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Battle for the Board: Climate Rebellion at Exxon marks a New Era of Shareholder Activism

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Less than a decade ago, ExxonMobil was the **most valuable company in the world**. Yet in June 2021, **Engine No. 1**—a newly launched impact hedge fund holding only 0.02% of Exxon’s shares—made history by successfully **replacing a quarter of the energy giant’s board of directors**.

The shareholder vote at Exxon was entirely unprecedented as Engine No. 1’s proxy contest was the first boardroom battle to focus on the issue of climate change. To successfully elect its dissident slate of nominees, the activist needed to secure the pivotal votes of the Big Three asset managers—BlackRock, Vanguard and State Street. In this respect, the campaign was perfectly timed and executed to test the credibility of the Big Three’s recent public commitments to address climate change.

In a new **paper**, forthcoming in the UC Davis Law Review, I examine the role of activist hedge funds and the Big Three in environmental, social and governance (‘ESG’) activism. I argue that activist hedge funds can play a unique role in nominating specialist directors—for example those with renewable energy or climate transition expertise—to corporate boards. The Big Three, in their assumed role as ‘sustainable capitalists,’ can then lend their voting support to credible alternative board nominees. The Exxon proxy contest vividly illustrates that the Big Three are in fact prepared to support ESG activist campaigns.

An unlikely protagonist and an obvious target

Activist hedge funds may seem unlikely heroes in the global effort to mitigate climate change. They are typically **portrayed as villainous actors**, embodying a **short-term** ‘greed is good’ mindset. However, this simplistic representation does not accurately depict the more recent evolution of activist board representation campaigns. Additionally, a vocal minority of

activist hedge funds have now begun to pursue ESG campaigns, effectively adopting a long-term ‘green is good’ approach.

Engine No. 1 is one such ESG fund. It officially launched in December 2020 with a mission to ‘create sustainable, long-term value by driving positive impact through active engagement’ and quickly announced its **inaugural activist campaign** at Exxon. Engine No. 1’s success is striking as it was not a well-established hedge fund with a formidable reputation for activism. It conducted its audacious campaign with only \$250 million in capital (**supplied by its founder**). By way of contrast, Elliott Management—the biggest activist hedge fund in the US—manages approximately **\$41.8 billion** in assets.

Even if Engine No. 1 was not a typical protagonist, Exxon was in many respects an **obvious target**. Despite its status as an energy behemoth, Exxon stood out for its staggering long-term **financial underperformance**. Last year it recorded a **\$22 billion loss** and was **removed from the S&P Dow Jones Industrial Average** for the first time in almost a century.

Financial performance ordinarily translates into unhappy shareholders. However, in Exxon’s case, shareholder discontent was much more deeply rooted. The board was notoriously indifferent to the concerns of shareholders and historically **refused to engage** with its largest investors. Exxon may have seemed invincible, but previous activist campaigns have exposed the risk of disregarding the legitimate concerns of shareholders. A similar approach already proved fatal to the incumbent management of S&P 500 constituent Darden Restaurants in 2014, enabling the activist hedge fund Starboard Value to succeed in **replacing the entire board**.

Exxon is also a notable industry laggard with respect to the energy transition. Due to decades of denial and misinformation about the impact of climate change, the company has long

been referred to as a ‘**fossil fuel dinosaur**’. More recently, investors grew uneasy about its outlier status in failing to take any meaningful steps towards energy transition.

These factors combined to create the conditions necessary for a perfect storm that resulted in Engine No. 1 ousting three incumbent directors from the Board. Instead of the activist hedge fund being cast as the villain, it was Exxon that proved to be the natural villain.

An alliance of powerful allies

Engine No. 1 could not succeed in its boardroom rebellion alone. Its campaign benefitted from the backing of powerful allies from the outset, including the vocal support of one of America’s largest pension funds, the California State Teachers’ Retirement System (**CalSTRS**). Significantly, the most influential **proxy advisory firms** that guide institutional investors how to vote also recommended that investors vote for nominees on Engine No. 1’s slate.

