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Climate Change Activists Gaining in Boardrooms and Courtrooms

By Tara Giunta, Jon Drimmer, Nicola Bonucci & Caroline Roberts

At Exxon's annual meeting on May 26, 2021, upstart climate change activist fund Engine No. 1, holding just 0.02% of Exxon's outstanding shares, successfully replaced three board members with its nominees. This development also came during a week when 61% of Chevron's shareholders voted in favor of a proposal to cut emissions and a Dutch court required Royal Dutch Shell ("Shell") to cut carbon emissions by 45% by 2030. These developments indicate that investors and shareholders are likely to continue to advocate for additional corporate measures to be utilized by companies in addressing climate change. These developments should also be understood in the context of action taken by the Biden Administration in the first six months of its term and the broader context of the global climate movement.

I. Recent Prioritization of Climate Change

While Engine No. 1's success in motivating other institutional investors and shareholders to vote for its nominees came as a surprise to many, it is less unexpected—and is reflective of the quickly accelerating momentum of activists' efforts to influence companies' approaches to climate change—when viewed in today's environmental, social and governance ("ESG") landscape. Regulators and investors are becoming increasingly focused on corporate efforts to address the unique, industry-specific ESG risks that companies face, especially when considering the broad recognition of climate change (as well as board diversity) as tied to enhanced corporate performance and long-term sustainable returns. Energy companies in particular face substantial pressure from shareholders, regulators, and non-governmental organizations ("NGOs"), such as Friends of the Earth and Greenpeace, to shift away from fossil fuels and towards renewables.

Like many governments globally, the Biden Administration has been particularly focused on developing policies to address the climate crisis, and has taken an "all of government" approach to addressing climate. Oil and gas companies in particular are uniquely exposed to the Biden Administration's climate change policies, as well as investor and shareholder activism, if they are unsuccessful in reassuring regulators and shareholders that they are sufficiently prepared for the coming energy transition.

A. Biden Administration's Stance

From the outset, the Biden Administration has prioritized addressing climate change, a strategy clearly articulated in President Biden's January 27, 2021 Executive Order on Tackling the Climate Crisis. President Biden specifically directed that the climate crisis be fought with "bold, progressive action that combines the full capacity of the Federal Government with efforts from every corner of our Nation, every level of government, and every sector of our economy."[1] President Biden called for global reductions in greenhouse gas emissions and net-zero global emissions by 2050. He also directed that relevant agencies and partners "identify steps through which the United States can promote ending international financing of carbon-intensive fossil fuel-based energy while simultaneously advancing sustainable development and a green recovery[.]" He expressly called on the Secretary of the Interior to pause new oil and natural gas leases on public lands pending further review, and for federal agencies to work together to achieve substantial reductions of methane emissions from the oil and gas sector as quickly as possible.

In his January 27, 2021 Executive Order, President Biden directly challenged fossil fuel subsidies, ordering that steps be taken to ensure that "Federal funding is not directly subsidizing fossil fuels" and that fossil fuel subsidies be eliminated from "the budget request for Fiscal Year 2022 and thereafter." A recent tax plan released by the Department of the Treasury addresses this call to action, and would replace subsidies for fossil fuel companies with incentives for the production of clean energy.

B. Resistance to Biden Administration's Anti-Fossil Fuel Stance

Response to President Biden's executive orders and proposals are, of course, varied, particularly with regards to proposals to eliminate tax preferences / subsidies (whether federal help for oil and gas companies are "subsidies" or "tax deductions" is a separate debate) for fossil fuels. Those opposed to the Biden Administration's efforts to address climate change often point to concerns around oil and gas industry job loss and producers' inability to profitably obtain compliance with tougher environmental regulations.

Concerns around the Biden Administration's strategy to combat climate change are reflected in a letter from 26 Republican senators to President Biden, following his executive orders addressing climate change. The January letter asserts that Biden's executive actions, "have put hundreds of thousands of jobs and billions of dollars in wages at risk. The letter further states that, "[f]rom revoking the permit for the Keystone XL pipeline, to halting leasing and permitting on federal lands and waters, including ANWR, and freezing continued energy development programs throughout our states, you've threatened middle-class jobs[.]"[2] Republicans do not stand alone in their concerns. In February 2021, Joe Manchin (D-WV), head of the U.S. Senate Energy Committee, urged President Biden to reverse his opposition to the Keystone XL pipeline.

