually getting its way at the target company.[40]

"The activist hedge fund makes purchases based on its determination that the target company is suffering from significant *managerial inefficiencies*."[41] It believes that if management adopts its recommended strategies then the value of the company's common stock would significantly increase and the company's performance would improve,[42] allowing the activist hedge fund's investors to potentially earn sizable returns. Hence, the activist hedge fund has wealth maximization as its objective based on the perspective of its investors.

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[34] For a detailed discussion of how corporate law can be modified to allow for the return of the hostile bidder, *see* Sharfman & Moore, *supra* note 27, at 21–29.

[35] As has been pointed out by Henry Manne in an email exchange with this author, the development of the *market for corporate influence* has no doubt been helped by federal securities and state corporate laws that have greatly inhibited the volume of hostile takeover transactions. E-mail from Henry G. Manne, Professor Emeritus of L., Geo. Mason Univ., to Bernard S. Sharfman, Assistant Professor of L., Case W. Univ. Sch. of L. (Sept. 11, 2013, 2:13 PM) (on file with author).

[36] Brian R. Cheffins & John Armour, *The Past, Present, and Future of Shareholder Activism by Hedge Funds*, 37 J. CORP. L. 51, 58 (2011).

[37] Sharfman, *supra* note 20, at 804.

[38] Sharfman, *supra* note 24, at 255.

[39] Sharfman, *supra* note 20, at 804–805.

[40] *Id.* at 806.

[41] Sharfman, *supra* note 24, at 255.

[42] Cheffins & Armour, *supra* note 36, at 56.

In order for an activist hedge fund to maximize returns, it cannot hold the target company's stock for a long period of time.[43] Once it becomes apparent that it has either succeeded or failed in its mission to correct managerial inefficiencies, it "must move on to the next target in order to maximize its number of interventions and thus the profits of its own investors."[44]

Typically, being a hedge fund activist means not just identifying managerial inefficiencies that exist in a public company, but also raising large amounts of capital in order to make a significant investment in the company. It also requires possessing both the expertise necessary to make the recommended changes that will correct the managerial inefficiencies and the time and financial resources available to vigorously advocate for change.[45] Moreover, being such an activist may mean giving up the benefits of portfolio diversification as the acquisition becomes an overweighted investment in the information trader's portfolio, exposing the activist hedge fund to non-systematic risk.[46]

2. The Activist Hedge Fund as a *Corrective Mechanism* in Corporate Governance

An activist hedge fund works in a similar manner to the potential acquirer who is seeking to correct managerial inefficiencies.[47] The difference is that the activist hedge fund, assuming it is an information trader, attempts to correct inefficiencies through its influence, not its control of the company.[48] It utilizes value investors who are voting with their feet as an opportunity to acquire a significant but not controlling share in a company at a relatively low price with the expectation that the inefficiencies will eventually be corrected through its efforts and the price will rise to reflect these enhanced efficiencies.[49] Once these enhanced efficiencies have been fully reflected in the stock price, the activist hedge fund can then sell its investment for a large profit if it so desires.[50] In essence, hedge fund activism provides a corrective function similar to but with less investment and more advocacy than what is required in hostile takeovers.[51]

Numerous empirical studies demonstrate that hedge fund activism increases the wealth of shareholders and improves the performance of the public companies it targets.[52] These studies

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[43] Paul Rose & Bernard S. Sharfman, *Shareholder Activism as a Corrective Mechanism in Corporate Governance*, 2014 BYU L. REV. 1014, 1046 (2014). *See also* Alon Brav, Wei Jiang, Frank Partnoy & Randall Thomas, *Hedge Fund Activism, Corporate Governance, and Firm Performance*, 63 J. FIN. 1729, 1732 (2008).
[44] Rose & Sharfman, *supra* note 43.
[45] Sharfman, *supra* note 20, at 805.
[46] *Id.* at 806.
[47] *Id.* at 805–07.
[48] *Id.*
[49] *Id.*
[50] *Id.*
[51] *Id.*
[52] *See* Lucian A. Bebchuk, Alon P. Brav & Wei Jiang, *The Long-Term Effects of Hedge Fund Activism*, 115 COLUM. L. REV. 1085, 1100 (2015); Alon Brav, Wei Jiang, Frank Partnoy & Randall Thomas, *Hedge Fund Activism, Corporate Governance, and Firm Performance*, 63 J. FIN. 1729, 1731 (2008); Nicole M. Boyson & Robert M. Mooradian, *Corporate Governance and Hedge Fund Activism*, 14 REV. DERIVATIVES RES. 169, 175–78, 201 (2011); Christopher P. Clifford, *Value Creation or Destruction? Hedge Funds as Shareholder Activists*, 14 J. CORP. FIN. 323, 324 (2008); Robin M. Greenwood & Michael Schor, *Investor Activism and Takeovers*, 92 J. FIN. ECON. 362, 374 (2009); April Klein & Emanuel Zur, *Entrepreneurial Shareholder Activism: Hedge Funds and Other*

support the arguments that hedge fund activism "is a valuable asset in and of itself" and has the overall effect of being a *corrective mechanism* in the governance of public companies.[53] Moreover, the similarities between potential acquirers and activist hedge funds as corrective mechanisms are more striking when one looks closer at the empirical results and sees that the wealth enhancement created by hedge fund activism has been primarily a result of recommendations that have led to "the sale of the company or changes in business strategy, such as refocusing and spinning-off noncore assets."[54] The results suggest a continuum between the market for corporate control and the market for corporate influence given that the activist hedge fund is utilizing its influence to convince a reluctant Board to seek a friendly merger or a spin-off of significant assets in order to correct the company's managerial inefficiencies.

