WHY INSTITUTIONAL INVESTORS SUPPORT ESG ISSUES

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ABSTRACT

For the first time ever, shareholder proposals related to environmental, social, and governance (ESG) issues are regularly passing with greater than 50% of investors' votes—in large part due to institutional investor support. What motivates institutional investors to support ESG issues? This Article proposes that the biggest motivator is serving the views of the people who matter. The people who matter to institutional investors differ by the type of institutional investor. For example: (1) religious funds may care about the views of the leaders and members of affiliated religious entities; (2) public pension funds may care about the views of their beneficiaries as well as the views of the voting electorate in affiliated cities or states; and (3) the largest asset managers may care about the views of the general population, particularly the views of current and future clients with money to invest.

Support for ESG issues does not appear overnight, but rather slowly builds over time. People must first become aware of ESG issues before they can become concerned about them. Once they are concerned about the issues, then they can become energized by the issues (i.e. willing to spend time and money on the issues, such as by joining demonstrations and donating to non-profits). As more people become energized by ESG issues, institutional investors start supporting the issues as well: (1) first, institutional investors catering to the narrowest groups of people (e.g. religious funds) will start supporting ESG issues; (2) then institutional investors that cater to broader groups of people (e.g. public pension funds) will start supporting ESG issues; and (3) finally, institutional investors that cater to the general population (e.g. the largest asset managers) will start supporting ESG issues. The largest asset managers (e.g. BlackRock, Vanguard) will support ESG issues to generate value from fund flows and fees as their current and future customer base coalesces around ESG issues.

To illustrate, I describe the climate change movement and resulting institutional investor support. The vast majority of the scientific community agreed by the 1950s that humans caused global warming, but it took until the 1980s for the media to bring broad awareness of the issue to the general public. Over the next few decades, more people became concerned about global warming, and the

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movement gathered steam as millions of people joined climate change protests. As the climate change movement gathered steam, institutional investors began to support the movement. Starting in the 1990s, religious funds, foundations, socially responsible funds, and public pension funds began to raise and support climate change shareholder proposals in order to cater to the concerns of their constituencies. Eventually, the largest asset managers began supporting climate change shareholder proposals in the 2010s in order to attract and retain clients who cared about the issue. The largest asset managers have also opened numerous ESG funds that address the climate change issue in order to attract additional fund flows and fees. So long as the people who matter continue to pour energy into the climate change issue, institutional investors will continue to follow suit.

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INTRODUCTION

For decades, investors have raised shareholder proposals[1] related to environmental, social, and governance (ESG) issues at U.S. companies' annual meetings. ESG investing is also known as socially responsible investing and involves engaging with issues related to people's values, such as climate change

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[1] Each year, companies provide shareholders with proxy ballots that ask shareholders to exercise their voting rights on various corporate governance issues. Shareholder proposals, also known as shareholder resolutions, are proxy ballot questions submitted by shareholders rather than by company management. Company management typically opposes shareholder proposals. *See* Manhattan Institute for Policy Research, *Frequently Asked Questions*, PROXY MONITOR, https://www.proxymonitor.org/Forms/FAQ.aspx (last visited July 30, 2021).

and diversity.[2] At annual meetings, a company's investors typically receive one vote per share of stock in the company, and a shareholder proposal passes when more than 50% of votes are cast in favor of the proposal.

Historically, ESG shareholder proposals typically received only single or low double digit percentage support at annual meetings. Within Fortune 250 companies, only a total of four ESG shareholder proposals passed with majority votes in the decade between 2006 and 2015, with most years seeing zero ESG shareholder proposals pass. Recently, however, ESG shareholder proposals have started passing every year. Within Fortune 250 companies, two ESG shareholder proposals passed in 2016, three in 2017, five in 2018, three in 2019, seven in 2020, and an astounding twenty-one thus far in 2021.[3] What explains this sudden shift in the success of ESG shareholder proposals?

Institutional investors are organizations that invest money, including asset managers. Commentators have pointed to a change in voting patterns among the largest asset managers, including BlackRock and Vanguard, for the dramatic change in successful ESG shareholder proposals.[4] BlackRock and Vanguard have historically consistently voted with management against ESG shareholder proposals, but started voting in favor of some ESG shareholder proposals in 2017.[5] Certainly, the largest asset managers have used their significant shareholdings and associated voting rights to push some ESG shareholder proposals across the 50% votes-in-favor threshold.[6] However, the change in the largest asset managers' voting patterns does not explain the entire phenomenon. For example, a 2017 shareholder proposal related to climate change raised at energy company PPL Corporation passed with 56.8% of votes in favor, *without* the support of the three largest asset managers BlackRock, Vanguard, and State Street (commonly known

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[2] Sometimes, certain governance issues, such as executive compensation and proxy access, are grouped under the ESG umbrella, and sometimes they are not. This Article will use the term "ESG" to refer to socially responsible investing and topics related to people's values.

[3] *See* Manhattan Institute for Policy Research, *Fortune 250 Shareholder Proposals*, PROXY MONITOR [hereinafter *Fortune 250 Shareholder Proposals*], www.proxymonitor.org (last visited Oct. 21, 2021).

[4] *See, e.g.*, Cydney Posner, *ExxonMobil shareholders approve climate change proposal – are shareholder proposals on climate change becoming a thing?*, COOLEY PUBCO (May 31, 2017), https://cooleypubco.com/2017/05/31/exxonmobil-shareholders-approve-climate-change-proposal-are-shareholder-proposals-on-climate-change-becoming-a-thing/ (attributing "inflection point" on climate-change shareholder proposals to some of the largest institutional investors, including BlackRock and Vanguard, switching sides on proxy votes); Ronald O. Mueller et al., *Shareholder Proposal Developments During the 2017 Proxy Season*, GIBSON DUNN (June 29, 2017), https://www.gibsondunn.com/shareholder-proposal-developments-during-the-2017-proxy-season/ (attributing success of environmental proposals in 2017 to shifts in voting by "certain institutional investors, including BlackRock, Vanguard and Fidelity").

[5] *See id.*

[6] *See id.*

as the "Big Three").[7] Similarly, a 2018 shareholder proposal related to managing the opioid crisis raised at drugstore Rite Aid Corporation passed with 54.5% of votes in favor, *without* the support of the Big Three asset managers.[8] It is inaccurate to state that the shift in the largest asset managers' voting patterns solely caused the recent success of ESG shareholder proposals. Instead, the shareholder proposals at PPL Corporation and Rite Aid Corporation passed due to the collective efforts of many smaller institutional investors. In fact, smaller institutional investors have been supporting ESG shareholder proposals for years in increasing numbers before the largest asset managers lent their support in order to remain competitive and cash in on the trend.[9]

This Article argues that institutional investors support ESG issues in order to cater to the people who matter to them. The people who matter to institutional investors differ by the type of institutional investor. For example: (1) religious funds may care about the views of the leaders and members of affiliated religious

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[7] In 2017, BlackRock, Vanguard, and State Street held the top three places for the most assets under management (AUM) in the world. BlackRock held $6.29 trillion AUM, Vanguard held $4.94 trillion, and State Street held $2.78 trillion. *See* THINKING AHEAD INST., THE WORLD'S LARGEST 500 ASSET MANAGERS 38 (2018), https://www.thinkingaheadinstitute.org/content/uploads/2020/11/TAI_PI_500_2018_formatted-1.pdf. BlackRock and Vanguard voted against the 2017 climate change shareholder proposal at PPL Corporation, and State Street abstained. The voting records of asset managers are contained in Form N-PX filings with the Securities and Exchange Commission. *See, e.g.*, iShares Trust, Annual Report of Proxy Voting Record (Form N-PX) (Aug. 25, 2017) (containing proxy voting records for BlackRock exchange-traded funds); Vanguard Index Funds, Annual Report of Proxy Voting Record (Form N-PX) (Aug. 30, 2017); SPDR Index Shares Funds, Annual Report of Proxy Voting Record (Form N-PX) (Aug. 30, 2017) (containing proxy voting records for State Street exchange-traded funds). 266,269,673 votes were cast "for" the shareholder proposal and 202,519,416 were cast "against" the shareholder proposal, leading to a 56.8% vote in favor. *See* PPL Corporation, Current Report (Form 8-K) (May 18, 2017); *see also* PPL Corporation, Proxy Statement (Form DEF 14A) at 87 (Apr. 5, 2017) (noting that only votes "for" and "against" will matter when counting votes on this shareholder proposal).

[8] In 2018, BlackRock, Vanguard, and State Street held the top three places for the most assets under management in the world. BlackRock held $5.98 trillion AUM, Vanguard held $4.87 trillion, and State Street held $2.51 trillion. *See* THINKING AHEAD INST., THE WORLD'S LARGEST 500 ASSET MANAGERS 38 (2019), https://www.thinkingaheadinstitute.org/content/uploads/2020/11/PI500_2019.pdf. BlackRock, Vanguard, and State Street voted against the 2018 shareholder proposal related to opioids at Rite Aid Corporation. Rite Aid's annual shareholder meeting occurred late in the year on October 30, 2018, so voting results are reported on 2019 Form N-PX filings. *See, e.g.*, iShares Trust, Annual Report of Proxy Voting Record (Form N-PX) (Aug. 29, 2019); Vanguard Total Stock Market Index Fund, Annual Report of Proxy Voting Record (Form N-PX) (Aug. 30, 2019); SPDR Series Trust, Annual Report of Proxy Voting Record (Form N-PX) (Aug. 29, 2019). 23,676,553 votes were cast in "for" the shareholder proposal, 15,298,848 votes "against," and 4,462,664 votes "abstain[ed]." *See* Rite Aid Corporation, Current Report (Form 8-K) (Nov. 5, 2018). At Rite Aid, abstentions are counted as votes against the proposal, leading to a 54.5% vote in support of the shareholder proposal. *See* Rite Aid Corporation, Proxy Statement (Form DEF 14A) at 5 (Sept. 29, 2018).

[9] *See* Part III, *infra*.

entities; (2) public pension funds may care about the views of their beneficiaries as well as the views of the voting electorate in affiliated cities or states; and (3) the largest asset managers may care about the views of the general population, particularly the views of current and future customers with money to invest.

Support for ESG issues does not appear overnight, but rather slowly builds over time. It takes time for enough people who matter to institutional investors to support ESG issues. People must first become aware of an ESG issue before they can become concerned about it. Once people are concerned about the issue, they can then become energized by the issue (i.e. willing to spend time and money on the issue). As more people become energized by an ESG issue, institutional investors that cater to broader populations start supporting the issue as well. In a ripple-like manner, the support of institutional investors catering to the narrowest groups of people (e.g. religious funds) will be followed by the support of institutional investors that cater to broader groups of people (e.g. public pension funds), and then by the support of institutional investors that cater to the general population (e.g. the Big Three asset managers). As an example, I describe the climate change movement and resulting institutional investor support. To narrow the focus of this paper, I focus on the U.S. market.

This Article contributes to the active debate among academics regarding institutional investors' stewardship activities and their support for ESG issues. Stewardship activities refer to actions that institutional investors take to protect their investments, including monitoring the companies in their investment portfolios (portfolio companies) and engaging with portfolio companies if something needs to change. Supporting ESG issues at portfolio companies is one type of stewardship activity. On one side of the debate, some scholars argue that the largest institutional investors do not have an incentive to invest in stewardship activities, because institutional investors must expend significant resources to achieve benefits that will be shared with their competitors.[10] On the other side of the debate, some scholars argue that the largest institutional investors have an incentive to engage in stewardship activities, including supporting ESG issues. The proposed incentives vary widely and include addressing systemic risk,[11] improving

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[10] *See* Lucian Bebchuk, Alma Cohen & Scott Hirst, *The Agency Problems of Institutional Investors*, 31(3) J. ECON. PERSPECTIVES 89, 90 (2017) (arguing that index fund managers do not have an incentive to invest in stewardship activities due to agency costs; specifically, index fund managers only capture a small fraction of the benefits that they create, creating such benefits would require additional fees, and the benefits they create would also benefit rival index fund managers); Dorothy S. Lund, *The Case Against Passive Shareholder Voting*, 43 J. CORP. L. 493, 495 (2018) (arguing that "passive funds lack a financial incentive to ensure that each of the companies in their portfolios are well-run").

[11] Stavros Gadinis & Amelia Miazad, *Corporate Law and Social Risk*, 73 VAND. L. REV. 1401, 1410 (2020) (arguing that companies use ESG initiatives to mitigate risk); Madison Condon, *Externalities and the Common Owner*, 95 WASH. L. REV. 1, 17-18 (2020) (arguing that diversified investors support climate change activism to address systemic risk at the portfolio level); Jill Fisch,

institutional investors' reputations,[12] increasing fees and fund flows,[13] and competing for the assets of socially-conscious millennials.[14] While many of these arguments have merit, they are only pieces of the puzzle.

This Article differs from prior work for three main reasons. *First*, this Article is to the first to break down the core reason why institutional investors support ESG issues: to cater to the views of the people who matter to them. Rather than viewing the relevant people as a homogenous mass, I examine the different populations who matter to specific types of institutional investors. *Second*, unlike many prior works, this Article does not focus solely on the largest asset managers, but rather shows how support for ESG issues started from the smallest institutional investors and grew to include the largest asset managers. *Third*, unlike many prior works, this Article does not present a theory by examining a moment in time, but rather, it describes a process that slowly developed over time. It took time for a significant number of people to actively support ESG issues, and it took even more time for a significant number of institutional investors to do so.

A brief summary of this Article follows.

In this Article, I first explain that institutional investors include religious funds, foundations, private labor union pension funds, socially responsible funds, public pension funds, hedge funds, passive index funds, and mutual funds. Because these funds hold significant shareholdings in the market, the largest institutional

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Assaf Hamdani & Steven Davidoff Solomon, *The New Titans of Wall Street: A Theoretical Framework for Passive Investors*, 18 U. PENN. L. REV. 17, 24-25 (2019) (arguing that passive investors focus on issues with a broad market impact to compete against active funds).

[12] Marcel Kahan & Edward B. Rock, *Index Funds and Corporate Governance: Let Shareholders Be Shareholders*, 100 B.U. L. REV. 1771, 1785-1800 (2020) (arguing that institutional investors have financial incentives to be informed and vote intelligently due to fees, fund flows, and reputational benefits); Philipp Krueger, Zacharias Sautner & Laura Starks, *The Importance of Climate Risks for Institutional Investors*, 33(3) REV. FIN. STUDIES 1067, 1070 (2020) (surveying institutional investor motivations for incorporation of climate risks into portfolio decisions, and finding agreement among the following motivations: protection of reputations, moral and ethical considerations, and legal and fiduciary duties. Also finding motivation in improving investment returns and reducing portfolio risks.).