Concerns around the Biden Administration's proposed tax plan include that such changes could lead to layoffs, increased energy costs, and higher gas prices. The power to amend the tax code rests with Congress, and unwinding tax breaks on fossil fuel companies may face opposition from both Democrats, particularly those representing fossil-fuel producing states, and Republicans. In May 2021, 56 Members of Congress sent House Speaker Nancy Pelosi and House Majority Leader Steny Hoyer a letter calling on Democrats to oppose Biden's plan to eliminate tax preferences for fossil fuels. The letter noted bipartisan support for the need to improve infrastructure, but flagged as problematic "proposed and devastating tax hikes… targeting the oil and gas sector and the 11 million high-paying jobs supported by the industry."[3]

Challenges to Biden's efforts have also arisen at the state level. In April 2021, 15 Republican governors questioned President Biden's authority to direct the conservation of certain U.S. lands and waters, noting that "Congress determines land use policies for the federal lands, while states have sole regulatory authority to govern other lands within our states."[4] Greg Abbott, the Governor of Texas, similarly vowed to fight the Biden Administration's climate change agenda, including through use of the courts, stating that "Texas is going to protect the oil and gas industry from any type of hostile attack launched from Washington DC."[5]

II. Activists' Focus on Climate Change

Today's political and societal environment reflects a complex mix of interests, including increasing shareholder and stakeholder support for ESG-related disclosures and compliance, an Administration focused on efforts to effectively combat climate change, and well-organized and well-funded resistance to certain climate-related initiatives. It was in this environment that Engine No. 1 sought to challenge Exxon's existing business strategy.

At Exxon's annual meeting last week, Engine No. 1, a small activist hedge fund, ran four directors against management's slate of directors. Engine No. 1's platform included what Engine No. 1 perceived as the need for Exxon to shift away from its fossil fuel business strategy and to more fully align with the global "net zero" movement to combat climate change. Three of Engine No. 1's proposed directors were elected. Exxon vigorously fought Engine No. 1, with Exxon and Engine No. 1's efforts culminating in one of the most expensive proxy fights ever,[6] with Exxon and Engine No. 1 spending a combined $65 million in the proxy fight.[7] Engine No. 1 sought to highlight to investors what it described as Exxon's alleged "lagging approach to lower-carbon energy and poor returns on past fossil fuel investments," advocating that reform required "a Board that includes individuals with relevant energy industry experience and skills."[8] Exxon, in contrast, fought the initiative through adding new board members, including one with sustainable investing experience, and stressing its plans to address future lower carbon demands and pursue lower-carbon initiatives. Though Engine No. 1 holds just a 0.02% stake in Exxon, through its initiatives, it succeeded in rallying support from large institutional investors, pension funds, and shareholder advisory firms.

Shareholders at other oil and gas companies have similarly underscored the increasing importance of corporate efforts to address climate change, including at Chevron, where 61% of shareholders voted in favor of a proposal to cut emissions generated by the use of the company's products. Other votes held at Chevron's annual investors meeting, such as proposals that would require reporting on how a significant reduction in fossil-fuel demand would affect its business and more information on its lobbying activities, failed, but only narrowly. More broadly, financial think tank Carbon Tracker highlighted that globally, oil and gas companies are under "strong pressure from investors to align their businesses with the Paris target, amid concerns about the impact of climate change and the risk of being left with stranded assets if they fail to plan for falling demand."[9] While at annual meetings, an increasing number of shareholders are voting for tougher emissions reductions, Carbon Tracker reported that it found that most companies are continuing to resist absolute cuts in their emissions, a finding likely to lead to continued shareholder activism.

In addition to pressure exerted by shareholders and activist investors, NGOs, human rights groups, and environmentalist have similarly had recent success advocating for climate-related change at oil and gas companies, both domestically and internationally. For instance, a Dutch court recently issued a ruling requiring Shell to cut carbon emissions by 45% by 2030 from 2019 levels. The lawsuit was filed by climate activists seeking to use the courts as an avenue to incent Shell—and potentially other oil and gas companies—to change its climate strategy. Environmental groups have also brought emissions-related suits against the French government, and a Paris court recently convicted the French state for failing to comply with its own emission reduction targets.[10] In addition, in Australia last week, the federal court held that the Australian Environment Minister has a duty of care to protect young people from future harm caused by climate change, though the tangible implications of this holding are currently unclear.

In light of these challenges, oil and gas companies are taking a variety of steps to demonstrate their commitment to climate change. For instance, French oil company Total is rebranding as "TotalEnergies" in an effort "to signal its diversification towards cleaner energy sources."[11] It has also begun to invest in solar and wind power, and plans to devote more than 20% of its investment budget to renewable energy sources. Likewise, following the recent success of activists, Spanish global energy and electricity provider Iberdrola announced that it planned to directly involve its Board of Directors in the company's climate initiatives in an effort to strengthen climate governance at the company and to set targets for reducing direct and indirect emissions. As such, at its upcoming General Shareholder Meeting, Iberdrola plans to consult with shareholders on its climate strategy and seek shareholder approval for making its Board responsible for "the company's fight against climate change, approving, supervising and reporting on the climate action plan to ensure the group's climate neutrality by 2050."[12] Despite these and other efforts, pressure on oil and gas companies is likely to continue as environmental activists push for further evidence of companies' efforts to combat climate change.

Success of shareholders, activist investors, and NGOs in pushing pro-climate agendas at major oil companies will likely force companies, particularly energy companies, to continue to confront growing concerns around climate change.