II. The Hedge Fund Activism of Engine No. 1

Based on the theory of hedge fund activism as presented in Part I, we can now analyze the activism of Engine No. 1 as it pertains to its engagement with ExxonMobil.

A. Initial Investment

The way Engine No. 1 initiated its activism at ExxonMobil provided a strong indication that it was not going to be a *corrective mechanism* in the company's corporate governance. On December 7, 2020, the date that it began its engagement with ExxonMobil management, instead of having accumulated 5% to 10% of ExxonMobil common stock, which would have totaled in the billions of dollars, it had only accumulated around $38 million.[55] By contrast, the amount that Engine No. 1 budgeted for its eventual proxy fight was almost as much as its investment, $30 million.[56] Based on the amount of its initial investment and expected expenses, it was clear, at least from the time that it proposed its own partial slate of director nominees (March 15, 2021), that the objective of this activism was not to make money for its primary investor, Christopher James,[57] from an expected rise in the price of ExxonMobil's stock.

Private Investors, 64 J. FIN. 187, 213, 217–18 (2009); Dionysia Katelouzou, *Myths and Realities of Hedge Fund Activism: Some Empirical Evidence*, 7 VA. L. & BUS. REV. 459, 479 (2013) (examining empirical results consistent with these studies but focusing on hedge fund activity outside the United States); Alon Brav, Jiang Wei, Ma Song & Tian Xuan, *How Does Hedge Fund Activism Reshape Corporate Innovation?*, 130 J. FIN. ECON. 237, 238 (2018) ("Firms targeted by activists improve their innovation efficiency over the five-year period following hedge fund intervention."). For an overview of these studies and others, *see* Alon Brav, Wei Jiang & Rongchen Li, *Governance by Persuasion: Hedge Fund Activism and the Market for Corporate Influence* (Eur. Corp. Governance Inst., Finance Working Paper No. 797/2021, 2021), https://papers.ssrn.com/sol3/papers.cfm?abstract_id=3955116.

[53] Rose & Sharfman, *supra* note 43, at 1037–38.

[54] Brav et al., *supra* note 52, at 1731; *see* Greenwood & Schor, *supra* note 52, at 363 (finding that abnormal positive returns only existed when the activism was associated with the ultimate sale of the target to a third party); Nicole M. Boyson, Nickolay Gantchev & Anil Shivdasani, *Activism Mergers*, 126 J. FIN. ECON. 54, 54 (2017) ("Shareholder value creation from hedge fund activism occurs primarily by influencing takeover outcomes for targeted firms.").

[55] Engine No. 1, Quarterly Report, (Form 13F Info. Table) (filed Feb. 16, 2021).

[56] Deveau, *supra* note 1.

[57] *Engine No. 1 LLC*, WHALEWISDOM (accessed July 18, 2021), https://whalewisdom.com/filer/engine-no-1-llc#tabadv_ownership_tab_link.

However, Engine No. 1's activism at ExxonMobil was not an altruistic endeavor. The expected economic payoff, while indirect and not typical, was to come in the form of a higher profile among investors, leading to an increased ability to raise funds for its ETFs. For example, shortly after concluding its successful proxy fight, Engine No. 1 announced the launch of its first ETF, "Engine No. 1 Transform 500 ETF" (ticker symbol "VOTE").[58] The $100 million fund is to invest in the largest 500 stocks and would aim to track the Morningstar U.S. Large Cap Select Index.[59] However, this fund is expected to distinguish itself from other index funds, especially those managed by the "Big 3" investment advisers, BlackRock, Vanguard, and State Street Global Advisors, by engaging in a relatively large amount of shareholder activism.[60] Later this year, Engine No. 1 is expected to launch another ETF, "The Transform Climate ETF"; this fund "will invest in companies that are transforming themselves to address the growing demands of climate change or that are helping other companies to do so."[61]

B. Activism Prior to the Proxy Fight

Based on the text of Engine No. 1's March 15 proxy statement announcing its partial slate of director nominees and replicated here in part,[62] its engagement with ExxonMobil appeared, at least on the surface, to resemble typical hedge fund activism:

- On December 7, 2020, Engine No. 1 sent a letter to the Board outlining its case for change at the Company and calling on the Company to (i) refresh the Board with highly qualified, independent directors who have diverse track records of success in the energy sector, (ii) impose greater long-term capital allocation discipline by applying more stringent approval criteria for new capital expenditures, including lower required break-even oil and gas prices, (iii) implement a strategic plan for sustainable value creation by fully exploring growth areas, including more significant investment in clean energy, and (iv) overhaul management compensation to better align incentives with shareholder value creation.
- On December 18, 2020, Engine No. 1's legal counsel sent a letter to the Company requesting the Company's questionnaire and nominee representations agreement, both of which are required for shareholders to nominate directors.
- On December 21, 2020, members of Engine No. 1 met by video with employees of the Company to discuss the matters raised by Engine No. 1 in its December 7 letter to the Board.

[58] Katherine Dunn, *Engine No. 1 to Launch $100 Million ETF Focused on ESG Engagement*, FORTUNE (June 22, 2021, 11:20 AM), https://fortune.com/2021/06/22/engine-no1-etfs-esg-finance-2021/.
[59] *Id.*
[60] Bernice Napach, *Engine No. 1 Introduces a New Kind of Purpose-Driven ETF*, THINKADVISOR (June 25, 2021, 11:29 PM), https://www.thinkadvisor.com/2021/06/25/engine-no-1-introduces-a-new-kind-of-purpose-driven-etf/.
[61] *Id.*
[62] Engine No. 1 LLC, Definitive Proxy Statement at 4–5, (Schedule 14A) (Mar. 15, 2021).