[13] Kahan & Rock, *supra* note 12, at 1785-1800; Krueger, Sautner & Starks, *supra* note 12, at 1070; Dana Brakman Reiser & Anne Tucker, *Buyer Beware: Variation and Opacity in ESG and ESG Index Funds*, 41 CARDOZO L. REV. 1921, 1992 (2020) (observing that "[r]ising interest in ESG investing has . . . generated a huge market opportunity for the providers of ESG indices and metrics, who are . . . capitalizing on this key moment"); Aneesh Raghunandan & Shivaram Rajgopal, *Do ESG Funds Make Stakeholder-Friendly Investments?* 5 (May 3, 2021) (unpublished manuscript), https:// ssrn.com/abstract=3826357 (suggesting that fund managers offer ESG products to command higher management fees).

[14] Michal Barzuza, Quinn Curtis & David Webber, *Shareholder Value(s): Index Fund ESG Activism and the New Millennial Corporate Governance*, 93 S. CAL. L. REV. 1243, 1249-50 (2020) (arguing that index fund activism on ESG issues is a result of asset managers being locked in competition for the assets of the millennial generation, which is more willing to integrate social values into economic decisions).

investors have significant influence at their portfolio companies.[15] I then explain that ESG issues matter because: (1) many people believe that companies should act in socially responsible ways, even if social responsibility cannot be captured on an income statement; and (2) supporting ESG issues may also help safeguard the long-term value of investments. Both these reasons tie into how companies treat *stakeholders*, who are non-shareholders that affect or are affected by a company's activities. Stakeholders include customers, employees, suppliers, the community, and the environment.[16] Institutional investors have three main tools to support ESG issues: (1) buying stock of companies that are socially responsible and selling stock of companies that are not; (2) raising and voting on shareholder proposals in support of ESG issues; and (3) directly engaging with management regarding ESG issues.[17]

However, major barriers prevent the largest institutional investors from supporting ESG issues. *First*, legal hurdles hinder action. The U.S. legal system has often interpreted an institutional investor's fiduciary duty to their clients and beneficiaries as requiring an increase in economic value, which does not always happen with ESG initiatives. The U.S. Securities and Exchange Commission (SEC) rules and regulations also limit the type of shareholder proposals that can be brought, including proposals that micromanage and affect the day-to-day operations of the company. *Second*, while people argue that supporting ESG issues may improve long-term value, ESG initiatives do not always create long-term value. For example, increasing salaries can improve employee retention but decrease profit. Even if long-term value exists, it is often difficult to quantify, and companies must balance short-term needs with long-term value. *Third*, an institutional investor's clients and beneficiaries hold widely varying views on ESG issues. An institutional investor often cannot support an ESG issue without upsetting the bulk of its clients and beneficiaries. *Fourth*, institutional investors run into structural barriers to supporting ESG issues, such as: (1) disregarding long-term value for short-term profit; (2) only dedicating limited resources to stewardship activities; (3) facing difficulties capturing the benefits from stewardship activities; (4) losing the right to vote on shareholder proposals when engaging in securities lending or fund-of-funds investing; (5) suffering from conflicts-of-interest; and (6) failing to act in the face of a collective action problem.[18]

While many barriers to action exist, institutional investors can overcome these barriers to action when they find the motivation to support ESG issues. Institutional investors are motivated by the people who matter to them. For

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[15] *See* Section I.A, *infra*.
[16] *See* Section I.B, *infra*.
[17] *See* Section I.C, *infra*.
[18] *See* Part II, *infra*.

example: (1) religious funds care about the views of the leaders and members of affiliated religious organizations; (2) public pension funds care about the views of their beneficiaries as well as voters in the relevant geography that the pension fund covers; and (3) the largest asset managers care about the views of the general population (particularly the members of the population with money to invest). Institutional investors will support ESG issues when the people who matter to them support ESG issues. However, this does not happen overnight. Rather, it takes time for: (1) awareness, concern, and energy for ESG issues to spread among these people; and (2) support for ESG issues to increase among institutional investors.

First, it took time for people to become aware of, concerned about, and energized by ESG issues. Publicity about ESG issues made people *aware* about the issues and allowed people to become *concerned* about them. People who became *energized* about ESG issues (i.e. willing to spend time and money to support the issues) took actions that energized others, such as joining marches and demonstrations. Eventually, more people became aware of, concerned about, and energized by ESG issues until the issues became mainstream. I call this process the "the ripple effect amongst people."[19]

Second, it also took time for institutional investors to support ESG issues. Institutional investors serve different groups of people, ranging from narrow groups of people to the general population. As awareness, concern, and energy about ESG issues spread among people, institutional investors catering to the narrowest populations began to support ESG issues, followed by institutional investors catering to broader populations, and then by institutional investors catering to the general population. I call this process "the ripple effect amongst institutional investors."[20] The following paragraphs describe the ripple effect amongst institutional investors in more detail.

Some institutional investors serve a narrow group of people who share similar views or a similar purpose. Because their memberships tend to agree on certain ESG issues, it is easier for these institutional investors to support certain ESG issues. For example, members of religious funds may share ethical concerns, members of labor unions may care about labor-related issues, and investors in socially responsible funds may believe in the issues that the funds seek to address. These people may be selected into the funds (such as with a labor union fund) or self-select into the funds (such as with a religious fund or socially responsible fund). Because they serve a limited pool of like-minded people, these funds are among the first to support shared ESG views.[21]

Some institutional investors cater to the views of a broader group of people, including people outside the fund. For example, not only do public pension funds

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[19] *See* Section III.A.1, *infra*.
[20] *See* Section III.A.2, *infra*.
[21] *See* Section III.A.2.i, *infra*.

serve current and future retirees who need money for retirement, but they also care about the opinions of the voting population in the city or state that sponsors the fund due to conflicts of interest (e.g. having elected or appointed city or state officials sitting on pension fund boards). Once this broader population becomes energized by an ESG issue, these broader funds may also support an issue that the broader population cares about.[22]

Some institutional investors care about the opinions of the general population. The largest asset managers fall into this category because they seek to attract investment from the general population to maximize their profits. Large asset managers are unlikely to support any special interests, but when an issue becomes mainstream and publicly salient, these asset managers may also support the issue to attract fund flows and earn additional fees. These asset managers may: (1) publicize their support for ESG issues to improve their reputations and drive fund flows to their conventional (non-ESG) funds; and (2) set up and drive fund flows to their socially responsible funds, which can charge higher fees than conventional funds. Not only do these asset managers seek to attract investment from people, but they also seek to attract investment from other institutional investors that serve narrower populations, such as pension funds. Thus, institutional investors that serve narrower populations (e.g. pension funds) can also influence the largest asset managers to support ESG issues.[23]

Ultimately, as institutional investor support increases past a tipping point, shareholder proposals will begin to pass. As more shareholder proposals pass, a new norm of institutional investors supporting ESG issues will develop, and institutional investors may feel more pressure to continue to conform to the new norm.[24]

As an example, I detail the evolution of the climate change movement. Climate change has gained significant publicity over the past few decades, which has built awareness and concern among the public and led to mass protests and demonstrations that further energized the movement. Over time, the topic became mainstream, and a majority of the population became concerned about global warming. Investors, including socially responsible funds and pension funds, began supporting environmentally-friendly shareholder proposals early on. Once the topic became mainstream and publicly salient, the largest asset managers also began to support ESG issues in hopes of gaining increased fund flows and fees from a more environmentally-conscious population. Now, the largest asset managers widely publicize their ESG efforts to earn more money, and stragglers have supported ESG issues to conform to the new norm and cash in on the movement. As a result, institutional investors have supported climate change

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[22] *See* Section III.A.2.ii, *infra*.
[23] *See* Section III.A.2.iii, *infra*.
[24] *See* Section III.B, *infra*.

shareholder proposals in increasing numbers, enabling climate change shareholder proposals to pass with regularity for the first time.[25]

Finally, I discuss some additional considerations. I explain that once people coalesce around an ESG issue, it becomes easy for institutional investors to find the motivation to support that issue and overcome barriers for such support. For example, in order to comply with their fiduciary duty to improve economic value, institutional investors frame ESG initiatives as essential to generating long-term shareholder value. In order to overcome the limits of SEC rules and regulations on the content of ESG shareholder proposals, institutional investors also use other corporate governance measures without these limitations, such as voting against company directors who failed to support ESG initiatives. Sometimes, opposing forces rise to counteract support for ESG issues, or momentum for ESG issues may waver. However, when enough people continue to pour energy into ESG issues, institutional investors can continue to make progress on ESG issues one step at a time.[26]

This Article is organized as follows. Part I discusses reasons institutional investors are called to support ESG issues. Part II discusses barriers to supporting ESG issues. Part III explains how awareness, concern, and energy about ESG issues spread among people, leading to increased support for ESG issues among institutional investors. Part IV provides an example of how people's support for the climate change movement led to institutional investor support for the issue. Part V explains additional considerations. A conclusion follows.

I. Institutional Investors' Call to Action

Part I discusses why institutional investors are called on to support ESG issues and ways that they can do so. Section A introduces institutional investors. Section B explains the connection between ESG issues and stakeholders, and the reasons institutional investors are called on to support ESG issues. Section C explains the tools that institutional investors can use to support ESG issues.

A. Who Are Institutional Investors?

Institutional investors are organizations that invest money. They include religious funds, foundations, private labor union pension funds, socially responsible funds, public pension funds, hedge funds, passive index funds, and mutual funds.

Institutional investors may manage money actively or passively. With active management, money managers engage in trading tactics designed to beat the market. With passive management, money managers simply follow the market,

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[25] *See* Part IV, *infra*.
[26] *See* Part V, *infra*.

such as by following an index like the S&P 500. Hedge funds and mutual funds are generally actively managed, whereas index funds and exchange-traded funds are generally passively managed. While some institutional investors focus on either active or passive strategies, others use both. For example, asset manager BlackRock runs both passive index funds as well as various active funds.[27]

Many institutional investors invest for clients or beneficiaries. Hedge funds, for example, invest money for wealthy clients. Mutual funds and exchange-traded funds invest money for a broad range of individual investors as well as other funds. Pension funds invest money for employee-beneficiaries to provide the employees with money in retirement.

Over the years, institutional investors have captured a significant portion of the stock market.[28] Institutional investors own 73% of the thousand largest U.S. companies.[29] The three largest index fund managers—BlackRock, Vanguard, and State Street, collectively known as the "Big Three"—hold about a fifth of the S&P 500 and constitute the largest shareholder in 88% of the S&P 500 companies through the funds that they run for their clients.[30] The largest U.S. public pension funds include California Public Employees' Retirement System (CalPERS), California State Teachers' Retirement System (CalSTRS), New York State Common Retirement Fund (NYCRF), and New York City Employees' Retirement System (NYCERS), which collectively manage about $1 trillion in assets.[31]

Companies generally listen to shareholders that hold a large amount of stock. Companies have a fiduciary duty to act in the best interests of their shareholders, and unhappy shareholders may bring suit for breaches of fiduciary duty. Shareholders may also vote on shareholder proposals or initiate proxy contests. Under the standard one-share one-vote practice, larger shareholders such as institutional investors with many shares have a greater ability to influence a

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[27] *See Investment Funds*, BLACKROCK, https://www.blackrock.com/us/individual/products/investment-funds (last visited Aug. 10, 2021).

[28] For a discussion of the rising share ownership and influence of institutional investors and the Big Three asset managers, see Lucian Bebchuk & Scott Hirst, *The Specter of the Giant Three*, 99 B.U. L. REV. 721, 723-24 (2019).

[29] Ronald J. Gilson & Jeffrey N. Gordon, *The Agency Costs of Agency Capitalism: Activist Investors and the Revaluation of Governance Rights*, 113 COLUM. L. REV. 863, 874 (2013).

[30] Dawn Lim & Julie Steinberg, *BlackRock to Hold Companies and Itself to Higher Standards on Climate Risk*, WALL ST. J. (Jan. 14, 2020), https://www.wsj.com/articles/blackrock-shakes-up-sustainable-investing-business-following-criticism-11579000873; David McLaughlin & Annie Massa, *The Hidden Dangers of the Great Index Fund Takeover*, BLOOMBERG (Jan. 9, 2020), https://www.bloomberg.com/news/features/2020-01-09/the-hidden-dangers-of-the-great-index-fund-takeover; Jan Fichtner, Eelke M. Heemskerk & Javier Garcia-Bernardo, *Hidden power of the Big Three? Passive index funds, reconcentration of corporate ownership, and new financial risk*, 19 BUS. & POL. 298, 313 (2017).

[31] *Funded status of the largest U.S. public pension funds*, PENSIONS & INVESTMENTS (Feb. 5, 2018), https://www.pionline.com/article/20180205/INTERACTIVE/180209925/funded-status-of-the-largest-u-s-public-pension-funds (2018 list of 30 largest public pension plans in the U.S.).

company. Moreover, institutional investors can buy and sell large amounts of shares, which can affect a company's stock price, so companies tend to pay attention to institutional investors' concerns.

B. Why Support ESG Issues and Stakeholders?

ESG issues are topics related to people's values, such as climate change and diversity. Investing with ESG considerations (ESG investing) is also known as socially responsible investing, sustainable investing, impact investing, and ethical investing.[32]

ESG issues matter because: (1) many people believe that companies should look at more than profits and act in a socially responsible manner; and (2) companies that consider ESG issues can safeguard long-term value. As explained below, both these reasons relate to how companies treat stakeholders, who are non-shareholders that affect or are affected by a company's activities. Stakeholders include customers, employees, suppliers, the community, and the environment.

1. Social Responsibility

Many people believe that companies should look beyond profit and operate in a socially responsible manner.[33] This belief, often called corporate social responsibility (CSR), includes attending to the needs of non-shareholder stakeholders. While companies pay attention to stakeholders to the extent that they contribute to costs and revenues, stakeholders often have non-financial needs that are often overlooked in the pursuit of profit. For example, a company can pollute the air and still be profitable to the extent that regulations do not impose penalties, yet air pollution can cause illness when people breath unhealthy air particles.[34] People may believe that polluting companies should attempt to reduce pollutants

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[32] *See* Michael Edesess, *The Misguided Role of Institutional Investors in Climate Change*, ADVISOR PERSPECTIVES (Nov. 30, 2020), https://www.advisorperspectives.com/articles/2020/11/30/the-misguided-role-of-institutional-investors-in-climate-change. Other formulations of "ESG" include: (1) environmental and social (E&S); and (2) employees, environmental, social, and governance (EESG). *See, e.g.*, Leo Strine, Kirby Smith & Reilly Steel, *Caremark and ESG, Perfect Together: A Practical Approach to Implementing an Integrated, Efficient, and Effective Caremark and EESG Strategy*, 106 IOWA L. REV. 1885, 1887 (2021).