III. Conclusion: The Activist Impact

Even if Biden and the U.S. Congress are ultimately hampered in their ability to refocus the fossil fuel industry through executive action and legislation, Engine No. 1's success demonstrates that shareholders and institutional investors are prioritizing ESG and are willing to expend substantial resources to achieve their ESG-related goals.

The success of activist investors, such as Engine No. 1, recent progress in the courts, and growing consumer demand should highlight to corporations, particularly corporations whose businesses have substantial climate-related impacts, that perceived or alleged failure to proactively and effectively address climate-related risks may expose companies to costly proxy fights and reputational damage.

Senior management and corporate boards responsible for ensuring that risks are appropriately identified, monitored, and mitigated should confirm that their companies' existing strategies, monitoring, and compliance systems account for ESG-related risks, and further develop such processes as necessary. Paul Hastings has developed recommendations around the tangible steps that companies can and should take to effectively address ESG-related trends and challenges, and to avoid potential regulatory and reputational pitfalls.[13] While each company's approach to addressing the risks posed by climate change will differ, most, if not all, companies operating in today's ESG-environment will need to ensure that they have implemented policies and processes around climate change that adequately satisfy investor, regulator, and stakeholder expectations.

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1 Exec. Order No. 14,008, 86 FR 7619, 7622 (Jan. 27, 2021).

2 Letter from Ted Cruz, U.S. Senator for Texas, et at., to Joseph R. Biden, Jr., President of the United States (Jan. 28, 2021).

3 Letter from Jodey C. Arrington, U.S. Representative for Texas's 19th congressional district, et al., to Nancy Pelosi, Speaker of the House, and Steny Hoyer, Majority Leader (May 13, 2021).

4 Letter from Pete Ricketts, Governor of Nebraska, et al., to Joseph R. Biden, Jr., President of the United States (Apr. 21, 2021).

5 Jeremy Blackman, *Gov. Abbott calls Biden's energy plan a 'hostile attack,' vows to sue*, HOUSTON CHRONICLE (Jan. 28, 2021).

6 Nell Minow, *Memo to Corporate Directors: Three Lessons from the Exxon-Mobil Activist Victory*, HARVARD LAW SCHOOL FORUM ON CORPORATE GOVERNANCE (May 30, 2021).

7 Jennifer Hiller and Svea Herbst-bayliss, *Exxon, activist spend over $65 mln in battle for oil giant's future*, REUTERS (Apr. 15, 2021).

8 Svea Herbst-bayliss, *Exxon under pressure as ISS backs Engine No 1. Nominees in board fight*, REUTERS (May 14, 2021).

9 *Oil majors' net zero plans still far from Paris targets*, THE CARBON TRACKER INITIATIVE (May 27, 2021).

10 The French Civil Code contains a provision regarding civil liability for ecological damage and allows NGOs to bring a claim for redress, which differs from other jurisdictions. It could be inferred that France recognizes the urgency of the climate crisis, and while it committed to reducing national emissions, its targets were not being met. As such, the court condemned the French State to comply with its own targets. The demand to impose more ambitious targets was rejected because France already has more ambitious targets than the EU, but the Court granted the claim for redress in kind. Prof. Dr. L. Lavrysen, *The French Climate Cases: Legal Basis and Broader Meaning*, INTERNATIONAL UNION FOR CONSERVATION OF NATURE (Feb. 12, 2021).

11 *French oil giant Total rebrands as Total Energies in climate push*, FRANCE24 (May 21, 2021).

12 *Iberdrola entrusts its Board of Directors with responsibility for climate action*, IBERDROLA (May 31, 2021).

13 For additional detail around recommended actions that companies should take, please see: Jon Drimmer, Tara Giunta, and Renata Parras, *The Integration of Business and Human Rights into International Regulatory Compliance*, PAUL HASTINGS (Dec. 7, 2020); Jon Drimmer, Tara Giunta, Nicola Bonucci, and Renata Parras, *Integrating Human Rights and ESG into International Regulatory Compliance: Governance Considerations*, PAUL HASTINGS (Jan. 26, 2021); Jon Drimmer, Tara Giunta, Nicola Bonucci, and Renata Parras, *Integrating Human Rights and ESG into International Regulatory Compliance: Policies and Procedures*, PAUL HASTINGS (Feb. 28, 2021); Tara Giunta, Morgan Miller, and Caroline Roberts, *Immediate Steps to Consider as SEC Task Force Targets ESG Reporting*, PAUL HASTINGS (Mar. 15, 2021); Jon Drimmer, Tara Giunta, Nicola Bonucci, and Renata Parras, *Integrating Human Rights and ESG into International Regulatory Compliance: Training and Education*, PAUL HASTINGS (Apr. 2, 2021); Tara Giunta, Michael Spafford, Paige Rinderer, and Katherine Berris, *CFTC Announces Interdivisional Climate-Related Risk Task Force*, PAUL HASTINGS (Apr. 21, 2021); Tara Giunta, Morgan Miller, and Caroline Roberts, *The ESG Corporate Governance Imperative*, PAUL HASTINGS (May 10, 2021).