- On December 24, 2020, a representative of Engine No. 1 and a representative of the Company had a call to further discuss the matters raised by Engine No. 1 in its December 7 letter to the Board.
- On January 4, 2021, Engine No. 1's legal counsel sent a letter to the Company requesting access to certain shareholder records.
- On January 6, 2021, a member of Engine No. 1 and an advisor to the Company had a follow-up call to further discuss the matters raised by Engine No. 1 in its December 7 letter to the Board.
- On January 11, 2021, Engine No. 1's legal counsel received a response letter from the Company to its January 4 request for access to certain shareholder records. The Company's response sought additional information from Engine No. 1 and stated that the Company was reserving "its right to reject [Engine No. 1's] request".
- On January 14, 2021, a member of Engine No. 1 had a follow-up call with an advisor to the Company who stated that the Company was willing to sign a confidentiality agreement with Engine No. 1 to review and give input with respect to announcements that the Company intended to make on the Company's upcoming quarterly earnings call and get some credit for such announcements, as well as to extend the notice date for Engine No. 1 to formally nominate individuals for election to the Board. This advisor, however, also stated that the Company did not intend to appoint or even to meet with any of Engine No. 1's nominees and was not concerned that institutional investors would expect them to meet with such nominees. The member of Engine No. 1 replied that Engine No. 1 was not interested in getting such credit (and no such confidentiality agreement was ever signed) but was concerned by the Company's position with respect to its nominees. At this point the advisor said that no final decisions had been made and that Engine No. 1 should encourage ExxonMobil's CEO and Lead Board Director to consider Engine No. 1's nominees. Engine No. 1 hereby states for the record that the Company never interviewed or asked to interview any of the Engine No. 1 Nominees.
- On January 20, 2021, Engine No. 1's legal counsel responded to the Company's January 11 letter by providing the additional information that the Company requested and noting that it was doing so "in the spirit of the constructive and substantive dialogue" and despite the fact that the Company's January 11 letter "raise[d] highly technical objections and ignore[d] black letter New York law" in delaying Engine No. 1's right to the shareholder materials it requested.
- On January 22, 2021, members of Engine No. 1 met by video with the Company's CEO and Lead Board Director (the "Lead Director") to discuss the matters raised by Engine No. 1 in its December 7 letter to the Board and a possible resolution. The Lead Director stated that Engine No. 1's nominees did not meet the Board's criteria for new directors, which he described generally as having held the CEO role at companies with large market capitalizations, scale, and geographic scope. A member of Engine No. 1 asked, given the Company's underperformance over the last decade,

whether it would be appropriate to reconsider such criteria, and also pointed out that in any case at least two of Engine No. 1's nominees met such criteria while others offered expertise in areas specifically described by ExxonMobil as being important to the Company's future. The Lead Director replied that while he could make no promises, he would discuss this with the Board . . . .

- On January 27, 2021, Engine No. 1 submitted a notice of its intent to nominate the four Nominees for election as directors at the Annual Meeting.
- On February 9, Engine No. 1 and the Company entered into an NDA [non-disclosure agreement] related to the shareholder information sought by Engine No. 1 in its January 4 letter.
- On February 15, 2021, Engine No. 1 received certain of the shareholder information it sought in its January 4 letter.
- On February 22, 2021, Engine No. 1 sent a letter to the Board, in response to Company claims regarding its adherence to the goals of the Paris Agreement and its carbon capture expertise, noting that while ExxonMobil has gone from dismissing emissions reduction goals as a "beauty competition" to claiming repeatedly that its emissions reduction plans are consistent with the Paris Agreement, ExxonMobil's methodology actually omits the majority of the Company's emissions.

In sum, prior to initiating its proxy fight, Engine No. 1's engagement efforts did yield results. Most importantly, the board of ExxonMobil added three new directors in the first quarter of 2021, including two that did not have large company CEO experience: Wan Zulkiflee (February 2021), the former President and Group CEO of Petronas, the national oil and gas company of Malaysia; Michael Angelakis (March 2021), the Chairman and CEO of Atairos (investment company) and former Vice Chairman and CFO of Comcast Corporation; and, with the support of D.E. Shaw (an activist shareholder seeking to enhance shareholder value at ExxonMobil by slashing operating and capital expenditures at ExxonMobil), Jeffrey Ubben (March 2021), the co-founder of Inclusive Capital Partners.[63]

However, these actions did not satisfy Engine No. 1; it still wanted its own director nominees to be added to the board of ExxonMobil. This now required Engine No. 1 to enter into a proxy fight with the board of ExxonMobil.

C. Engine No. 1's Lack of Specific Recommendations

To garner ExxonMobil shareholder support for its dissident slate of four director nominees, Engine No. 1 provided the following recommendations for ExxonMobil shareholders to consider:[64]

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[63] BlackRock, *Vote Bulletin: Exxon Mobil Corporation* at 3–4 (May 26, 2021), https://www.blackrock.com/corporate/literature/press-release/blk-vote-bulletin-exxon-may-2021.pdf

[64] Engine No. 1 LLC, Definitive Proxy Statement at 9, (Schedule 14A) (Mar. 15, 2021) (emphasis added).

- **Imposing Better Long-Term Capital Allocation Discipline:** We believe ExxonMobil needs a more disciplined and forward-thinking approach to capital allocation strategy, *including a long-term commitment to only funding projects that can break even at much more conservative oil and gas prices*. We believe that a long-term commitment to cutting unproductive CapEx and tightening project return requirements for approval would likely increase free cash flow, strengthen the Company's balance sheet, and help secure its ability to cover its dividend, which are crucial considerations particularly for the Company's smaller shareholders.