[33] *See, e.g.*, Gerard Hertig, *Governance by Institutional Investors in a Stakeholder World*, in THE OXFORD HANDBOOK OF CORPORATE LAW AND GOVERNANCE ch. 35, at 1, 7-8 (Jeffrey Gordon & Wolf-Georg Ringe eds., 2015) (Some people believe that companies should engage in corporate social responsibility initiatives when they produce negative externalities that cannot be captured by their income statements but that still harm communities.).

[34] *See How Air Pollution Is Destroying Our Health*, WORLD HEALTH ORG., https://www.who.int/news-room/spotlight/how-air-pollution-is-destroying-our-health (last visited Aug. 1, 2021) ("The health effects of air pollution are serious – one third of deaths from stroke, lung cancer and heart disease are due to air pollution.").

(e.g. install air filtration systems in factories) or switch to cleaner methods of production (e.g. use wind power instead of coal power) in order to reduce illness resulting from air pollution, even if doing so reduces profitability. Companies can avoid harming stakeholders and contribute to the prosperity of society as a whole by attending to stakeholders' non-financial needs.

With ESG investing, institutional investors can seek to influence their portfolio companies to operate in socially responsible ways. The U.S. follows a shareholder-primacy model: a company's sole duty is to its shareholders.[35] Because institutional investors are large shareholders, institutional investors have the power to affect this change.

Corporate social responsibility has many supporters, including individuals, academics, judges, companies, and institutional investors. First, on the individual level, a 2017 survey of 1,000 Americans found that 87% of respondents have a more positive image of a company that supports social or environmental issues.[36] This suggests that people favor companies that operate in a socially responsible manner.

Second, on the academic level, many commentators have sought to redefine the purpose of a company to encompass some form of corporate social responsibility or duty to stakeholders. For example, Virginia Harper Ho argued that: "shareholders should not achieve wealth through disregard for the impact of corporate decision making on stakeholders."[37] Margaret Blair and Lynn Stout argue for a "team production theory," in which a company serves the interests of both shareholders and stakeholders and mediates any disputes between them.[38] Communitarian theorists argue that companies exist to serve the long-term well-being of the economy as a whole, and thus should consider stakeholders and the broader public interest.[39]

Third, even judges have commented on how the U.S. should shift toward corporate social responsibility. Leo Strine, the former Chief Justice of the Delaware Supreme Court, wrote:

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35 *See, e.g.*, Robert J. Rhee, *A Legal Theory of Shareholder Primacy*, 102 MINN. L. REV. 1951, 1951-54 (2018) (defining shareholder primacy and finding that "courts have pervasively embraced the concept that corporate managers should maximize shareholder wealth").

36 *2017 Cone Communications CSR Study*, CONE COMMC'NS (2017), https://www.conecomm.com /2017-cone-communications-csr-study-pdf (surveying demographically representative sample of 1,000 Americans).

37 *See* Virginia Harper Ho, *"Enlightened Shareholder Value": Corporate Governance Beyond the Shareholder-Stakeholder Divide*, 36 J. CORP. L. 59, 62 (2010).

38 Margaret M. Blair & Lynn A. Stout, *A Team Production Theory of Corporate Law*, 85 VA. L. REV. 247, 250 (1999).

39 *See* Iris Chiu, *Institutional Shareholders as Stewards: Toward a New Conception of Corporate Governance*, 6 BROOK. J. CORP. FIN. & COM. L. 387, 410 (2012) (describing communitarian model of corporate governance).

Requiring all large companies and institutional investors to act in a socially responsible way that respects all stakeholders would bring our system into greater harmony with other high-functioning market economies like Germany and those in Scandinavia that compete effectively in the global market while producing widespread prosperity. The real danger now for the U.S. is inaction and failure to recognize that our current model of corporate law does not function fairly, and is, as a result, tearing away our social fabric.[40]

Finally, companies and institutional investors have lent their support to corporate social responsibility. In 2019, the Business Roundtable released a Statement on the Purpose of a Corporation signed by the CEOs of some of the largest companies and institutional investors. The signatories stated that they "share a fundamental commitment to all of our stakeholders," including "[d]elivering value to our customers," "[i]nvesting in our employees," "[d]ealing fairly and ethically with our suppliers," "[s]upporting the communities in which we work," and "protect[ing] the environment." They concluded: "[e]ach of our stakeholders is essential. We commit to deliver value to all of them, for the future success of our companies, our communities and our country."[41]

As shown above, many people—including the general public, academics, and judges—believe that companies should act in a socially responsible manner by supporting the interests of non-shareholder stakeholders. Many companies and institutional investors have also declared their support for non-shareholder stakeholder issues. Non-shareholder stakeholder issues fall under the umbrella of ESG issues. By supporting ESG issues, institutional investors can influence their portfolio companies to act in a socially responsible manner.

2. Long-Term Value

The previous section discussed how institutional investors may support ESG issues because many people believe in corporate social responsibility and want to help non-shareholder stakeholders. This section will explore the argument that supporting ESG issues can also improve the long-term value of a company.

Companies are often criticized as myopic, or short-sighted.[42] Corporate myopia refers to a company overly prioritizing short-term profit over long-term

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[40] Leo Strine, *Restoration: The Role Stakeholder Governance Must Play in Recreating a Fair and Sustainable American Economy – A Reply to Professor Rock*, HARV. L. SCH. F. ON CORP. GOVERNANCE (Jan. 7, 2021), https://corpgov.law.harvard.edu/2021/01/07/restoration-the-role-stakeholder-governance-must-play-in-recreating-a-fair-and-sustainable-american-economy-a-reply-to-professor-rock/.

[41] *Statement on the Purpose of a Corporation*, BUS. ROUNDTABLE, https://opportunity.businessroundtable.org/ourcommitment/ (last visited July 1, 2021).

[42] *See, e.g.*, Steve Lohr, *Fixing Corporate America's Short-Term Mind-Set*, N.Y. TIMES (Sept. 2, 1992), https://www.nytimes.com/1992/09/02/business/fixing-corporate-america-s-short-term-mind-set.html; John D. Stoll, *For Companies, It Can Be Hard to Think Long Term*, WALL ST. J. (Dec. 3,

value. Corporate myopia is a problem because it can destroy the company's value in the long term. In one quintessential example of corporate myopia, companies repurchased billions of dollars of stock during the bull market from 2010 to 2019. Commentators have criticized these stock buybacks, because companies have spent significant money to boost stock prices without actually adding value to the company.[43] Focusing on long-term value addresses the problem of corporate myopia. By focusing on long-term value, a company can avoid taking actions that boost profit or stock price in the short term but destroy value in the long term.

Companies often have quarterly or one-to-two-year timelines. Part of the reason for the short-sightedness is that publicly-traded companies must publicize their financial information in quarterly reports including: revenue, profits, and earnings per share. Companies often attempt to hit or surpass targets, such as forward-looking earnings per share, on a quarterly basis. This focus on the next quarter's results leads to corporate myopia.[44] Another reason for myopia is that CEOs often only have their jobs for a short period of time; their median tenure is five years.[45] They must provide short-term results or risk being pushed out. They must also act quickly to leave a legacy during their short tenure.[46] According to a 2016 survey, 51% of CEOs felt pressure to deliver strong financial results within 1 year or less, and 36% of CEOs felt pressure to deliver strong financial performance within 1-2 years.[47]

While corporations may focus on the next quarter or the next year or two, many institutional investors hold investments for a much longer period of time. Large institutional investors may hold a significant number of shares in a single company and cannot trade them readily without affecting the stock price. Passive index funds hold stock in a company for as long as that company is still part of the index they follow (e.g. the S&P 500). Pension funds have a decades-long time

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2018), https://www.wsj.com/articles/for-companies-it-can-be-hard-to-think-long-term-1543846491 ?mod=article_inline.

[43] *See, e.g.*, David Trainer & Great Speculations, *How Stock Buybacks Destroy Shareholder Value*, FORBES (Feb. 24, 2016), https://www.forbes.com/sites/greatspeculations/2016/02/24/how-stock-buybacks-destroy-shareholder-value/?sh=240c7a997841.

[44] *See* Jamie Dimon & Warren E. Buffett, *Short-Termism Is Harming the Economy*, WALL ST. J. (June 6, 2018), https://www.wsj.com/articles/short-termism-is-harming-the-economy-1528336801.

[45] Stoll, *For Companies, It Can Be Hard to Think Long Term*, WALL ST. J. (Dec. 3, 2018), https://www.wsj.com/articles/for-companies-it-can-be-hard-to-think-long-term-1543846491.

[46] *See id.*; *see also* Douglas G. Cogan, *Corporate Governance and Climate Change: Making the Connection*, CERES 15 (Mar. 2006), http://www.rrojasdatabank.info/ceres06.pdf ("A typical corporate CEO may look three to five years ahead when making a capital investment. By comparison, the average term of service for a long-lived asset like a fossil fuel energy plant is eight times longer and carbon dioxide emissions from such a plant last an average of 100 years.").

[47] Stoll, *For Companies, It Can Be Hard to Think Long Term*, *supra* note 45 (citing FCLT Global/McKinsey & Co. 2016 survey of McKinsey Quarterly panelists).

horizon to provide employees with retirement funds, and thus may also have a long-term time horizon.[48]

Because of their long-term investment horizon, institutional investors may seek to generate long-term shareholder value by helping non-shareholder stakeholders (i.e. customers, employees, suppliers, the community, and the environment) through ESG investing. Non-shareholder stakeholders are essential to the survival of the company: customers buy a company's product or service and thus generate revenue, employees build a company's product or service, and suppliers provide key components or supporting functions for a company's product or service. While helping non-shareholder stakeholders may not always generate short-term value for a company, helping non-shareholder stakeholders may generate long-term value.[49] For example, creating a better product may be costly in the short term but increase consumer demand in the long term. Increasing employee wages may be costly in the short term but may increase employee retention during a pandemic or other crisis.[50] Establishing good supplier relationships can encourage suppliers to make company-specific investments. Moreover, damaging the community and environment can hinder future growth, so spending money now to protect the community and environment can allow for company growth in the future.[51]

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[48] *See Institutional Investors and Long Term Investment*, ORG. FOR ECON. COOP. & DEV. (OECD) 1 (2013), https://www.oecd.org/daf/fin/private-pensions/ltiprojectbrochure.pdf.

[49] Academics have discussed the argument that advancing stakeholder interests may increase long-term shareholder value. *See, e.g.*, John H. Matheson & Brent A. Olson, *Corporate Cooperation, Relationship Management, and the Trialogical Imperative for Corporate Law*, 78 MINN. L. REV. 1443, 1488 (1994) (subscribing to shareholder primacy but noting that cooperation with long-term non-shareholder constituencies is essential to maximizing the value of the corporate pie); Larry E. Ribstein, *Accountability and Responsibility in Corporate Governance*, 81 NOTRE DAME L. REV. 1431, 1459 (2006) (a "firm's long-run profits may depend significantly on satisfying the social demands of consumers, employees and local communities"); Shlomit Azgad-Tromer, *Corporations and the 99%: Team Production Revisited*, 21 FORDHAM J. CORP. FIN. L. 163, 189 (2016) (discussing the "doing well by doing good" theory, whereby investors can improve financial performance by promoting the needs of other stakeholders); James T. Hawley & Andrew T. Williams, *The Universal Owner's Role in Sustainable Economic Development*, 9 CORP. ENV'T STRATEGY 284, 287 (2002) (arguing that institutional investors, as "universal owners," should address sources of positive and negative externalities to maximize the return to their beneficiaries).

[50] *See* Hertig, *supra* note 33, at 7 (labor-oriented initiatives can improve employee morale and increase productivity); John D. Stoll, *How's the CEO 'Stakeholder Pledge' Working Out? Depends Who You Ask*, WALL ST. J. (Aug. 28, 2020), https://www.wsj.com/articles/hows-the-ceo-stakeholder-pledge-working-out-depends-who-you-ask-11598632678 (describing how Costco was able to retain employees during the coronavirus pandemic because it had been paying employees premium wages pre-pandemic).

[51] *See, e.g.*, Chiu, *supra* note 39, at 387, 396 (discussing institutional investors' role as stewards for corporate governance, including taking steps towards monitoring the corporate sector for the economy, the environment, and society); Ronen Shamir, *Capitalism, Governance, and Authority: The Case of Corporate Social Responsibility*, 6 ANN. REV. L. & SOC. SCI. 531, 543 (2010).

Institutional investors have signed pledges to look after ESG issues, including non-shareholder stakeholder issues, to increase long-term value. Almost 2,000 asset managers—holding half of the assets held by institutional investors—have signed the United Nations' Principles for Responsible Investing (PRI) and committed to incorporating ESG principles in their investments.[52] The pledge states: "As institutional investors, we have a duty to act in the best long-term interests of our beneficiaries. In this fiduciary role, we believe that environmental, social, and corporate governance (ESG) issues can affect the performance of investment portfolios."[53] The Business Roundtable's Statement on the Purpose of a Corporation declares: "we and our fellow CEOs endeavor every day to create value for all our stakeholders, whose long-term interests are inseparable."[54] These quotes show that institutional investors believe that serving non-shareholder stakeholders, such as by supporting ESG issues, can improve the long-term value of their portfolio companies.

B. Tools That Institutional Investors Can Use to Support ESG Issues

Institutional investors primarily use three tools to support ESG issues: (1) buying and selling stock; (2) raising and voting on shareholder proposals; and (3) engaging with management.

First, institutional investors can buy and sell stock. They can invest in companies that meet certain ESG criteria (positive screening) and exclude companies that do not meet those criteria (negative screening). Alternatively, all investments are allowed with best-in-class investing, but preference is given to companies with the best performance on ESG issues.[55] For example, many university endowment funds divested from fossil fuel companies after students protested for university endowment funds to do so.[56]

Second, institutional investors can raise and vote on shareholder proposals. While shareholder proposals are generally non-binding, or precatory, companies will typically review and respond to proposals that garner more than 50% of the

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[52] *Signatory Directory*, PRI ASS'N, https://www.unpri.org/signatories/signatory-resources/signatory-directory (last visited June 28, 2021); Rajna Gibson Brandon et al., *Do Responsible Investors Invest Responsibly?* 10 (Eur. Corp. Governance Inst., Fin. Working Paper No. 712, 2021), https://papers.ssrn.com/sol3/papers.cfm?abstract_id=3525530.

[53] *What are the Principles for Responsible Investment?*, PRI ASS'N, https://www.unpri.org/pri/what-are-the-principles-for-responsible-investment (last visited June 24, 2021).

[54] *Statement on the Purpose of a Corporation*, *supra* note 41.

[55] Stephanie Pfeifer & Rory Sullivan, *Public policy, institutional investors and climate change: a UK case-study*, 89 CLIMATIC CHANGE 245, 249-50 (2008); Timothy Smith, *Institutional and Social Investors Find Common Ground*, 14 J. INVESTING 57, 64 (2005).

