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CORPORATE GOVERNANCE

Analysis

EESG Activism After ExxonMobil

In this edition of their Corporate Governance column, David A. Katz and Laura A. McIntosh discuss the high-profile ExxonMobil shareholder vote in May that sent shock waves through many of corporate America's boardrooms. The ExxonMobil example reflects the recent increase in shareholder support for EESG-related proposals, and it demonstrates the risks and dynamics at play in the current environment.

By David A. Katz and Laura A. McIntosh | July 21, 2021 at 12:50 PM

David A. Katz and Laura McIntosh. Courtesy photos

The high-profile ExxonMobil shareholder vote in May sent shock waves through many of corporate America's boardrooms. While there were various factors at play in the ExxonMobil scenario, the bottom line is this: A newly launched and virtually unknown hedge fund with a tiny stake in a massive global enterprise managed to leverage environmental and governance issues into winning three board seats at the annual meeting, displacing three incumbent directors, and is now in a position to influence the strategic direction of the company. Engine No. 1 LLC accomplished the unlikely feat of electing three nominees to ExxonMobil's board by garnering broad support from an array of sources, notably profit-oriented activists and major institutional investors.

Overall, the 2021 proxy season saw a significant increase in shareholder support for EESG-related (i.e., relating to environmental, employee, social, and governance issues) proposals compared to 2020 and 2019. The ExxonMobil proxy contest is an example of the risks and dynamics at play in the current environment.

EESG as a Platform

Engine No. 1's dissident platform called for ExxonMobil to set carbon emission reduction targets, rethink long-term capital allocation, and accelerate the transition to a low carbon economy. It was joined in its campaign by D.E. Shaw, a major hedge fund focused on financial return activism, and BNP Paribas Asset Management, which proposed a resolution calling for a climate lobbying report. While the attack on ExxonMobil was led by activists, the public support and involvement of three institutional investors played a major role. Each of BlackRock, Vanguard, and State Street issued explanations of their voting decisions at the ExxonMobil shareholder meeting. The statements offer insights that may be useful for other companies as they navigate the post-ExxonMobil EESG-oriented activist landscape.

First, the institutional investors' statements reflected extensive engagement with ExxonMobil directors and management as well as with Engine No. 1's director nominees. Engagement with institutional investors is fundamental to good governance and can be crucial to ensuring that management will have the ability to carry out its strategic plans. ExxonMobil's extensive shareholder engagement is likely the only reason that not all of Engine No. 1's four independent nominees were elected and not all of the activist shareholder proposals were approved.

Another May 2021 proxy battle, that of TEGNA Inc. (its second in two years), demonstrates that effective investor engagement can be successful in countering attacks by even significant shareholders. In the TEGNA situation, hedge fund and seven percent shareholder Standard General sought three board seats. When Standard General was unable to gain support for its operational attacks in light of TEGNA's strong financial performance, it turned instead to an attack based on diversity, equity, and inclusion (DE&I) themes in order to try to undermine board leadership. These allegations also failed to find support among other investors, and Standard General did not win any board seats in the election contest. TEGNA's board had in fact addressed DE&I issues prior to the proxy contest and, importantly, "TEGNA also proved it could move quickly to set the record straight, engage effectively across all constituencies and provide clarity and consistency with board and management-level messages and engagement." Robust shareholder engagement, when backed by substance and responsive actions, remains a strong defense against activist attacks, even those that unfortunately include, as in the TEGNA case, anonymous and ad hominem allegations.

Second, the institutional investors appeared to share a concern that ExxonMobil's climate lobbying efforts might be at odds with its various public statements, despite ExxonMobil's assertions to the contrary. While BlackRock, Vanguard, and State Street did not vote in lockstep overall—they voted for different activist nominees and split on the environmentally-oriented proposals—they were unified in voting for the proposal filed by BNP Paribas Asset Management that called for an evaluation and 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)" and addressing "the risks presented by any misaligned lobbying and the company's plans, if any, to mitigate these risks." In its statement, BlackRock cited "the reputational risk to the company of misalignment in public positions on key strategic policy issues" as a reason for its vote in favor of the proposal and noted that Exxon "is increasingly falling behind its peers in the production of a climate lobbying alignment report." Similarly, Vanguard noted that Exxon's

disclosure about its lobbying activities "does not clearly explain how the company's lobbying efforts align with its strategy and publicly stated positions … [such as] how its lobbying efforts are tied to its publicly stated support of the Paris Agreement goals."

Companies are increasingly being held to account for their statements and past actions. Any public positioning must be followed by action and be consistent with other corporate activities. This can present difficulties for companies that do not wish to take public stances. Silence on major issues may no longer be an acceptable or effective strategy, mere statements are not enough, and yet the actions desired by shareholder activists may be detrimental to corporate strategy or other interests. In such situations, extensive shareholder engagement may be the answer, but it will have to be substantive and sustained in order to generate real solutions in both the short- and longer terms and persuade institutional investors to support management's recommendations.

Perhaps accelerated by the dramatic societal upheavals of 2020, there is an unfortunate and unmistakable movement toward the politicization of corporate activity. Not in the sense of electoral politics—in fact, in the ExxonMobil situation, all three major institutional investors voted against the resolution calling for greater disclosure regarding electoral contributions and expenditures involving corporate funds, on the ground that ExxonMobil already makes adequate disclosures in this regard—but in the sense that corporate actions and statements are increasingly being viewed by the public as associated with left- or right-wing viewpoints. The risks to corporations of overt political activity are widely acknowledged (as in BlackRock's statement on the topic), but the risks inherent in the ongoing politicization of everyday issues in America are not. The current era of overheated public discourse and increasingly partisan divisions around formerly apolitical topics, including many that pertain to EESG, is a perilous one for public companies, just as it is for politicians and other public figures. There are no easy solutions for corporations as they confront this pervasive and pernicious societal trend.

EESG as a Tool

As social and economic politicization, EESG impact investing, and financial activism increasingly intersect in corporate America, public companies must stay alert to potential attacks on many fronts. EESG often presents a useful lever for activists regardless of their true goals and intentions. The ExxonMobil situation exemplified a type of strategic onslaught that has been dubbed the "pincer attack," in which an initiative by EESG activists creates the opportunity for profit-seeking activists to attack from their vantage point at the same time. Many financially-motivated activists are eager to leverage EESG themes to gain support from institutional investors. As EESG-oriented funds continue to increase in number and size, the opportunities will also grow for other activists to maximize the impact of attacks on companies for their own purposes. While the success of the TEGNA management's defense shows that robust communications and substantive operational and financial strength can be a winning combination against activists, it will be important for companies to leave no openings that may be exploited. In some cases, DE&I issues may present an opportunity for boards to actively demonstrate a meaningful commitment to EESG more broadly.

It is important for management teams to brief boards of directors regularly on EESG and other investor concerns so that they are not surprised by activist attacks or institutional investor

support of activists' platforms. Activists will seek to drive a wedge between the board and management in order to enhance the probability of success. Highlighting EESG—which can include a wide array of thorny issues—is one potential means for activists to create conflict within a targeted company. Directors do not like to be surprised, and management credibility is often a casualty when boards are taken unawares, whether by activists or institutional investors. A comprehensive investor engagement program can enable management and the board to understand investor frustrations and concerns and take affirmative steps to avoid conflict down the road. Investors are much more likely to support management teams and boards when they are confident that the company is responsive to their concerns and addressing potentially problematic issues in a proactive manner.

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