- **Overhaul Management Compensation to Better Align Incentives with Shareholder Value Creation:** We believe that the Company's management compensation plans should be overhauled for the long term to better align compensation with value creation for shareholders. Such changes would include utilizing pre-set weightings and targets, employing more cost management and balance sheet-focused metrics, and measuring value creation not just by reference to the oil and gas industry but to the overall market, to ensure that management is not rewarded for outperforming the industry but eroding shareholder value.

- **Implementing a Strategic Plan for Sustainable Value Creation in a Changing World:** While we understand that change will not come overnight, we believe that ExxonMobil should fully explore ways to leverage its scale and expertise in delivering energy by exploring growth areas, including more significant investment in net-zero emissions energy sources and clean energy infrastructure, under the guidance of a special committee of the Board with relevant experience created for this purpose.

- **Refreshing the Board with Engine No. 1's Highly Qualified, Independent Nominees:** As demonstrated in more detail in Proposal 1 below, we believe our Nominees bring to bear a diverse set of experiences in successful, global energy operations and decades of leading value-creating transformations in the industry. We believe that, based on their track record and experience in the energy arena, they can help the Board unlock sustainable, long-term shareholder value by addressing the fundamental issues facing the Company as it looks toward the future.

From Engine No. 1's investor presentation of May 2021,[65] they added the following points:

- 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.

  . . .

[65] Engine No. 1, *Reenergize ExxonMobil // Investor Presentation* at 6–26 (May 2021), https://assets.contentstack.io/v3/assets/bltc7c628ccc85453af/blt3dbbabebb3dbed9d/611e6bf1e8898d66a7c9495c/Investor-Presentation-May-2021-v2_(1).pdf.

- While its balance sheet once had almost zero net debt, today ExxonMobil has the most debt in its history, increasing over $80 billion in the last 12 years, and since 2016 has had three debt ratings downgrades by S&P (including two pre-COVID).
  . . .
- ExxonMobil's long-term trajectory of growing emissions creates existential long-term business model risk in a rapidly decarbonizing world.
  . . .
- Scope 3 emissions are a fundamental long-term threat to [ExxonMobil's] business model.
  . . .
- ExxonMobil significantly lags public integrated oil companies in measures of transition-readiness, scoring better than only state-controlled entities.

- While recently shifting its rhetoric on the importance of low-carbon strategies, ExxonMobil has paid little actual attention to such efforts.

In sum, Engine No. 1 has two primary goals: "reducing . . . [ExxonMobil's] emissions that are warming the planet and lifting the profits and stock price of Exxon."[66] It believes this can be done if ExxonMobil would acknowledge that the world is rapidly decarbonizing and adjust its long-term strategy accordingly; cut back on its capital expenditures on new oil and gas drilling development; focus only on development projects that use much more conservative oil and gas breakeven prices; reduce outstanding debt associated with unprofitable low-value oil and gas investments; implement executive compensation practices that do a better job focusing on shareholder value; increase investment in clean energy projects; and enhance the energy industry experience of the board with its own director nominees.

Yet, the inability to provide specific recommendations that could enhance shareholder value or reduce the company's carbon emissions in a value enhancing way was extremely telling. For example, what precisely are the profitable clean energy opportunities that the company is currently not investing in that would enhance shareholder value and reduce the company's carbon emissions? Or, what enhanced methodology should the company use in determining more conservative oil and gas breakeven prices? Moreover, if the world is *rapidly* decarbonizing, where is the evidence for this except for the wish that it be so? Yes, the world is starting to decarbonize or at least recognizes the threat of not doing so, but economic growth continues, especially as the world bounces back from the pandemic, and total emissions are now expected to break records in 2023 and continue to grow in the years to come.[67] In summary, a lack of

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[66] Peter Eavis & Clifford Krauss, *Activists Crashed Exxon's Board, but Forcing Change Will Be Hard*, N.Y. TIMES (May 27, 2021), https://www.nytimes.com/2021/05/27/business/economy/exxon-board-climate-change.html.

[67] Anmar Frangoul, *CO2 Emissions Set to Hit Record Levels in 2023 and There's 'No Clear Peak in Sight,' IEA Says*, CNBC (July 20, 2021, 4:26 AM), https://www.cnbc.com/2021/07/20/co2-emissions-will-hit-record-levels-in-2023-iea-says.html. Such projections for carbon emissions growth support the argument that the trip to net zero carbon emissions will be an extremely long and difficult one, an argument that Mark Mills convincingly makes in his 2019 report. *See* Mark Mills, *The "New Energy Economy": An Exercise in Magical Thinking*, MANHATTAN INSTITUTE 4 (Mar. 2019), https://media4.manhattan-institute.org/sites/default/files/R-0319-MM.pdf. One extremely

specificity in Engine No. 1's recommendations indicated that it was not truly informed about the operations of ExxonMobil or how to manage its long-term future.

Confirmation that Engine No. 1's activism was not expected to correct managerial inefficiencies can be found in how the stock market reacted to its activism. According to Henry Manne, changes in stock price in a liquid stock market is the only objective measure of whether managerial inefficiencies will be corrected.[68] In that regard, there is no evidence that Engine No. 1's activism yielded positive abnormal returns to ExxonMobil's stockholders. As observed by Desai, Rajagopal, and Tomar, whatever increase in the price of ExxonMobil's stock since Engine No. 1's activism became public can be attributed to a rise in oil prices that has benefited all oil and gas companies.[69] Therefore, if the market thought Engine No. 1 was acting as a *corrective mechanism*, it certainly did not reveal it.