[56] *See* Matt Wirz, *Universities Cut Oil Investments as Student Activism Builds*, WALL ST. J. (July 14, 2020), https://www.wsj.com/articles/universities-cut-oil-investments-as-student-activism-builds-11594719181.

vote.[57] For example, in 2017, shareholders of Occidental Petroleum Corp, a major oil-and-gas company, voted to ask the company to assess the long-term impact of climate change on the business. Shareholders, including the Big Three (i.e. BlackRock, Vanguard, and State Street), voted in favor of the proposal with a total of 65.7% approval. In response, the company produced the requested report.[58] Even a shareholder proposal that receives less than 50% of the vote can attract significant media attention and cause company boards and management to reexamine their policies. For example, a 2016 shareholder proposal asking Chevron to examine the impact on its operations of a major, concerted effort to curb global emissions gained 40% of the vote. While not a majority vote, the 40% vote nevertheless prompted Chevron to produce a report examining climate risk.[59]

Third, institutional investors can engage in private discussions with company management and boards. Through these discussions, management and boards may agree to change policy or provide additional disclosure about an issue, and these discussions can encourage management and boards to pay more attention to and address the issue in the future. Management and boards may also reach out to institutional investors to induce the institutional investor to withdraw a shareholder proposal in exchange for promises to make changes.[60] In its latest revision of Rule 14a-8(i), the SEC encourages these discussions by requiring the proponent of a shareholder proposal to provide the company with dates and times the proponent can meet with the company to discuss the proposal.[61]

Different types of institutional investors may use different tools. For example, pension funds must diversify their portfolios, so they may resist calls to divest from non-ESG-friendly stocks (e.g. oil company stocks) in order to keep their investments diversified. While pension funds may not divest from non-ESG-friendly stocks, they can still support ESG issues by raising and voting on shareholder proposals and engaging with management and boards.[62] Index funds without an ESG mandate similarly cannot sell stocks that are part of the index. For example, an index fund that follows the S&P 500 cannot sell the stock of the largest

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[57] Andrew R. Brownstein & Igor Kirman, *Can a Board Say No When Shareholders Say Yes? Responding to Majority Vote Resolutions*, 60 BUS. LAW. 23, 23-24 (2004).

[58] Erin Ailworth, *Occidental Shareholders Vote for Climate Proposal*, WALL ST. J. (May 12, 2017), https://www.wsj.com/articles/occidental-shareholders-vote-for-climate-proposal-1494616669.

[59] Bradley Olson, *Chevron Says Climate Actions Pose Minimal Risk to Operations*, WALL ST. J. (Mar. 9, 2017), https://www.wsj.com/articles/chevron-says-climate-actions-pose-minimal-risk-to-operations-1489072494.

[60] *See* Rob Bauer, Frank Moers & Michael Viehs, *Who Withdraws Shareholder Proposals and Does It Matter? An Analysis of Sponsor Identity and Pay Practices*, 23 CORP. GOVERNANCE: AN INT'L REV. 472, 472-73 (2015).

[61] 17 C.F.R. § 240.14a-8(b)(iii); Procedural Requirements and Resubmission Thresholds under Exchange Act Rule 14a-8, SEC Release No. 34-89964 at 49 (Sept. 23, 2020), https://www.sec.gov/rules/final/2020/34-89964.pdf.

[62] Smith, *supra* note 55, at 64.

oil companies that are part of the S&P 500. Due to this limitation, index funds can only raise and vote on shareholder proposals and engage with management and boards.[63] Some of the largest asset managers traditionally have not brought ESG shareholder proposals, but instead engaged with management and boards and voted on the proposals they supported.[64]

II. BARRIERS TO INSTITUTIONAL INVESTOR SUPPORT FOR ESG ISSUES

While Part I discussed reasons that institutional investors are called to support ESG issues and the tools they use in doing so, Part II will discuss impediments to supporting ESG issues. Section A explains legal hurdles to supporting ESG issues. Section B addresses difficulties in pursuing long-term value. Section C describes how people hold widely varying views. Section D describes structural issues among institutional investors that prevent support for ESG issues.

A. Legal Hurdles

The legal system limits the extent to which institutional investors can support ESG issues. Subsection 1 describes how fiduciary duty has often been interpreted to require maximizing economic value, which does not always occur with ESG initiatives. Subsection 2 explains SEC rules and regulations that limit the subject matter of shareholder proposals.

1. Fiduciary Duty to Increase Economic Value

Institutional investors have a fiduciary duty to act in the best interests of their clients and beneficiaries. Generally, institutional investors act in their clients and beneficiaries' best interests when they maximize return given a certain risk tolerance. Theoretically, institutional investors can also serve their clients and beneficiaries' best interests by supporting their non-monetary goals, including ESG goals.[65]

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63 Eric Rosenbaum, *Exxon Mobil loses support of a powerful voice in climate change policy*, CNBC (Aug. 31, 2017), https://www.cnbc.com/2017/08/31/investing-power-vanguard-votes-against-exxon-mobil-on-climate-change.html.

64 *See* Posner, *supra* note 4.

65 *See* Joakim Sandberg, *Socially Responsible Investment and Fiduciary Duty: Putting the Freshfields Report into Perspective*, 101 J. BUS. ETHICS 143, 145 (2011); Mary Francia, *Corporate Governance & Climate Change*, ODGERS BERNDTSON (Aug. 19, 2020), https://www.odgersberndtson.com/en-us/insights/corporate-governance-climate-change (discussing directors' duty of care and responsibility to use "reasonable diligence" to inform themselves about climate change's impact and risks climate change poses for their companies); Elizabeth Douglass, *Exxon's Gamble: 25 Years of Rejecting Shareholder Concerns on Climate Change*, INSIDE CLIMATE NEWS (June 8, 2015), https://insideclimatenews.org/news/08062015/exxons-gamble-25-years-rejecting-sharehold

While the concept of fiduciary duty means to act in the best interests of the one to whom the duty is owed, the legal system has tended to gravitate toward interpreting "best interests" as "best *financial* interests." In *Dodge v. Ford Motor Company*, the Michigan Supreme Court held that a for-profit company must be operated "for the profit of the stockholders" rather than for "other purposes," such as "a general purpose and plan to benefit mankind."[66] Similarly, in *eBay Domestic Holdings, Inc. v. Craig Newmark*, the Delaware Chancery Court stated that a non-financial mission that "seeks not to maximize the economic value of a for-profit Delaware Corporation for the benefit of its stockholders" is inconsistent with directors' fiduciary duties.[67] While these two cases dealt with individual companies, the fiduciary duty to maximize financial gain applies to institutional investors as well. For example, in 2020, the U.S. Department of Labor warned that ERISA plan fiduciaries, such as private pension funds, must focus "solely on pecuniary factors" when making investment decisions.[68]

While fiduciary duty has often been interpreted as requiring financial profit maximization, courts and commentators have suggested that institutional investors can still advance ESG goals as an incidental benefit of a financially-motivated course of action. For example, the Michigan Supreme Court in *Dodge v. Ford Motor Company* suggested in dicta that a company could make "an incidental humanitarian expenditure of corporate funds for the benefit of the employees."[69] In other words, so long as the purpose of an action is still to maximize stockholders' financial gain, a company can take an action that may also incidentally benefit other interests. Academics have also come to a similar conclusion. For example, Max Schanzenbach and Robert Sitkoff analyzed trust fiduciary law and concluded that ESG investing is permissible if: "(1) the trustee reasonably concludes that the ESG investment program will benefit the beneficiary directly by improving risk-adjusted return; and (2) the trustee's exclusive motive for adopting the ESG investment program is to obtain this direct benefit."[70] In other words, ESG investing is permissible if non-monetary benefits are incidental to a primary monetary purpose. Another famous commentary suggests a slightly more relaxed

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er-concerns-climate-change-2/ (discussing possibility that oil companies may face retribution for fiduciary negligence if their shareholders raise concerns and the warnings come true).

66 Dodge v. Ford Motor Co., 204 Mich. 459, 506-07 (1919).

67 eBay Domestic Holdings, Inc. v. Newmark, 16 A. 3d 1, 35 (Del. Ch. 2010) ("Directors of a for-profit Delaware corporation cannot deploy a rights plan to defend a business strategy that openly eschews stockholder wealth maximization—at least not consistently with the directors' fiduciary duties under Delaware law.").

68 *See* Financial Factors in Selecting Plan Investments, 85 Fed. Reg. 72,846, 72,851 (Nov. 13. 2020) (codified at 28 C.F.R. § 2550.404a-1 (2020)).

69 *Dodge*, 204 Mich. at 506-07.

70 *See* Max M. Schanzenbach & Robert H. Sitkoff, *Reconciling Fiduciary Duty and Social Conscience: The Law and Economics of ESG Investing by a Trustee*, 72 STAN. L. REV. 381, 385-86 (2020).

interpretation of fiduciary duty. The United Nations Environment Programme's Finance Initiative commissioned a report known as the Freshfields Report, which examined the laws surrounding fiduciary duty. The Freshfields Report concluded that institutional investors must take ESG issues into consideration if these issues are expected to have a material impact on the financial performance of the investment. It further concluded that institutional investors may also take ESG issues into consideration if two investments are equally attractive financially.[71] While the Freshfields Report suggests that institutional investors may consider ESG issues in certain situations, the primary consideration for institutional investors is still financial value.

2. SEC Rules and Regulations

As explained in Part I.C, *supra*, one of institutional investors' most important tools is raising and voting on shareholder proposals. Shareholder proposals can: (1) draw directors' and officers' attention to an issue; (2) cause management to engage in private discussions with the proponent of a shareholder proposal about an issue; and (3) prompt management to address the issue. However, certain rules and regulations limit the impact of shareholder proposals. For example, SEC Rule 14a-8(i) contains a list of limitations for shareholder proposals.[72] When an investor raises a shareholder proposal, management may request the SEC issue a "no action" letter for overstepping the bounds of allowable shareholder proposals. If the SEC agrees that the shareholder proposal violated its rules and issues a no-action letter, then the shareholder proposal will not appear on the proxy ballot for other shareholders to vote on. Below are some of the most important restrictions regarding shareholder proposals.

First, shareholder proposals are generally precatory, or non-binding. SEC Rule 14a-8(i)(1) requires that shareholder proposals abide by the laws of the state of incorporation.[73] State laws generally do not allow shareholders to require the board to take action because such a requirement could interfere with the board's ability to effectively govern the affairs of the company.[74] Thus, investors generally cannot require a company to take an action, even if more than 50% of investors vote in favor of that action.

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[71] Freshfields Bruckhaus Deringer, *A legal framework for the integration of environmental, social and governance issues into institutional investment*, UNEP FIN. INITIATIVE (Oct. 2005), https://www.unepfi.org/fileadmin/documents/freshfields_legal_resp_20051123.pdf.

[72] 17 C.F.R. § 240.14a-8(i).

[73] 17 C.F.R. § 240.14a-8(i)(1).

[74] Cmt. to 17 C.F.R. § 240.14a-8(i)(1).

Second, SEC rules and regulations also limit the content of shareholder proposals.[75] SEC Rule 14a-8(i) contains a list of limitations, including a ban on proposals that relate to a company's ordinary business operations or that otherwise micromanage the company.[76] This rule limits the ability of institutional investors to support ESG issues because they cannot raise specific proposals that affect a business's day-to-day operations, but can only promote broader ESG topics. SEC Rule 14a-8(i) also limits proposals not significantly related to the company's business and proposals that the company has already substantially implemented.[77]

The case *Trinity Wall Street v. Wal-Mart Stores, Inc.* provides an example of how SEC rules and regulations can block ESG shareholder proposals.[78] Trinity Wall Street was a church that brought a shareholder proposal at retailer Wal-Mart asking Wal-Mart's board to implement standards for the sale of products that endanger public safety—including high-capacity assault rifles used in mass shootings.[79] The Third Circuit found that Trinity Wall Street's shareholder proposal related to Wal-Mart's ordinary business operations and thus could be excluded from a shareholder vote pursuant to SEC Rule 14a-8(i)(7). An exception to SEC Rule 14a-8(i)(7) is the social policy exception. Under the social policy exception, a "proposal generally will not be excludable" when the "underlying subject matter transcends the day-to-day business matters of the company and raises policy issues so significant that it would be appropriate for a shareholder vote."[80] However, the Third Circuit found that the social policy exception did not apply because Trinity's proposal did not transcend day-to-day business dealings because Wal-Mart's inventory decisions are the core of its business.[81] To better explain when the social policy exception would and would not apply, the appeals court contrasted Trinity Wall Street's shareholder proposal with other hypothetical shareholder proposals. While Wal-Mart's inventory decisions related to the core of its business and did not fall within the social policy exception, a hypothetical shareholder proposal addressing discriminatory hiring or compensation practices would be disengaged from the essence of the company's business and would fall within the social policy exception.[82] Thus, while SEC rules and regulations may block some ESG issues (e.g. inventory of assault rifles), these rules and regulations

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[75] *See* Richard Alsop & Yoon-jee Kim, *Shareholder Proposals 2019—ESG No-Action Letter Trends and Strategies*, HARV. L. SCH. F. ON CORP. GOVERNANCE (Mar. 25, 2020), https://corpgov.law.harvard.edu/2020/03/25/shareholder-proposals-2019-esg-no-action-letter-trends-and-strategies/#3b.

[76] 17 C.F.R. § 240.14a-8(i)(7).

[77] 17 C.F.R. § 240.14a-8(i)(5) (relevance); 17 C.F.R. § 240.14a-8(i)(10) (substantially implemented).

[78] 792 F.3d 323 (3d Cir. 2015).

[79] *Id.* at 329-30.

[80] *Id.* at 345 (quoting SEC Staff Legal Bulletin No. 14E, 2009 WL 4363205, at *2 (Oct. 27, 2009)).

[81] *Id.* at 347-48.

[82] *Id.* at 347.

may allow other ESG issues (e.g. discriminatory hiring or compensation practices) to remain on company proxies for a shareholder vote.

B. Difficulties Pursuing Long-Term Value

Section I.B.2, *supra*, discussed how institutional investors may support ESG issues to improve the long-term value of their portfolio companies. However, it is important to note that: (1) ESG initiatives do not always improve long-term value; (2) even if ESG initiatives produce long-term value, long-term value can be difficult to measure; and (3) companies must balance long-term value with short-term needs.

1. ESG Initiatives Do Not Always Improve Long-Term Value

While supporting ESG issues often improves a company's long-term value, this is not always the case. For example, paying employees a competitive market wage with good benefits can improve retention in the long term and reduce recruitment and training costs for new employees.[83] However, paying employees higher salaries can also increase labor costs and decrease profit.[84]

From a quantitative standpoint, the research is mixed regarding whether ESG initiatives improve the long-term value of a company. Some studies find that supporting ESG issues shields a company from risk, while others find no such effect.[85] Diversity initiatives theoretically may improve board performance, but empirical evidence generally shows little effect on company value and performance.[86]

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[83] *See* Ray Fisman & Michael Luca, *How Higher Wages Can Increase Profits*, WALL ST. J. (Jan. 21, 2021), https://www.wsj.com/articles/the-case-for-higher-wages-in-hard-times-11611241084.