Ultimately, the pivotal voters in any proxy contest are the Big Three asset managers. In Exxon’s case, the Big Three controlled **almost 21% of the total shares**. This translated into **collective voting power of 31%**. Why did Engine No. 1 think it could secure the support of the Big Three? Like **other institutional investors**, the Big Three had expressed frustration with Exxon in the past. As one example, BlackRock lost patience with Exxon in 2016 and **voted against key directors** due to a board policy that prohibited direct engagement with shareholders.

More importantly, BlackRock and other large asset managers had strengthened their public commitments to addressing climate change. BlackRock’s CEO, Larry Fink, had repeatedly emphasised that **climate risk is investment risk** and warned companies that BlackRock would be increasingly disposed to vote against directors who failed to make sufficient progress on climate change.

Exxon's defence

Although much of Engine No. 1's campaign replicated classic activist hedge fund tactics, Exxon's response was atypical compared with other recent activist campaigns. Since 2010, **over 100 S&P 500 companies** have been the target of activist board representation campaigns but only seven risked the campaign culminating in an actual shareholder vote. Instead, most campaigns for board representation result in **settlements** between the activist and the company, with the company agreeing to add at least one of the activist's nominees to the board.

As part of its defence, Exxon committed to some **climate-friendly projects**. More drastically, it announced **three new board directors**, one of whom was **Jeffrey Ubben**—a veteran activist hedge fund manager and the founder of another ESG fund, Inclusive Capital Partners. This appeared to be an attempt to use the presence of another ESG activist as a form of '**white knight**' to protect management from further shareholder interference.

In the end, Engine No. 1 was victorious, with three of its four nominees winning seats on Exxon's board. The Big Three's voting reports revealed that **BlackRock** voted in favour of three of Engine No. 1's nominees, with **Vanguard and State Street** each supporting two candidates.

Implications of the landmark victory

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 galvanise crucial support from the Big Three and effect major board changes.

The dramatic success of this closely watched battle means that further ESG activism is likely to proliferate. However, future

campaigns may not take the form of high-profile shareholder votes. Proxy contests are incredibly costly, both for the activist and the target company. Engine No. 1 spent approximately \$30 million on the campaign which was almost equal to its \$33 million investment in Exxon's shares. Exxon similarly spent at least \$35 million in its defence. Given the activist's ultimate victory, future target companies may choose to settle with the activist and work more collaboratively. Indeed, there have already been some more subdued examples of ESG activist board representation at S&P 500 companies. In 2018, Jeffrey Ubben joined the board of AES to support the company selling its legacy coal assets and focusing on renewable energy. Similarly, in 2020, Evergy agreed to place two of Elliott Management's candidates on the board to implement a sustainability transformation.

Another expected impact of the increase in ESG activism is that companies will take pre-emptive action to avoid becoming the next target. Therefore, we may see more climate directors and energy transition specialists being added to 'green' boardrooms.

It is also important to acknowledge that this form of 'sustainable capitalism' has limits and is very different from grassroots climate activism. Engine No. 1 itself stressed that it is a capitalist group and was upfront that its campaign focused on financial underperformance as well as climate. Even a specialist ESG hedge fund will only be incentivised to intervene if climate goals can be appropriately aligned with the opportunity to capture financial returns. The limit of the Big Three's support is also evident from the fact that the 'greenest' board nominee secured less than 10% of the shareholder vote and thus was the only Engine No. 1 candidate who failed to secure a board seat. Given that the successful nominees have strong backgrounds in traditional energy, the extent to which the board overhaul will transform Exxon's overall business remains to be seen. What is clear, however, is that there is a

growing tendency for activists and institutional investors to view climate risk as a major financial risk and thus ESG activism as a **value-creation opportunity**.

What's next for Engine No. 1?

The high-profile campaign at Exxon cemented Engine No. 1's reputation as a formidable activist. Engine No. 1's ambitions are not, however, limited to the active investing market. It plans to capitalise on the boom in ESG investing by **raising funds** for its recently launched 'Transform 500 ETF' (ticker symbol 'VOTE'). This socially-conscious index fund aims to hold companies accountable on ESG issues through active voting and engagement. It is also introducing a new 'Total Value Framework' which aims to successfully integrate ESG data into broader financial analysis to accurately report the impact of ESG issues on a company's value.

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