D. Engine No. 1's Proxy Fight

Even without specific recommendations or a positive market price reaction to justify entering into a proxy fight, Engine No. 1 was still able to convince enough ExxonMobil shareholders to elect three of its four nominees to ExxonMobil's board of directors: Kaisa Hietala, Gregory J. Goff, and Alexander A. Karsner.[70] This was an astonishing accomplishment and defied conventional thinking about what makes for successful hedge fund activism.

How was Engine No. 1 able to do this? No doubt the timing was right. ExxonMobil was floundering financially as a result of a high debt load, pandemic-reduced demand for its products, and the resulting low oil and gas prices. Moreover, even when the consensus opinion of the scientific community had long suggested otherwise, ExxonMobil had a history of at least being perceived as denying climate change and funding organizations that supported that perspective.[71] Finally, company management did not see climate change as creating the need to

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interesting point he makes (one of many) is that new inventions and advances in technology create significant new demands for energy. *Id.* at 18. One example that readily comes to mind is the significant energy demands that Bitcoin mining is now making on the world's electrical grid and the additional carbon emissions that it has created. It has been reported that Bitcoin mining consumes more electricity than is generated in Argentina. Josh Saul, *Bitcoin Power Consumption Jumped 66-Fold Since 2015, Citi Says*, BLOOMBERG GREEN (April 13, 2021, 5:59 PM), https://www.bloomberg.com/news/articles/2021-04-13/bitcoin-power-consumption-jumped-66-fold-since-2015-citi-says; s*ee also* Will Mathis, *U.S. Offshore Wind Push Set to Fall Short of Biden's 2030 Goal*, BLOOMBERG GREEN (July 28, 2021, 8:05 AM), https://www.bloomberg.com/news/articles/2021-07-28/u-s-offshore-wind-push-set-to-fall-short-of-biden-s-2030-goal.

[68] Manne, *supra* note 14, at 113.

[69] Desai, Rajagopal & Tomar, *supra* note 4.

[70] Exxon Mobil Corp., Current Report (Form 8-K/A) (June 21, 2021), https://www.sec.gov/ix?doc=/Archives/edgar/data/34088/000003408821000037/xom-20210526.htm. All three have experience in the oil industry. Interestingly, the fourth nominee, Anders Runevad, a former wind power company CEO, received the fewest votes of all the nominees on the ballot. *See id.* This lack of votes for a wind power expert can be understood as a signal from market participants that ExxonMobil's clean energy future, if there is to be such a future, does not include significant investment in wind energy production. *See* Engine No. 1 LLC, Definitive Proxy Statement at 9, (Schedule 14A) (Mar. 15, 2021).

[71] Paul Krugman, *Enemy of the Planet*, N.Y. TIMES (April 17, 2006), https://www.nytimes.com/2006/04/17/opinion/enemy-of-the-planet.html; *see also* Suzanne, Goldenberg, *Exxon Knew of Climate Change in 1981, Email Says – But It Funded Deniers for 27 More Years*, THE GUARDIAN (July 8,

change its primary strategy of focusing on fossil fuels.[72] Thus, it was extremely vulnerable to criticism by many different types of stakeholders, not just shareholders. Yet, at the time that Engine No. 1 filed its March 15, 2021 definitive proxy statement seeking the election of its partial slate of four director nominees, ExxonMobil was still a $250 billion company and recognized as one of those small number of top performing companies, based on decades of capital appreciation and dividend payouts, that have allowed the stock market to significantly outperform Treasuries over time.[73]

Engine No. 1 succeeded because it focused on gaining the support of the "Big Three" investment advisers to index and ESG funds—BlackRock, Vanguard, and State Street Global Advisors. The Big Three own approximately 21% of ExxonMobil's voting stock.[74] But that percentage significantly understates their voting power because they will likely vote all their shares while retail investors, who own approximately 47% of ExxonMobil common stock,[75] will not.[76] To garner the Big Three's support, Engine No. 1 appealed to their desire to be perceived as investment advisers who are making a difference in helping to mitigate climate change. Such a perception is necessary in order to attract "millennial" investors, the investor segment that will eventually replace baby boomers as the dominant investor segment in mutual fund and ETF investing.[77] According to Larry Fink (CEO of BlackRock) in his 2019 letter to CEOs,

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2015, 4:41 PM), https://www.theguardian.com/environment/2015/jul/08/exxon-climate-change-1981-climate-denier-funding.

[72] John Schwartz, *Climate Change Activists Either Prod Exxon Mobil or Dump It*, N.Y. TIMES (May 25, 2016), https://www.nytimes.com/2016/05/26/science/exxon-mobil-annual-meeting.html.

[73] Hendrik Bessembinder, *Do Stocks Outperform Treasury Bills?*, 129 J. FIN. ECON. 440, 440 (2018). Hendrik Bessembinder observed that there is a significant amount of positive skewness in the returns of individual public companies that have made up the stock market from July 1926 to December 2016. He found that "in terms of lifetime dollar wealth creation, the best performing 4% of listed companies explain the net gain for the entire US stock market since 1926, as other stocks collectively matched Treasury bills" with lifetime dollar wealth creation defined as "accumulated December 2016 value in excess of the outcome that would have been obtained if the invested capital had earned one-month Treasury bill returns." *Id.* at 440, 454. His results also showed that the sum of the individual contributions to lifetime dollar wealth creation provided by the top fifty companies (with ExxonMobil being number one on the list) represented almost 40% of total lifetime dollar wealth creation. *Id.* at 454. Thus, the returns earned by a relatively small number of best-performing companies were critical to the stock market earning returns above short-term Treasuries. *Id.* at 441. However, by the end of 2019, Exxon had fallen to number three on the list. Hendrik Bessembinder, *Wealth Creation in the U.S. Public Stock Markets 1926 to 2019*, 30 J. OF INVESTING 47, 51 (2021).