[84] *See* Ken Brown, *Wages Up, Profits Down: Winners and Losers of Higher Labor Costs*, WALL ST. J. (May 11, 2016), https://www.wsj.com/articles/wages-up-profits-down-winners-and-losers-of-higher-labor-costs-1462976935; Justin Lahart, *Tight Jobs Market Equals Higher Pay, Lower Profits*, WALL ST. J. (May 5, 2017), https://www.wsj.com/articles/tight-jobs-market-equals-higher-pay-lower-profits-1493998752.

[85] A study found that, even though ESG investing is not generally associated with higher returns or *alphas*, a portfolio's ESG footprint is negatively correlated with portfolio risk, and therefore provides downside risk mitigation. *See* Brandon et al., *supra* note 52, at 25. Another paper examined the literature and found evidence in support of the view that ESG investing can improve risk-adjusted returns, but found that such support is not uniform. *See* Schanzenbach & Sitkoff, *supra* note 70, at 433-38.

[86] Jesse M. Fried, *Will Nasdaq's Diversity Rules Harm Investors?* (Eur. Corp. Governance Inst., Law Working Paper No. 579, 2021), https://ssrn.com/abstract=3812642 (empirical evidence provides little support for notion that gender or ethnic diversity in the boardroom increases shareholder value; increasing board diversity can actually lead to lower share prices).

2. Long-Term Value Can Be Difficult to Measure

Even if an ESG initiative has long-term value, its long-term value is often difficult to quantify. Whereas a project related to a company's core business can be expected to generate a certain cash flow year after year, an ESG initiative often only has immediately measurable costs but uncertain benefits that may not materialize for years.[87]

The issue of climate change presents an example of the difficulty of measuring long-term value. Many people believe that burning fossil fuels pollutes the Earth and leads to unnatural global warming, rising sea levels, and disruption of the planet's ecosystems.[88] From a business standpoint, oil companies may face a diminishing supply of nonrenewable fossil fuel resources that they can sell. Oil companies may also face diminishing demand for fossil fuels as consumers switch to clean, renewable energy sources and governments set regulatory caps on fossil fuels.[89] Even if people agree about the theoretical risks of climate change, quantitative estimates about the impact of climate change differ wildly. First, people disagree about when the effects of climate change will begin to affect companies. In 2016, oil giant Shell's finance chief Simon Henry said the company saw oil demand peaking between 2021 and 2031, but the International Energy Agency saw oil demand rising through 2040.[90] Second, people disagree about the dollar impact of climate change. In a 2019 survey, 215 of the world's largest listed companies reported nearly $1 trillion at risk from climate impact, much of it in the next five years.[91] Institutional investor Barclays PC estimated that energy producers could lose $34 trillion in revenue between 2014 and 2040 should the world transition to a low-carbon economy.[92] According to a report released by a Financial Stability Board task force, there has been so little consensus on how

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87 *See* Kamel Mellahi, *Measuring CSR Is Difficult and Is Not Always Desirable*, WARWICK BUS. SCH. (Oct. 18, 2013), https://www.wbs.ac.uk/news/measuring-csr-comes-with-problems-and-is-not-always-desirable/; Cogan, *supra* note 46, at 15.

88 *See, e.g.*, *The Causes of Climate Change*, NASA, https://climate.nasa.gov/causes/ (last visited Aug. 9, 2021).

89 *See* Scott Patterson & Amrith Ramkumar, *Green Finance Goes Mainstream, Lining Up Trillions Behind Global Energy Transition*, WALL ST. J. (May 22, 2021), https://www.wsj.com/articles/green-finance-goes-mainstream-lining-up-trillions-behind-global-energy-transition-11621656039; Douglass, *supra* note 65.

90 Olson, *supra* note 59; Selina Williams, *IEA Sees Peak Oil Demand After 2040*, WALL ST. J. (Nov. 16, 2016), https://www.wsj.com/articles/iea-seespeak-oil-demand-after-2040-1479283354?mod=article_inline.

91 *World's biggest companies face $1 trillion in climate change risks*, CDP (June 4, 2019), https://www.cdp.net/en/articles/media/worlds-biggest-companies-face-1-trillion-in-climate-change-risks.

92 Nicole Friedman & Bradley Olson, *Calpers Pushes Exxon to Outline Potential Effects of Climate-Change Initiatives*, WALL ST. J. (Apr. 12, 2016), https://www.wsj.com/articles/calpers-pushes-exxon-to-outline-potential-effects-of-climate-change-initiatives-1460475184.

investors should quantify carbon risks that around 400 sets of guidelines exist for disclosures related to climate and sustainability.[93]

Since ESG initiatives may have uncertain, difficult-to-quantify returns, they can be considered risky investments. Company structures are not conducive to investments with uncertain reward-to-risk ratios. Company departments have annual targets, and companies produce quarterly reports that measure quantifiable results. Because the long-term value of ESG initiatives may be difficult to quantify, company management may not think that the potential value of ESG initiatives is worth the risk.

3. Companies Must Balance Long-Term Value with Short-Term Needs

Even if a company can quantify the long-term value of an ESG initiative, it must balance its long-term and short-term needs. When the economy suffers a downturn, immediate survivability becomes the focus. When bankruptcy is imminent, supporting ESG issues to create long-term value takes a backseat to providing immediate financial results. For example, when the coronavirus pandemic first hit, the economy slowed and businesses had uncertain financial futures. Companies that had previously embraced environmentalism scaled back on sustainability.[94] For instance, auto makers that spent billions of dollars to make transportation cleaner and safer delayed or cancelled their autonomous-vehicle, electrification, and car sharing programs.[95] While ESG initiatives did not evaporate, they took a back seat to the short-term needs of conserving cash during an economic downturn.[96]

C. People's Views Vary Widely

Institutional investors invest money on behalf of clients and beneficiaries, many of whom are ordinary people. Institutional investors can potentially make these people happy by supporting their ESG views. However, people hold diverse views on ESG issues. Thus, it would be difficult for institutional investors to

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[93] *Id.*

[94] John D. Stoll, *Airbnb Aimed to Practice Stakeholder Capitalism. Coronavirus Complicated Its Goals.*, WALL ST. J. (May 5, 2020), https://www.wsj.com/articles/airbnb-aimed-to-practice-stakeholder-capitalism-coronavirus-complicated-its-goals-11588726267.

[95] *Id.*; Joann Muller, *Ford's big year upended by coronavirus*, AXIOS (Apr. 29, 2020), https://www.axios.com/fords-big-year-upended-by-coronavirus-7fdb5eae-3853-4a9c-ae73-4a12fd3925d2.html; Mike Colias, *GM Shuts Down Car-Sharing Business*, WALL ST. J. (Apr. 22, 2020), https://www.wsj.com/livecoverage/coronavirus-2020-04-22/card/BNJ2HUPTRoGfH4db0eFD.

[96] *Id.*

support one person's view at the risk of upsetting other people who hold different views.

1. People Care About ESG Issues to Different Extents

Client and beneficiary views on ESG issues vary widely. As a preliminary matter, people differ on whether they are willing to use their investments to support ESG issues at all. Some people believe that investments should only be used for financial gain and ESG issues should be pursued elsewhere, such as through regulation. They might see little value in pursuing ESG issues, or prize economic return above all else, perhaps to sustain their retirements or to spur the economy. Some other people are willing to sacrifice profits for their personal, non-financial values. Moreover, people care about various ESG issues to different extents. Some people may harbor lukewarm feelings towards a cause, while others may feel strongly about that cause. For example, many people care about gender equality but are not willing to sacrifice investment returns to advance the cause. In contrast, investors in the Pax Ellevate Global Women's Leadership Fund care strongly about gender equality and are willing to sacrifice profits to advance the cause.[97] Thus, people care about ESG issues to different extents.

2. Different ESG Goals Can Lead to Conflict

Clients and beneficiaries harbor different feelings about different ESG issues, and these views can lead to both direct and indirect conflict.

First, different ESG goals can *directly* conflict with each other. For example, environmentalists opposed the Keystone XL Pipeline, a proposal for Trans-Canada to build a pipeline to transport oil, due to concerns about pollution and oil spills. However, the pipeline would have created thousands of union jobs and an estimated 42,000 jobs for supporting industries from the pipeline's construction.[98] Thus, the environmentalists' and labor proponents' ESG goals directly opposed each other.

Second, different ESG goals can also lead to *indirect* conflict, because institutional investors have scarce resources to allocate to different ESG causes. Time and money spent on one initiative could detract from time and money spent on another. For example, supporters of uniform climate-change disclosure disagree on whether they should also push companies to produce disclosures on other environmental issues beyond climate change. Some may want to focus on carbon

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[97] *See Pax Ellevate Global Women's Leadership Fund*, IMPAX ASSET MGMT., https://impaxam.com/products/gender-lens-investing/impax-ellevate-global-womens-leadership-strategy/pax-ellevate-global-womens-leadership-fund/ (last visited Aug. 9, 2021).

[98] Jillian Kay Melchior, *The Keystone Pipeline Is a Plus for the Environment*, N.Y. POST (Mar. 24, 2017), https://nypost.com/2017/03/24/the-keystone-pipeline-is-a-plus-for-the-environment/.

risk because they fear that tackling additional goals will distract a company and create more risk of failure.[99]

As shown above, because people care about different ESG issues, their views can directly and indirectly conflict with each other.

3. Implications for Institutional Investors

If people directly owned company stock, they could vote on shareholder proposals the way they wanted. However, people have increasingly chosen to own stock indirectly through institutional investors. People invest through institutional investors for various reasons, including: (1) institutional investors can provide investment expertise; (2) institutional investors can gain access to investments that ordinary people cannot; and (3) institutional investors provide ordinary people with the opportunity to invest in diversified portfolios of stocks with lower fees.[100] Individual households' direct shareholdings of all outstanding corporate equities decreased from 93% in 1945 to 36% in 2014.[101] As of 2019, institutional investors owned 80% of all stock in the S&P 500.[102] Thus, people have increasingly shifted their money away from direct investments towards indirect investments through institutional investors.

When institutional investors directly own the stock, institutional investors are the owners of record that can vote the stock. The people who invest through institutional investors (i.e. clients and beneficiaries of institutional investors) are not the record holders and cannot vote the shares that they only indirectly own.[103] Thus, institutional investors must vote for their clients and beneficiaries.

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[99] Gabriel Rosenberg et al., *Commenters Weigh in on SEC Climate Disclosures Request for Public Input*, HARV. L. SCH. F. ON CORP. GOVERNANCE (July 24, 2021), https://corpgov.law.harvard.edu/2021/07/24/commenters-weigh-in-on-sec-climate-disclosures-request-for-public-input/.

[100] Barclay Palmer, *Institutional vs. Retail Investors: What's the Difference?*, INVESTOPEDIA (Aug. 5, 2021), https://www.investopedia.com/ask/answers/06/institutionalinvestor.asp; Jacob Greenspon, *How Big a Problem Is It That a Few Shareholders Own Stock in So Many Competing Companies?*, HARV. BUS. REV. (Feb. 22, 2019), https://hbr.org/2019/02/how-big-a-problem-is-it-that-a-few-shareholders-own-stock-in-so-many-competing-companies.

[101] Azgad-Tromer, 21 FORDHAM J. CORP. FINANC. LAW at 171-72.

[102] Greenspon, *supra* note 100.

[103] Clients and beneficiaries do not own shares of companies. Clients of index funds own shares of the fund, and the fund owns shares of the company. Clients of mutual funds own units of the mutual fund, and the mutual fund owns shares of companies. *See, e.g.*, *Mutual Funds and ETFs*, BANK AM., https://www.privatebank.bankofamerica.com/financial-empowerment/mutual-funds. html (last visited Aug. 9, 2021). Beneficiaries of pension funds claim a future liability from the pension fund when they retire, and the pension fund owns shares of the company. *See* Eric Whiteside, *How Do Pension Funds Work?*, INVESTOPEDIA (Aug. 29, 2021), https://www.investopedia.com/articles/investing-strategy/090916/how-do-pension-funds-work.asp.

Institutional investors tend to vote all their shares the same way: "for," "against," or "abstain" on a shareholder proposal.[104] Because clients and beneficiaries hold widely varying views, it is difficult for an institutional investor to support any one view. For example, an institutional investor may run a fund with thousands of clients. If a couple clients support animal rights, the institutional investor is unlikely to vote "for" an animal rights shareholder proposal if the rest of the institutional investors' clients are unwilling to support the animal rights issue. A fund manager will not represent a special interest and risk losing other clients who are unwilling to support the special interest.

In conclusion, since most people indirectly invest in stocks through institutional investors, institutional investors are the ones that directly own the stock and have the right to vote on shareholder proposals. Because people hold widely varying views on ESG issues, some of which conflict with each other, institutional investors may find it difficult to support ESG issues.

D. Structural Barriers with Institutional Investors

The way that institutional investors are structured can also impede support for ESG issues, as institutional investors may: (1) be short-sighted and disregard long-term value; (2) have limited resources to engage in stewardship activities; (3) not capture the benefits resulting from any stewardship activities; (4) not be able to vote on shareholder proposals when they engage in securities lending or fund-of-funds investing; (5) experience conflicts of interest; and (6) experience a collective action problem.

1. Institutional Investor Myopia

Section I.B.2, *supra*, explained that institutional investors may support ESG issues to counter corporate myopia, or short-sightedness. Some institutional investors have long investing time horizons and may support ESG issues to improve the long-term value of their portfolio companies. However, institutional investors may be myopic themselves and thus fail to safeguard long-term value.

First, not all institutional investors trade for the long term. For example, hedge funds tend to engage in aggressive, short-term trading strategies. Leo Strine has observed that: "institutional investors who hold stocks, on average, for a very brief period of time and are highly focused on short-term movements in stock prices have become far more influential and prevalent."[105] While the average stock

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[104] *See* Scott Hirst, *Social Responsibility Resolutions*, 43 J. CORP. L. 217, 219-20 (2018).

[105] Simon C.Y. Wong, *Why Stewardship is Proving Elusive for Institutional Investors*, BUTTERWORTHS J. OF INT'L BANKING & FIN. L. 406, 408 (July 9, 2010), https://papers.ssrn.com/sol3/papers.cfm?abstract_id=1635662.

holding period in the U.S. was 5 years in 1980, it dropped to fourteen months in 1999 and to five and a half months in 2020.[106]

Second, institutional investors employ money managers to oversee funds, and money managers' bonuses and careers are tied to annual returns. Money managers are often evaluated on an annual basis, with quarterly reviews. For the most competitive type of financial institutions, such as hedge funds, money managers have one to three years to prove themselves before they are let go. Thus, these compensation structures and review cycles incentivize money managers to prioritize short-term return over long-term value.[107]

Third, even institutional investors with long investing time horizons must keep up with the requirement to achieve certain annual returns. For example, pension funds must achieve a certain return each year to provide sufficient retirement funds for their beneficiaries.[108] Active mutual funds attempt to provide clients with *alpha*, or return over the market, each year.[109]

Because institutional investors and their money managers may be short-sighted, they may not necessarily support ESG issues to improve long-term value.

2. Limited Resources for Stewardship Activities

Stewardship activities refer to actions that institutional investors take to protect their investments, including monitoring their portfolio companies and engaging with management and boards of portfolio companies. Supporting ESG issues at portfolio companies is one type of stewardship activity.

Institutional investors have different amounts of resources to dedicate to stewardship activities. Larger, better-funded institutional investors may have in-house departments and dedicated personnel to work on shareholder proposals, engage with management, and analyze and advocate for ESG issues. However, smaller institutional investors may not be able to afford these resources and may instead robotically follow the advice of proxy advisors[110] when voting on

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[106] *Id.*; Saikat Chatterjee & Thyagaraju Adinarayan, *Buy, sell, repeat! No room for 'hold' in whipsawing markets*, REUTERS (Aug. 3, 2020), https://www.reuters.com/article/us-health-coronavirus-short-termism-anal/buy-sell-repeat-no-room-for-hold-in-whipsawing-markets-idUSKBN24Z0XZ.

[107] Raffaele Della Croce, Fiona Stewart & Juan Yermo, *Promoting Longer-Term Investment by Institutional Investors: Selected Issues and Policies*, OECD J.: FIN. MKT. TRENDS 145, 152 (2011); Pfeifer & Sullivan, *supra* note 55, at 258-59.

[108] Susan Banta & Keith Sliwa, *Pension Funds Adjust Investment Return Targets as Economic Growth Slows*, PEW CHARITABLE TRS. (Jan. 8, 2020), https://www.pewtrusts.org/en/research-and-analysis/articles/2020/01/08/pension-funds-adjust-investment-return-targets-as-economic-growth-slows.

[109] James Chen, *Alpha*, INVESTOPEDIA (May 17, 2021), https://www.investopedia.com/terms/a/alpha.asp.

[110] Proxy advisors provide institutional investors with recommendations on how to vote on shareholder resolutions.

shareholder proposals or not engage at all. For example, large pension funds such as CalPERS have dedicated teams to engage management and raise shareholder proposals regarding ESG issues, but many smaller pension funds do not have such resources.[111]

Even institutional investors with internal departments and personnel dedicated to stewardship may not dedicate sufficient resources to stewardship. Institutional investors may underinvest in stewardship because, as discussed in Sections II.D.3 and II.D.5, *infra*: (1) institutional investors often have difficulty capturing the value of stewardship activities; (2) stewardship activities may benefit their competitors; and (3) institutional investors have conflicts of interest that may lead them to excessively defer to company management.[112] This underinvestment in stewardship activities is particularly a problem at large, diversified funds such as index funds. Index funds focus on tracking a specific index, so index fund managers have little incentive to actively vote proxies. Moreover, because passively managed funds minimize fees to attract clients, they have limited resources to allocate to proxy voting and engagement with portfolio companies.[113] Large, diversified funds also contain thousands of stocks, and significant resources are needed to engage with each of the portfolio companies. As of 2016, Vanguard only employed about 15 staff for voting and stewardship at its 13,000 portfolio companies; BlackRock employed 24 staff for voting and stewardship at 14,000 portfolio companies; and State Street employed fewer than 10 staff for voting and stewardship at 9,000 portfolio companies.[114] Because institutional investors have limited staff dedicated to corporate governance and ESG issues, they must pick and choose the companies and issues that they research and analyze.

3. Difficulty Capturing Benefits of Stewardship Activities

Many institutional investors also have low incentive to engage in stewardship activities, including supporting ESG issues, because they cannot capture the value stewardship activities create for their portfolio companies.

First, stewardship activities can be expensive. Engaging with company management takes time and requires research and preparation. Raising a

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111 *See Environmental, Social & Governance Integration*, CALPERS, https://www.calpers.ca.gov/page/investments/sustainable-investments-program/esg-integration (June 3, 2021) (discussing separate Sustainable Investments team at CalPERS).

112 Bebchuk, Cohen & Hirst, *supra* note 10, at 90.

113 *Id.* at 100-01 (discussing "practically negligible resources that index funds spend on stewardship beyond what is required to comply with regulations requiring investment managers to vote shares in portfolio companies and to avoid doing so in an uninformed fashion"); Wong, *supra* note 105, at 409.

114 Sarah Krouse, David Benoit & Tom McGinty, *Meet the New Corporate Power Brokers: Passive Investors*, WALL ST. J. (Oct. 24, 2016), https://www.wsj.com/articles/the-new-corporate-power-brokers-passive-investors-1477320101.

shareholder proposal requires not only drafting and submitting the proposal, but also contacting other major investors and convincing them to support the action, among other legal, analytical, and financial expenditures. Voting on shareholder proposals in an informed manner requires time and money for research.[115]

Second, benefits to portfolio companies created from stewardship activities are often shared with competitors and provide negligible net gain for the instigating institutional investor. Each institutional investor may own a few percentage or a fractional percentage of a company. When an institutional investor engages in stewardship at a portfolio company and generates value, it only captures the same percentage of the value generated as its percent ownership of the company. The rest of the benefits are distributed to other shareholders, including its competitors. For example, if an institutional investor instigates an action to increase the value of a portfolio company by $1 million, and the instigating institutional investor only owns 1% of the company, then the instigating institutional investor would only capture $10,000 of the increase in value. The other $990,000 in benefit would be captured by the portfolio company's other investors, including the instigating institutional investor's competitors. Unless an ESG issue is particularly valuable and the costs to engage in stewardship are low, the instigating institutional investor does not receive much net gain from stewardship actions. Moreover, the instigating institutional investor would not receive any competitive advantage over competitors, who did not have to spend resources to initiate the action.[116] Thus, institutional investors often do not have the incentive to spend the resources to drive ESG initiatives.

4. Stock Ownership Concerns with Securities Lending and Fund-of-Funds Investing

Sometimes, institutional investors do not own the shares that they invest on behalf of their clients and beneficiaries. The shares may be lent out through securities lending, or an institutional investor may indirectly own the shares when it invests in other funds (called fund-of-funds investing). When an institutional investor does not directly own shares of a portfolio company, then it cannot vote those shares, and its stewardship activities are less effective.

With securities lending, an institutional investor lends shares to other investors, such as hedge funds that engage in short selling or arbitrage, for a fixed or variable fee. These other investors often take bets against the shares they have borrowed, which contributes to speculative trading practices not geared towards improving the long-term value of the target corporation. Moreover, because the shares are now in the hands of other investors, the original institutional investor

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[115] *See* Krouse, Benoit & McGinty, *supra* note 114.

[116] *See* Bebchuk, Cohen & Hirst, *supra* note 10, at 90; Lund, *supra* note 10, at 495.

that lent the shares cannot vote the shares anymore. The original institutional investor could recall the shares to vote them during an annual meeting, but they will often weigh the value of voting as zero due to the uncertainty in valuing shareholder proposals. Thus, the institutional investor will choose not to recall the shares to avoid losing its source of revenue.[117] Research has shown that the lent shares are often left unvoted by the borrowers.[118] Securities lending is common with passive funds. Because passive index funds have low management fees, they often turn to securities lending to make money.[119]

With fund-of-funds investing, an institutional investor may invest in another institutional investor's fund, rather than investing directly in a company. Because an institutional investor has invested in another fund, the other fund owns shares of the portfolio company and has the right to vote the shares, unlike the original institutional investor. Thus, the original institutional investor loses the ability to directly vote its shares the way it wants, such as in support of ESG shareholder proposals.

5. Conflicts of Interest

Some of the largest asset managers, including BlackRock and Vanguard, have conflicts of interest that may lead them to excessively defer to their portfolio companies' management. Not only do many asset managers invest their clients' money in portfolio companies, but they also provide other services to their portfolio companies. This conflict of interest causes them to often vote with their portfolio companies' management and against shareholder proposals related to ESG issues.[120] Research studies have found that institutional investors with greater business ties with portfolio companies tend to vote more often in support of company management.[121]

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117 Wong, *supra* note 105, at 408.
118 Richard B. Evans et al., *Phantom of the Opera: ETF Shorting and Shareholder Voting* 1-2 (Eur. Corp. Governance Inst., Fin. Working Paper No. 763, 2021), https://ssrn.com/abstract=3345799.
119 Croce, Stewart & Yermo, *supra* note 107, at 152.
120 Lucian Bebchuk & Scott Hirst, *Index Funds and the Future of Corporate Governance: Theory, Evidence, and Policy*, 119 COLUM. L. REV. 2029, 2122-23 (2019) (finding that index funds have strong incentives to under-invest in stewardship and excessively defer to the positions of corporate managers).
121 *Id.* at 2064 (citing the following studies supporting the proposition: Rasha Ashraf, Narayanan Jayaraman & Harley E. Ryan, Jr., *Do Pension-Related Business Ties Influence Mutual Fund Proxy Voting? Evidence from Shareholder Proposals on Executive Compensation*, 47 J. FIN. & QUANTITATIVE ANALYSIS 567, 587 (2012) ("[I]n voting on executive pay in public companies, the volume of business that investment managers receive from companies is associated with voting more frequently in support of corporate managers."); Gerald F. Davis & E. Han Kim, *Business Ties and Proxy Voting by Mutual Funds*, 85 J. FIN. ECON. 552, 569 (2007) ("[I]n voting on shareholder proposals in public companies, '[a]ggregate votes at the fund family level indicate a positive relation between business ties and the propensity to vote with management.'")).

Some institutional investors rely on proxy advisors, such as Institutional Shareholder Services (ISS) and Glass Lewis, when voting on shareholder proposals.[122] Proxy advisers provide recommendations on how to vote on a company's proxy. Proxy advisers have significant influence and can sway 13-30% of shareholder votes for various corporate governance issues.[123] Like institutional investors, proxy advisors also have conflicts of interest. For example, ISS provides shareholder voting recommendations for the proxies of the same companies to which it offers other services.[124] However, proxy advisors appear to recommend votes against management more often than the Big Three asset managers. While the Big Three tend to vote with management a majority of the time, ISS recommends voting in favor of shareholder proposals 79% of the time, and Glass Lewis recommends support for 53% of shareholder proposals.[125]

6. Collective Action Problem

Even if an institutional investor wishes to support an ESG issue, it faces a collective problem with other institutional investors. A company may have many institutional investors that individually own small pieces of the company but collectively own a significant portion of the company. However, institutional investors vary widely on investment timelines, resources, and strategies. It is unlikely that all institutional investors will be aligned on an ESG issue. It is difficult for institutional investors to collaborate amongst themselves in the face of such differences.

III. INSTITUTIONAL INVESTORS SUPPORT ESG ISSUES TO CATER TO PEOPLE'S VIEWS

Due to the barriers to institutional investor support for ESG issues as described in Part II, *supra*, shareholder proposals on ESG topics have rarely passed in the past few decades. However, as described in the introduction, ESG shareholder proposals have seen increased success in the last few years. Within the Fortune 250 alone, two ESG shareholder proposals have passed in 2016, three in 2017, five in 2018, three in 2019, seven in 2020, and twenty-one thus far in 2021.[126]

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122 *See* Croce, Stewart & Yermo, *supra* note 107, at 152, 157.

123 Kevin Chuah, Isobel Mitchell & Lily Tomson, *Another Link in the Chain: Uncovering the Role of Proxy Advisors in Investor Voting*, SHAREACTION 4 (Oct. 2, 2020), https://shareaction.org/wp-content/uploads/2020/02/Another-Link-in-the-Chain_Uncovering-the-role-of-proxy-advisors-in-investor-voting.pdf.

124 Chester S. Spatt, *Proxy Advisory Firms, Governance, Market Failure, and Regulation*, MILKEN INST. 9 (June 11, 2019), https://milkeninstitute.org/sites/default/files/reports-pdf/Proxy%20Advisory%20Firms%20FINAL_0.pdf.

125 Chuah, Mitchell & Tomson, *supra* note 123, at 5.

126 *See Fortune 250 Shareholder Proposals*, *supra* note 3.

Much of this shareholder success comes from the support of institutional investors. Why have institutional investors turned the tide on ESG shareholder proposals?

At the core of this momentum for ESG issues is institutional investors catering to the views of the people who matter to them. For example: (1) religious funds may cater to the views of the members of affiliated religious organizations; (2) public pension funds may cater to the views of the people in the relevant geography that the pension fund covers; and (3) the largest asset managers may cater to the views of the general population (particularly members of the population with money to invest).

This Part describes how people's energy for ESG issues created momentum for institutional investor support for ESG issues and ultimately led to the recent success of ESG shareholder proposals. Section A describes how this momentum for ESG issues was not generated overnight, but rather gradually, in a ripple-like manner: (1) ESG issues energized more and more people over time; and (2) more and more institutional investors began supporting ESG issues over time. Section B describes how the increase in support for ESG issues among people and institutional investors has shifted the market and created a new ESG norm.

A. The Ripple Effect

When an object falls into a body of water, the impact creates ripples that spread into wider and wider circles. A similar ripple effect occurs: (1) as more and more people become aware of, concerned about, and energized by ESG issues; and (2) as institutional investors catering to larger and larger groups of people begin supporting ESG issues.

First, information about an ESG issue spreads through private and public communications and generates awareness, concern, and energy among more and more people. As used in this Article, "awareness" means knowing about an ESG issue, "concern" means caring about an ESG issue, and "energy" means caring so much about an ESG issue that a person is willing to spend time and money on the issue. As awareness, concern, and energy build, the ESG issue eventually becomes mainstream.

Second, institutional investors respond to the concerns of the people who matter to them. Thus, institutional investor support for ESG issues will grow as more people become energized by those issues. Institutional investors serving a narrow group of people (e.g. a religious fund serving members of a church) will first start supporting an issue, followed by institutional investors catering to broader populations (e.g. a California public pension fund catering to the views of the people of California), and ending with institutional investors that care about the views of the general population (e.g. the Big Three asset managers caring about the views of the general population because they seek to maximize investment from current and future clients).

The following two sub-sections describe: (1) the ripple effect among people; and (2) how people's awareness, concern, and energy drive a concurrent ripple effect among institutional investors.