[74] Exxon Mobil Corp., Proxy Statement at 35 (Schedule 14A) (March 16, 2021).

[75] *Exxon Mobil Corporation,* YAHOO! FINANCE, (accessed July 24, 2021), https://finance.yahoo.com/quote/XOM/holders?p=XOM.

[76] Caleb Griffin finds that while the Big Three control approximately 20.1% of shares at the largest 250 publicly traded companies in the U.S., they cast a combined 25% of the proxy votes. Caleb N. Griffin, *Margins: Estimating the Influence of the Big Three on Shareholder Proposals,* 73 SMU L. REV. 409, 411 (2020). He further estimated that Vanguard had an average voting influence of 10.6%, BlackRock 9.0%, and State Street 4.4%. *Id.* at 418, Table 1. *See also* Alon Brav, Matthew Cain & Jonathon Zytnick, *Retail Shareholder Participation in the Proxy Process: Monitoring, Engagement, and Voting*, J. FIN. ECON., (Aug. 14, 2021), https://doi.org/10.1016/j.jfineco.2021.07.013.

[77] *See* Michal Barzuza, Quinn Curtis & David H. Webber, *Shareholder Value(s): Index Fund ESG Activism and the New Millennial Corporate Governance*, 93 S. CAL. L. REV. 1243, 1246 (2020).

millennials, more so than prior generations, see the primary objective of business to be the improvement of society, not the generation of profits[78]:

> Companies that fulfill their purpose and responsibilities to stakeholders reap rewards over the long-term. Companies that ignore them stumble and fail. This dynamic is becoming increasingly apparent as the public holds companies to more exacting standards. And it will continue to accelerate as *millennials*—who today represent 35 percent of the workforce—express new expectations of the companies they work for, buy from, and invest in . . . .
>
> Over the past year, we have seen some of the world's most skilled employees stage walkouts and participate in contentious town halls, expressing their perspective on the importance of corporate purpose. This phenomenon will only grow as *millennials* and even younger generations occupy increasingly senior positions in business. In a recent survey by Deloitte, *millennial* workers were asked what the *primary purpose* of businesses should be—63 percent more of them said "improving society" than said "generating profit."
>
> In the years to come, the sentiments of these generations will drive not only their decisions as employees but also as investors, with the world undergoing *the largest transfer of wealth in history: $24 trillion from baby boomers to millennials.* As wealth shifts and investing preferences change, *environmental, social, and governance issues* will be increasingly material to corporate valuations. This is one of the reasons why BlackRock devotes considerable resources to improving the data and analytics for measuring these factors, integrates them across our entire investment platform, and engages with the companies in which we invest on behalf of our clients to better understand your approach to them.[79]

So, the Big Three were arguably in a bind. They were under a lot of pressure to support Engine No. 1's efforts or else they would be perceived as not walking the talk on climate change. If so, then that would hinder their ability to market their products to millennials. Based on their voting, it appears that the marketing implications won out over the need to actually implement value enhancing change at ExxonMobil. BlackRock ended up supporting three Engine No. 1 director nominees,[80] while Vanguard and State Street Global Investors each supported two.[81] Engine No. 1 was also supported by a number of large public pension funds and the major proxy advisors to institutional investors, Institutional Shareholder Services and Glass Lewis.[82]

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[78] Larry Fink, *Larry Fink's 2019 Letter to CEOs: Purpose and Profit*, BLACKROCK, https://www.blackrock.com/corporate/investor-relations/2019-larry-fink-ceo-letter (emphasis added). This letter was apparently the inspiration for the Barzuza, Curtis, and Webber article. *See id.*

[79] Fink, *supra* note 78.

[80] BlackRock, *supra* note 63.

[81] Richard J. Grossman & Neil P. Stronski, *What the Exxon Mobil Shareholder Votes Mean*, SKADDEN, ARPS, SLATE, MEAGHER & FLOM LLP (June 16, 2021), https://www.skadden.com/insights/publications/2021/06/the-informed-board/what-the-exxon-mobil-shareholder-votes-mean.

[82] *Id.*

E. The Issue of Agency Costs

The author of this Article cannot claim to have been in the offices of the Big Three's investment stewardship teams when they were deciding how to vote on Engine No. 1's dissident slate of director nominees. However, the argument presented above seems quite plausible and would appear to reflect a rational voting approach in support of their marketing goals. If so, then we need to be concerned about the *agency costs of agency capitalism*[83] that this type of shareholder voting reflects. In the context of investment advisers to investment funds, such agency costs are created when investment advisers vote their shares as a means to meet their own needs, such as voting to support their marketing of investment products to millennials, and not necessarily the needs of those who actually invest in the funds they manage.[84]

Such opportunistic shareholder voting by an investment adviser is arguably a breach of an adviser's fiduciary duties under the Investment Act of 1940.[85] While it is beyond the scope of this paper to go deeper into this issue, it would appear that the Act would at least require an investment adviser to disclose such conflicts of interest. Unfortunately, given the U.S. Supreme Court's decision in *Transamerica Mortgage Advisors v. Lewis*,[86] it is unlikely that index funds or their beneficial investors have an express or implied private right of action to file suit for this type of breach. Therefore, it is up to the SEC to provide the necessary investor protection through enforcement actions.