1. People's Awareness, Concern, and Energy About ESG Issues Grows

At the center of the ripple effect is people with information. People with information include someone personally affected by an issue or a researcher who has collected information about an issue. For example, people who have been personally affected by discrimination may have information about diversity issues, and scientists who have studied the effects of climate change may have information about climate change.

More people become *aware* of an ESG issue when communication spreads information about an issue. Communication can be private, such as talking to a friend about an issue, but can also be public, such as through publicity. Publicity includes sharing stories through news outlets and social media or publishing research findings in journals. Publicity can build on publicity. For example, the New York Times published an exposé revealing that Google had paid millions of dollars in exit packages to executives accused of sexual misconduct, but stayed silent about the accusations.[127] In response, Google employees conducted a public walkout to protest Google's handling of sexual harassment, and the walkout was featured on various news channels and social media.[128] When Google responded to the walkout by rescinding mandatory arbitration requirements for sexual harassment claims, its response was also publicized.[129] News about the walkout also fed into various shareholder proposals, which were further shared with other shareholders.[130] Ultimately, more and more people became aware of the ESG issue.

After people become aware of an ESG issue, they become *concerned* about it. This sequence is important, because without awareness of an issue, people cannot form an opinion about it. When people become concerned about an issue,

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[127] Daisuke Wakabayashi & Katie Benner, *How Google Protected Andy Rubin, the 'Father of Android'*, N.Y. TIMES (Oct. 25, 2018), https://www.nytimes.com/2018/10/25/technology/google-sexual-harassment-andy-rubin.html.

[128] *See, e.g.*, Daisuke Wakabayashi et al., *Google Walkout: Employees Stage Protest Over Handling of Sexual Harassment*, N.Y. TIMES (Nov. 1, 2018), https://www.nytimes.com/2018/11/01/technology/google-walkout-sexual-harassment.html.

[129] Kate Conger & Daisuke Wakabayashi, *Google Overhauls Sexual Misconduct Policy After Employee Walkout*, N.Y. TIMES (Nov. 8, 2018), https://www.nytimes.com/2018/11/08/technology/google-arbitration-sexual-harassment.html.

[130] *See, e.g.*, Alphabet Inc., Proxy Statement at 68 (Schedule 14A) (Apr. 30, 2019) (raising shareholder proposal at parent company Alphabet seeking a report on sexual harassment risk management and referencing the New York Times exposé regarding Google's payouts to executives accused of harassment and subsequent employee walkout in protest).

they may share their concerns with others and continue to spread the information throughout the community.

Some people may be so concerned about an issue that they become *energized* by it. A person is energized by an issue when a person is willing to spend time and money to support it. For example, a person may join marches and demonstrations to support an issue or donate to non-profits dedicated to an issue. The energy of supporters is important. A large pool of passive supporters who do not act on an issue may not be as effective as a smaller pool of active supporters who spend time and money to support an issue. For example, the climate movement has enjoyed substantial support from institutional investors and has had shareholder proposals pass, partly because people have become passionate about the topic and millions have joined rallies and marches. On the other hand, most people believe that animal cruelty is wrong, but the movement does not have as many active supporters as the climate change movement. Thus, while People for the Ethical Treatment of Animals (PETA), a non-profit that fights against animal cruelty, regularly raises shareholder proposals related to animal cruelty, these proposals have won at most 9% of votes for its proposals.[131]

Awareness, concern, and energy about ESG issues spreads throughout the community in a ripple effect as they affect more and more people. At some point, awareness, concern, and energy in the community has affected much of the general population, and the issue becomes mainstream. An issue is mainstream when almost everyone knows about it and a significant number of people are concerned or energized about the issue.

As described above, the ripple effect among people consists of increasing awareness, concern, and energy in the community about an issue. The next section will discuss a corresponding ripple effect among institutional investors.

2. Institutional Investor Support for ESG Issues Increases

While a ripple of awareness, concern, and energy spreads among people, a ripple of support for ESG issues also spreads among institutional investors.[132]

As discussed in the previous section, it takes time for people to become energized about an ESG issue (i.e. willing to spend time and money on an ESG issue). People must first become aware of an issue before they can be concerned about an issue, and this concern must grow before they are energized by the issue.

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[131] *See Fortune 250 Shareholder Proposals*, *supra* note 3.

[132] Institutional investors can support ESG issues by (1) buying stock of companies that support an ESG cause and selling stock of companies that detract from the ESG cause (e.g. buying stock from renewable energy companies and selling stock from oil companies); (2) raising and voting “for” ESG shareholder proposals; and (3) engaging in discussions with management to influence management to address an ESG issue. See Section I.C, *supra*, for a more detailed discussion of an institutional investors’ tools.

Moreover, it takes time for energy about an ESG issue to expand from a couple supporters to the general population.

The first institutional investors to support an ESG issue are those that cater to a narrow audience. In this early stage of an ESG movement, few people have become energized about an issue, as the rest of the population may not yet be aware of, concerned about, or energized about this issue. Institutional investors that cater to a narrow audience—such as religious funds, non-profits, and socially responsible funds—tend to serve members who share similar views about certain ESG issues. For example, a religious fund may cater to the views of the members of an affiliated church, who may share similar views about gun control.[133]

The second group of institutional investors to support an ESG issue are those that cater to a broader population. In this intermediate stage of an ESG movement, a larger number of people have become energized about an issue; however, much of the population has not yet become aware of, concerned about, or energized about this issue. An example of an institutional investor that caters to a broader audience is public pension funds. While public pension funds primarily serve to provide retirees with a pension, they often receive funding from affiliated cities or states and have elected members of city or state governments on their boards. As a result, public pension funds also care about the views of the voting population in affiliated geographies. Public pension funds may support an ESG issue when the relevant voting population supports that ESG issue. For example, public pension funds in liberal states like California may support more liberal ESG issues when the California electorate supports such issues.[134]

The third and final group of institutional investors to support an ESG issue are those that cater to the general population. At this final, mature stage of an ESG movement, the ESG issue has become mainstream (i.e. the majority of the population is concerned about or energized by an ESG issue). Many of the largest asset managers care about the views of the general population because, as profit-maximizing entities, these asset managers seek to increase investment (and hence revenue) from current and future clients. These asset managers place added weight on the views of people with more money to invest, so the views of millennials may carry more weight than the views of retirees. These asset managers will be the last to support ESG issues, because they cater to the greatest population of people, and it takes time for a majority of the general population to become concerned or energized about an ESG issue.[135]

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[133] See Section III.A.2.a, *infra*, for an example of a religious community raising a shareholder proposal related to gun control.

[134] See Section III.A.2.b, *infra*, for a detailed discussion of public pension funds' conflicts of interest that lead them to care about a broader population that just their beneficiaries.

[135] See Section III.A.2.c, *infra*, for a detailed discussion of institutional investors that cater to the general population.

The following subsections will discuss in more detail how the ripple of momentum for ESG issues: (1) starts from institutional investors that serve narrow populations; (2) expands to institutional investors that serve broader populations; and (3) ultimately reaches institutional investors that serve the general population. These subsections will also discuss the people who matter to various types of institutional investors in more detail.

a. Institutional Investors that Cater to a Narrow Population

The first set of institutional investors to support an ESG issue tends to be institutional investors that cater to a narrow population. These institutional investors may be driven by a social policy purpose or have members who hold similar views on certain ESG issues. They include religious funds, foundations, non-profits, public policy interest groups, private labor unions, and socially responsible funds. This section will describe who matters to each of these types of institutional investors. It will then describe how serving a narrow population allows these funds to be first movers on ESG issues.

Starting with religious funds, the people who matter are the leaders and members of the affiliated religious institution. Religious funds often make shareholder proposals based on the moral and ethical values of their leaders and congregants. For example, a Catholic nun believed that gun violence was a social issue that needed to be addressed and successfully convinced a group of fellow nuns to raise a shareholder proposal requesting that a gun manufacturer produce a report related to gun violence.[136]

Certain non-profits, foundations, and public policy interest groups are established to serve a specific purpose. These groups will attract members who believe in and work to serve that purpose. These purpose-driven organizations will support issues that align with the purpose that their members share. For example, the Humane Society is a non-profit formed to end animal cruelty, and it attracts members and donors who care about animals.[137] The Humane Society has raised various shareholder proposals related to animal cruelty.[138] Another example of a purpose-driven organization is the Park Foundation, which supports environmental, education, and public broadcasting causes.[139] The Park Foundation has raised shareholder proposals related to the environment.[140] A final example of a purpose-driven organization is SumOfUs, which is a public policy interest group

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[136] Jon Schuppe, *How a Seattle nun led a shareholder revolt against gun makers*, NBC NEWS (Sept. 30, 2018), https://www.nbcnews.com/news/us-news/how-seattle-nun-led-shareholder-revolt-against-gun-makers-n915006.

[137] *Our Mission*, HUMANE SOC'Y U.S., https://www.humanesociety.org/our-mission (last visited Aug. 10, 2021).

[138] *Fortune 250 Shareholder Proposals*, *supra* note 3.

[139] *About Us*, PARK FOUND., https://parkfoundation.org/about-us/ (last visited July 29, 2021).

[140] *Fortune 250 Shareholder Proposals*, *supra* note 3.

that seeks to hold companies accountable on issues related to the environment, workers, and democracy.[141] SumOfUs has raised shareholder proposals related to deforestation and human rights.[142]

Private labor unions are designed to advocate for workers' rights and interests.[143] The people who matter to private labor unions are employees with union membership. The leaders of unions are elected directly or indirectly by worker-members. For example, the UAW Executive Board is elected by delegates that local union members elect.[144] Thus, the views of the union members carry significant weight during board meetings. Since union members are employees who care about employee issues, unions will raise and support shareholder proposals that are related to issues that matter to employees. Through their associated pensions and healthcare trusts, labor unions have historically raised shareholder proposals related to factory closings, healthcare, and workplace safety.[145]

Socially responsible funds encompass a broad range of funds. Some are non-profits and others are for-profit entities.[146] Some serve a narrow purpose, such as gender equality, while others serve a broad purpose, such as ESG issues generally.[147] One common denominator is that socially responsible funds have a social mission in their investment mandates.[148] People put money in socially responsible funds because they believe in the funds' social missions. Thus, the people who invest in socially responsible funds tend to agree on certain ESG issues. For example, the Pax Ellevate Global Women's Leadership Fund likely attracts investors who care about gender equality.[149] Socially responsible funds will support ESG issues to: (1) serve the views of its current clients; and (2) attract additional fund flows from future clients who care about these issues.

Institutional investors that cater to a narrow population easily overcome the problem of varying views among people, discussed in Section II.C, *supra*. The people who matter to these institutional investors tend to have similar views on certain ESG issues. In the case of religious funds, foundations, non-profits, public

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141 *About Us*, SUMOFUS, https://www.sumofus.org/about/ (last visited July 29, 2021).
142 *Fortune 250 Shareholder Proposals*, *supra* note 3.
143 *See, e.g.*, *UAW Basics,* UNITED AUTO., AEROSPACE AND AGRIC. IMPLEMENT WORKERS OF AM. 2 (June 2020), https://uaw.org/wp-content/uploads/2015/09/515-UAW-Basics-071318-1.pdf.
144 *See id.* at 3.
145 *Fortune 250 Shareholder Proposals*, *supra* note 3.
146 *See, e.g.*, *About Green Century Capital Management*, GREEN CENTURY FUNDS, https://www.greencentury.com/about-us/ (last visited Aug. 10, 2021) (describing unique non-profit ownership).
147 *Compare Pax Ellevate Global Women's Leadership Fund*, *supra* note 97*, with iShares ESG Aware MSCI USA ETF*, BLACKROCK, https://www.blackrock.com/us/financial-professionals/products/286007/ishares-esg-aware-msci-usa-etf (last visited Aug. 10, 2021).
148 *See* Cheryl Winokur Munk, *The New Math of Socially Responsible Investing*, WALL ST. J. (June 27, 2021), https://www.wsj.com/articles/socially-responsible-investing-11624288038.
149 *See Pax Ellevate Global Women's Leadership Fund*, *supra* note 97.

policy interest groups, and socially responsible funds, people self-select into these funds and organizations based on shared views. In the case of labor unions, people are selected into the group based on their jobs, but they share a common background as workers. Because these institutional investors cater to the needs of a smaller group of people with relatively similar views on certain ESG issues, it is easier for institutional investors to support certain ESG issues. In fact, the majority of ESG shareholder proposals are brought by institutional investors that cater to a narrow population. In the last fifteen years, at Fortune 250 companies, out of 2,072 shareholder proposals related to social policy, 1160 (56%) were made by these institutional investors that cater to a narrow population. Specifically, socially responsible funds made 494 (24%) of those proposals, religious institutions made 321 (15%), public-policy interest groups made 124 (6%), labor union pension funds made 111 (5%), and foundations and non-profits made 99 (5%).[150]

Institutional investors that cater to a narrow population tend to be first movers on ESG issues and may support an ESG issue before it becomes popular. As discussed in Section III.A.1, *supra*, it takes time for people to become aware of, concerned about, and energized by an ESG issue. Before a significant number of people are energized by an issue (i.e. willing to spend time and money on an issue), the few people who have already become energized by an issue may self-select themselves into these specialized, narrower funds. Since their members already agree on an ESG issue, these funds will support an ESG issue first—before funds serving broader, more ideologically-diverse groups of people lend their support. For example, some of the first proponents of climate change shareholder proposals were socially responsible funds, religious institutions, public policy interest groups, and foundations.[151]

b. Institutional Investors That Cater to a Broader Population

Some institutional investors care about a broader population than just their membership and the organization's shared purpose. For example, public pension funds care about not just their beneficiaries, but they also may care about the views of a city or state's general electorate due to conflicts of interest.

Public pension funds provide retirement benefits for employees of participating schools, cities, counties, and states. Members of public pension funds can include teachers, firefighters, police, and government employees. For public

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[150] *Fortune 250 Shareholder Proposals*, *supra* note 3. Other important proponents of shareholder resolutions are pension funds, which will be discussed in the next subsection, and individuals, who are often called "corporate gadflies." *See* Yaron Nili & Kobi Kastiel, *The Giant Shadow of Corporate Gadflies,* 94 S. Calif. L. Rev. (U. Wisc. L. Sch., Legal Studies Research Paper Series Paper No. 1523, 2020), https://ssrn.com/abstract=3520214 (discussing how corporate gadflies play an important role in corporate governance and can influence corporate agendas through their shareholder proposals).

[151] *See Fortune 250 Shareholder Proposals*, *supra* note 3.

pension funds, the people who matter are two-fold: (1) the current and future retirees to whom they are obligated to provide retirement funds; and (2) the electorate in the relevant geographies that the pension fund covers.