In addition, it would seem reasonable to believe that the fiduciary duties of the boards of directors or trustees of mutual funds and ETFs under the Investment Company Act of 1940[87] or state entity law (corporations, trusts, etc.) would require directors or trustees to have knowledge of such conflicts in shareholder voting for purposes of mitigating such conflicts or at least disclosing them to the beneficial investors of the funds they govern.

Alternatively, a market-oriented approach could be the solution. For example, if index funds were to provide their investors with the option of conforming their proportional voting interest,

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[83] This term was coined by Gilson and Gordon but in a different context. *See* Ronald J. Gilson & Jeffrey N. Gordon, *Agency Costs of Agency Capitalism: Activist Investors and the Revaluation of Governance Rights*, 113 COLUM. L. REV. 863 (2013).

[84] *See generally* Bernard S. Sharfman, *How the SEC Can Help Mitigate the "Proactive" Agency Costs of Agency Capitalism*, 8 AM. U. BUS. L. REV. 1, 4 (2019). *See also* Bernard Sharfman, *The Problem of Three In the Voting of Public Company Shares*, REALCLEARMARKETS (Aug. 30, 2021), https://www.realclearmarkets.com/articles/2021/08/30/the_problem_of_three_in_the_voting_of_public_company_shares_792063.html.

[85] 15 U.S.C. § 80b-1. The SEC, in its Release on proxy voting by an investment adviser, took the position that an investment adviser "is a fiduciary that owes each of its clients duties of care and loyalty with respect to all services undertaken on the client's behalf, including proxy voting." Proxy Voting by Investment Advisers, Investment Advisers Act Release No. 2106, 79 SEC Docket 1673 (Jan. 31, 2003). However, the SEC has yet to clarify what these fiduciary duties really mean for the Big Three and other investment advisers with large amounts of delegated voting authority. *See* Sharfman, *supra* note 84, at 2. Interestingly, such fiduciary duties have also yet to be clarified in the United Kingdom. *See* Andrew Johnston, Rachelle Belinga & Blanche Segrestin, *Governing Institutional Investor Engagement: From Activism to Stewardship to Custodianship?*, 21 J. CORP. L. STUDIES 1, 11 (2021).

[86] Transamerica Mortgage Advisors v. Lewis, 444 U.S. 11 (1979).

[87] 15 U.S.C. § 80a-1.

as represented by their percentage of ownership in a specific fund, to a requirement that when an alternative slate of directors is presented, the investment adviser is to: 1) abstain from voting; or 2) vote based only on the board's recommendations.[88] If enough investors request the implementation of their voting preferences, this would have a significant impact on reducing the current concentration of Big Three voting power at public companies.[89]

III. Engine No. 1's Activism Will Not Mitigate Climate Change

According to Professor Anna Christie, "Engine No. 1's victory at Exxon is a defining moment for ESG activism. It illustrates how an activist with an extremely modest stake can campaign on a platform of climate issues to galvanize crucial support from the Big Three and effect major board changes."[90] However, what also needs to be understood "is that characterizing Engine No. 1's victory as a win for climate action is akin to greenwashing when the concrete actions that oil and gas firms must take to transition sustainably, both from a financial and environmental perspective, remain elusive."[91] For example, it is worth repeating that Engine No. 1 failed in making any specific recommendations that would allow ExxonMobil to profitably transition from being a global leader in oil and gas production to a global leader in clean energy production.

Moreover, Engine No. 1's hedge fund activism is arguably an impediment to the world's ability to deal with climate change. As observed by Tariq Fancy, BlackRock's former chief investment officer for sustainable investing, "one lesson COVID-19 has hammered home is that systemic problems—such as a global pandemic or climate change—require systemic solutions. Only governments have the wide-ranging powers, resources and responsibilities that need to be brought to bear on the problem."[92] If so, then the activities of market participants such as hedge fund activists, including the activism of Engine No. 1, are not going to solve the problem.

Assuming Mr. Fancy is correct, then the recent proxy fight by Engine No. 1 may have also caused significant harm to climate change mitigation efforts "by creating a *societal placebo* that *delayed* overdue government reforms."[93] That is, the sustained focus on the proxy fight and the

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[88] Bernard Sharfman, *Giving Index-Fund Investors a Voice In Shareholder Voting*, REALCLEARMARKETS (March 17, 2021), https://realclearmarkets.com/articles/2021/03/17/giving_index-fund_investors_a_voice_in_shareholder_voting_768444.html (discussing this market oriented approach in the context of shareholder proposals).

[89] *Id.*

[90] Anna Christie, *Battle for the Board: Climate Rebellion at Exxon Marks a New Era of Shareholder Activism*, OXFORD BUS. L. BLOG (July 12, 2021), https://www.law.ox.ac.uk/business-law-blog/blog/2021/07/battle-board-climate-rebellion-exxon-marks-new-era-shareholder.

[91] Desai, Rajagopal & Tomar, *supra* note 4.

[92] Tariq Fancy, *BlackRock Hired Me to Make Sustainable Investing Mainstream. Now I Realize It's a Deadly Distraction from the Climate-Change Threat*, THE GLOBE AND MAIL (March 25, 2021), https://www.theglobeandmail.com/amp/business/commentary/article-sustainable-investing-is-a-deadly-distraction-from-actually-averting/. *See also* Tariq Fancy, *The Secret Diary of a 'Sustainable Investor'* (Aug. 2021), https://www.dropbox.com/s/bvskswxwkro41rh/The%20Secret%20Diary%20of%20a%20Sustainable%20Investor%20-%20Tariq%20Fancy.pdf?dl=0.

[93] Tariq Fancy, *BlackRock Hired Me to Make Sustainable Investing Mainstream. Now I Realize It's a Deadly Distraction from the Climate-Change Threat*, THE GLOBE AND MAIL (March 25, 2021),

perception that Engine No. 1's victory represents a victory in the fight against climate change may have reduced our sense of urgency to advocate for strong governmental actions that will have a real impact on mitigating climate change. Mr. Fancy refers to this as a *deadly distraction*.[94]

This is not the only harm that may have been caused by Engine No. 1's hedge fund activism. We also need to add the *unintended consequences* that may be caused by ExxonMobil being pressured to reduce its oil and gas development projects or divest its oil and gas assets. The economic argument for these actions is that energy companies need to reduce their exposure to fossil fuels or they will be stuck with billions of dollars of stranded assets.[95] This is the argument made by BlackRock in voting for the election of three Engine No. 1 director nominees.[96]

An example of such unintended consequences is BP's decision to sell off its entire Alaska oil operations to a private investor, resulting in the company having a much smaller carbon footprint.[97] Moreover, BP was divesting itself of a type of oil that created a higher than average level of emissions when extracted.[98] So, by all appearances, the activists got what they wanted from their interference in BP's corporate governance—but there was one problem: the activists did not consider how concerned the new owner was going to be about carbon emissions.[99] The new buyer, a privately owned company, has allegedly allowed these assets to generate a significantly higher level of emissions than what occurred during BP's ownership.[100]

As a result of Engine No. 1's activism, ExxonMobil may also end up making fewer investments in oil and drilling. However, there is nothing stopping other companies, especially private or national companies, from taking up the opportunities that ExxonMobil decides to decline. Engine No. 1 has no such influence with private companies or the national oil

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https://www.theglobeandmail.com/amp/business/commentary/article-sustainable-investing-is-a-deadly-distraction-from-actually-averting/ (emphasis added).

[94] *Id.* Alternatively, Jeffrey N. Gordon argues that activism such as Engine No. 1's may encourage legislative action on climate change. He argues that "[t]hose who favor engagement over divestment think that if even one major fossil-fuel producer is induced to undertake profit-reducing measures in the name of reducing climate change risk, the 'if me, then them too' dynamic will potently add to the coalition of those promoting legislative action." *See* Jeffrey N. Gordon, *Systematic Stewardship* 6 (Colum. L. and Econ. Working Paper, Working Paper No. 640, 2021), https://papers.ssrn.com/sol3/papers.cfm?abstract_id=3782814. However, even assuming that ExxonMobil will proceed down a path of lower profits in the name of climate change, which appears doubtful, there is no evidence that ExxonMobil has changed its political stance. *See* Matt Egan, *Undercover Exxon Video Reveals an Anti-Climate Campaign*, CNN BUS. (July 1, 2021, 5:15 PM), https://www.cnn.com/2021/07/01/business/exxon-tape-video-keith-mccoy/index.html.

[95] BlackRock, *Climate Risk and the Transition to a Low-Carbon Economy* 1–2 (Feb. 2021), https://www.blackrock.com/corporate/literature/publication/blk-commentary-climate-risk-and-energy-transition.pdf.

[96] BlackRock, *supra* note 63, at 3.

[97] Rachel Adams-Heard, *What Happens When an Oil Giant Walks Away*, BLOOMBERG GREEN (Apr. 15, 2021), https://www.bloomberg.com/graphics/2021-tracking-carbon-emissions-BP-hilcorp/?srnd=premium.

[98] *Id.*

[99] *Id.*

[100] *Id.*

companies that own the vast majority of the world's oil and gas reserves.[101] In sum, while Engine No. 1's activism may help it raise funds for its ETFs, it will do little in the fight against climate change.

Conclusion

The private ordering which resulted in ExxonMobil not having a controlling shareholder provided the opportunity for Engine No. 1 to enter into a proxy fight with management and win. From a contractarian perspective this is all well and good. However, when evaluating the hedge fund activism of Engine No. 1, we must ask whether its activism provided ExxonMobil with a roadmap for enhancing its financial performance or helping to mitigate climate change.[102] The answers to these questions are critical for informing shareholders on how to vote in future proxy contests with similar fact patterns.

Unfortunately, the answer is a resounding no to both. Engine No. 1's activism did not serve as a corrective mechanism consistent with this Article's theory of hedge fund activism or provide ExxonMobil with guidance on what clean energy investments it should pursue. Instead, its activism resulted in ExxonMobil needlessly spending significant resources on defending its director nominees and thereby distracting ExxonMobil from engaging in its current strategy of focusing on the production of oil and gas, a strategy that Engine No. 1 could not adequately disprove as being the correct one. Yes, ExxonMobil's current strategy may result in the company stranding oil and gas assets or the company eventually losing its independent existence if the road to decarbonization speeds up, but until proven otherwise (perhaps a different hedge fund activist will one day appear that will make the necessary investment to be informed about the operations of ExxonMobil and then be able to provide specific recommendations that will correct the company's managerial inefficiencies) its strategy cannot be discounted as the one that will maximize the present value of its cash flows. Moreover, and perhaps most importantly, Engine No. 1's activism created a *deadly distraction* in our fight against climate change, a fight that should be taken on by governments all over the world, not hedge fund activists.

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[101] Joel Abrams, *Fossil Fuel Divestment Will Increase Carbon Emissions, Not Lower Them – Here's Why,* THE CONVERSATION (Nov. 15, 2019, 12.02 PM), https://theconversation.com/fossil-fuel-divestment-will-increase-carbon-emissions-not-lower-them-heres-why-126392.

[102] Desai, Rajagopal & Tomar, *supra* note 4.