First, public pension funds serve their beneficiaries, who are current and future retirees to whom they are obligated to provide retirement funds. These beneficiaries are employees or former employees, and thus they may care about employee issues. Public pension funds may support labor-related ESG issues to represent their beneficiaries' views. In fact, public pension funds have raised and supported a variety of employee-oriented shareholder proposals.[152] When they only cater to the views of their beneficiaries, they can be categorized as institutional investors that serve a narrow population.

Second, public pension funds have conflicts of interest that can lead them to also care about the views of the electorate in the relevant geographies that the pension fund covers.[153] Some members of public pension fund boards are affiliated with the local government, because the local government must address any shortfall of the pension.[154] These board members may include officials who are appointed by elected local government officials and *ex officio* members who are directly elected by the population in the relevant geographies. For example, seven out of thirteen members of the CalPERS board are affiliated with the California state government: the State Treasurer, the State Controller, the Director of the California Department of Human Resources, a representative of the State Personnel Board, two members appointed by the governor of California, and one public representative appointed jointly by the Speaker of the Assembly and the Senate Rules Committee.[155] Eight out of the eleven members of the NYCERS board are affiliated with New York City government: the Mayor's Representative, the City Comptroller, the Public Advocate, and five Borough Presidents.[156] Because many public pension board members are appointed by elected government officials or directly elected, they are accountable to the opinions of the electorate of the relevant city or state. Thus, public pension funds may also tackle issues that the electorate in the relevant geographies care about. In more liberal states such as New York and California, public pension funds may take on liberal issues such as

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[152] *Id.*

[153] *See* Roberta Romano, *Public Pension Fund Activism in Corporate Governance Reconsidered*, 93 COLUM L. REV. 795, 796 (1993) (discussing conflicts of interests within public pension funds).

[154] *See* Olivia Mitchell & Leora Friedberg, *The Time Bomb Inside Public Pension Plans*, KNOWLEDGE@WHARTON (Aug. 23, 2018), https://knowledge.wharton.upenn.edu/article/the-time-bomb-inside-public-pension-plans/.

[155] *See Board Members*, CalPERS, https://www.calpers.ca.gov/page/about/board/board-members (last visited July 22, 2021).

[156] *See Board of Trustees*, NYCERS, https://www.nycers.org/board-trustees (last visited July 22, 2021).

environmentalism and diversity, and in fact have raised and supported shareholder proposals related to these issues.[157]

Public pension funds may support ESG issues later than institutional investors that cater to a narrow population, which were discussed in the previous section. The reason for this is that it takes time for enough people in the relevant geography to learn about, become concerned about, and become energized by an issue. The more people in the relevant geography share the same views, the faster a public pension fund may take on an issue. For example, New York and California are known to be extremely liberal and thus support liberal causes quite quickly, whereas less liberal states may wait longer to support an issue because the relevant electorate has not yet become sufficiently energized by an issue.[158]

Public pension funds have brought a significant number of shareholder proposals. In the last fifteen years, at Fortune 250 companies, out of 2,072 shareholder proposals related to social policy, public pension funds made 248 (12%) of those proposals. Public pension funds have also historically raised a significant number of shareholder proposals related to climate change and diversity relatively early in their movements, years before these types of shareholder proposals finally succeeded.[159]

c. Institutional Investors that Cater to the General Population

Unlike the specialty organizations discussed earlier, most asset managers seek to maximize profit and do not have social missions as their goals. I call these asset managers "conventional asset managers" to distinguish them from asset managers solely dedicated to socially responsible investing and other specialty organizations. Conventional asset managers include some of the largest asset managers, including BlackRock, Vanguard, and State Street (the Big Three). Conventional asset managers may run mutual funds and index funds without social missions.

To maximize profit, conventional asset managers seek fund flows from everywhere, including the general population and other institutional investors. Conventional asset managers may begin to support an ESG issue when: (1) the general population is energized about an ESG issue; and (2) other institutional investors already support an ESG issue.

i. Supporting the General Population's Views on ESG Issues

Conventional asset managers draw significant fund flows from the general public through mutual funds and index funds. Conventional asset managers often

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[157] *See Fortune 250 Shareholder Proposals*, *supra* note 3.
[158] *See id.*
[159] *See id*.

earn a percentage fee on their assets under management. Because these fees are a large source of revenue, conventional asset managers may cater to the views of the general population to attract additional investment and thus earn additional fees. Not everyone's opinion carries equal weight. Conventional asset managers particularly care about the views of those people with more money to invest because they seek to maximize profit. For example, conventional asset managers may pay more attention to the views of millennials who will be investing trillions of dollars in the stock market.[160] By contrast, conventional asset managers may pay less attention to the views of retirees who live off savings and may be taking money out of the stock market.

As profit-maximizing entities, conventional asset managers will only support an ESG issue if supporting the issue generates net positive fund flows. In other words, the money that the asset manager can attract from current and future clients must exceed the money that will leave if it supports the ESG issue.

Typically, conventional asset managers do not support most ESG issues, because people usually hold widely varying views on ESG issues.[161] A conventional asset manager would likely not risk upsetting the bulk of its clients and potential future clients by supporting a controversial ESG issue and losing fund flows as a result.

However, a special situation emerges when the general population's views on certain ESG issues converge. When an ESG issue has become publicly-salient and mainstream, a conventional asset manager may infer that many people are energized by the issue and willing to invest money to support the issue. This is particularly the case when a conventional fund puts extra weight on the opinions of millennials, who are more willing to integrate social values into their investment decisions.[162] While a conventional asset manager may upset some clients by supporting the ESG issue, it may gain even more clients than it loses by supporting an ESG issue. This special situation does not occur often and does not arise quickly. It takes time for an ESG issue to become publicly salient and mainstream (and for energy about an ESG issue to build within a large population), so conventional asset managers may be some of the last institutional investors to support ESG issues.[163]

Conventional asset managers can profit in two ways from supporting ESG issues. First, conventional asset managers can drive fund flows to their conventional funds, which are profit-maximizing funds without a social mandate. Second, conventional asset managers can set up and drive fund flows towards their socially responsible funds.

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[160] Barzuza, Curtis & Webber, *supra* note 14, at 1249.

[161] *See* Part II.C, *supra*.

[162] Barzuza, Curtis & Webber, *supra* note 14, at 1303.

[163] For example, it took BlackRock, Vanguard, and Fidelity until 2017 to start supporting ESG shareholder proposals. *See* Mueller et al., *supra* note 4.

a) Driving Fund Flows to Conventional Funds

First, by proclaiming support for ESG issues, a conventional asset manager can drive fund flows to its conventional funds. As the Occupy Wall Street movement demonstrated, the big banks, including some conventional asset managers, are often seen as greedy and opportunistic.[164] To improve their reputations and encourage people to trust them with their money, conventional asset managers may write or speak about popular social causes.[165] When a conventional asset manager announces that it believes in a popular ESG issue, it can: (1) develop a positive, ESG-friendly reputation; and (2) put its name in front of ESG-conscious people. When people think about investing their money, they may think of the ESG-friendly asset managers.

For example, BlackRock runs many types of funds but is especially well-known for its iShares-branded exchange-traded funds.[166] Recently, BlackRock has been touting its own sustainability goals and climate change advocacy, and this has led to many headlines.[167] These headlines enhance BlackRock's reputation and give it positive publicity. As BlackRock becomes known for its environmental advocacy, people who care about the environment are more likely to think of BlackRock when choosing where to invest their money.

Conventional asset managers may focus on the most publicly-salient ESG issues to gain the greatest benefit in terms of positive reputation and name recognition. For example, after a mass shooting at a high school in Parkland, Florida led to public outrage and mass demonstrations, BlackRock and other institutional investors supported a shareholder proposal related to gun control at Sturm Ruger, a gun manufacturer, and the shareholder proposal passed.[168] In another example, when litigation regarding the opioid crisis in the United States

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[164] Edith Honan & Edward McAllister, *Thousands protest banks, corporate greed in U.S. marches*, REUTERS (Oct. 14, 2011), https://www.reuters.com/article/us-usa-wallstreet-protests/thousands-protest-banks-corporate-greed-in-u-s-marches-idUSTRE79A41E20111015.

[165] Martin Gelter & Julia M. Puaschunder, *COVID-19 and Comparative Corporate Governance* 63 & n.421 (Eur. Corp. Governance Inst., Law Working Paper No. 563, 2021), https://papers.ssrn.com/sol3/papers.cfm?abstract_id=3772965 (indicating that institutional investors may care about improving their reputations to avoid being seen as evil or the bad guys).

[166] *Investment Funds*, *supra* note 27.

[167] *See, e.g.*, Dawn Lim, *BlackRock's Fink Urges Companies to Disclose, Do More on Greenhouse-Gas Emissions*, WALL ST. J (Jan. 26, 2021), https://www.wsj.com/articles/blackrocks-fink-urges-companies-to-disclose-do-more-on-greenhouse-gas-emissions-11611670619; Andrew Ross Sorkin, *BlackRock C.E.O. Larry Fink: Climate Crisis Will Reshape Finance*, N.Y. TIMES (Feb. 24, 2020), https://www.nytimes.com/2020/01/14/business/dealbook/larry-fink-blackrock-climate-change.html

[168] Schuppe, *supra* note 136.

was making headlines, conventional asset managers supported shareholder proposals related to the opioid crisis, and these shareholder proposals passed.[169]

Publicity also acts as an enforcement mechanism to keep institutional investors accountable to their promises. Instances of greenwashing—or generating publicity on ESG issues without taking meaningful action—are common in the U.S.[170] For example, BlackRock's CEO, Larry Fink, has stressed the importance of addressing climate change since 2016 in his annual letters to CEOs and made headlines for his rhetoric on climate change.[171] Despite the loud proclamations, BlackRock had one of the lowest rates of support for climate change shareholder proposals among the largest asset managers.[172] BlackRock only supported 4% of climate change shareholder proposals among the Fortune 250 in 2017, 6% in 2018, 25% in 2019, and 14% in 2020.[173] The media and public interest organizations criticized BlackRock for greenwashing and not fully committing to addressing climate change by supporting climate change shareholder proposals.[174] In response, BlackRock supported 91% of climate change shareholder proposals in the first half of the 2021 proxy year to bolster its reputation and avoid losing clients.[175]

b) Driving Fund Flows to Socially Responsible Funds

Second, conventional asset managers can set up and drive money towards their socially responsible funds. People nowadays are pouring money into socially responsible funds. In 2020, growth in socially responsible funds grew by 250% in

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169 *See* Martine Costello, *Amid Opioid Crisis, Shareholders Push for Better Governance in the Pharmaceutical Sector*, IMPACTIVATE (June 5, 2018), https://www.theimpactivate.com/amid-opioid-crisis-shareholders-push-for-better-governance-in-the-pharmaceutical-sector/.

170 *See* Brandon et al., *supra* note 52, at 6-7, 21, 27-29 (finding that U.S. investors did not improve their portfolio-level ESG footprints after joining the PRI and pledging to incorporate ESG criteria into their investment decisions); Raghunandan & Rajgopal, *supra* note 13, at 3, 7-9 (finding that ESG funds' portfolio companies have more violations of environmental laws and worse performance with respect to carbon emissions than non-ESG funds' portfolio companies).

171 *See, e.g.*, *Larry Fink's 2016 Letter to CEOs*, BlackRock, https://www.blackrock.com/corporate/investor-relations/2016-larry-fink-ceo-letter (last visited Aug. 10, 2021); Sarah Krouse, *BlackRock CEO to Companies: Pay Attention To 'Societal Impact'*, WALL ST. J. (Jan. 16, 2018), https://www.wsj.com/articles/blackrock-ceo-to-companies-pay-attention-to-societal-impact-1516120840.

172 *Climate in the Boardroom: How Asset Manager Voting Shaped Corporate Climate Action in 2020*, MAJORITY ACTION 24 (2020), https://www.majorityaction.us/asset-manager-report-2020.

173 *Fortune 250 Shareholder Proposals*, *supra* note 3.

174 *See, e.g.*, Eric Rosenbaum, *Activists thought BlackRock, Vanguard found religion on climate change. Not anymore*, CNBC (Oct. 13, 2019), https://www.cnbc.com/2019/10/13/blackrock-vanguard-found-religion-on-climate-doubts-are-growing.html.

175 Dawn Lim, *BlackRock Starts to Use Voting Power More Aggressively*, WALL ST. J. (Apr. 30, 2021), https://www.wsj.com/articles/blackrock-takes-aggressive-posture-on-esg-proxy-votes-11619775002.

one year.[176] Socially responsible funds had almost $2 trillion of assets globally in Q1 2021, which is more than triple the amount of assets invested in socially responsible funds three years prior.[177] Running a socially responsible fund is particularly lucrative for asset managers because they can charge higher fees for socially responsible funds. Socially responsible funds can command higher fees because they may require additional manpower to run. Some funds may conduct additional research about ESG issues and their portfolio companies' stances on these issues, while other funds may also raise shareholder proposals or engage company management on these issues. In addition, socially responsible funds can command higher fees because consumer demand for ESG investment options is on the rise. As fees for conventional funds continue to fall, sometimes to 0% (due to intense competition for market share), the additional premium for socially responsible funds provides institutional investors with additional revenue.[178]

To capitalize on increased fund flows and fees, conventional asset managers are repurposing some conventional funds as socially responsible funds as well as setting up new socially responsible funds.[179] For example, BlackRock capitalized on the socially responsible investing trend by starting several socially responsible funds beginning in 2016,[180] which is also the same year it began publicizing its support for ESG issues in earnest.[181] As BlackRock continued to publicize its support for ESG issues, its socially responsible funds grew to collect $23.1 billion in fund flows, or 45% of all sustainable fund flows, in 2020. This represented the most sustainable fund flows in the market, as no other asset managers captured as much sustainable fund flows as BlackRock.[182]

ii. Supporting Other Institutional Investors' Views on ESG Issues

As described in Sections III.A.2.a and III.A.2.b, *supra*, some institutional investors cater to the views of narrower populations than the general population. These institutional investors may support an ESG issue earlier than conventional funds, because it takes less time for energy about an ESG issue to build within a

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[176] Mindy Lubber, *Why This Proxy Season Is A Record Breaker For Climate Proposals*, FORBES (May 14, 2021), https://www.forbes.com/sites/mindylubber/2021/05/14/why-this-proxy-season-is-a-record-breaker-for-climate-proposals/?sh=1be0f4c054d4.

[177] Patterson & Ramkumar, *supra* note 89.

[178] *See* Nellie S. Huang, *Here Come the Zero-Fee ETFs*, KIPLINGER (May 10, 2019), https://www.kiplinger.com/article/investing/t022-c009-s002-here-come-the-zero-fee-etfs.html.

[179] Jon Hale, *A Broken Record: Flows for U.S. Sustainable Funds Again Reach New Heights*, MORNINGSTAR (Jan. 28, 2021), https://www.morningstar.com/articles/1019195/a-broken-record-flows-for-us-sustainable-funds-again-reach-new-heights.

[180] *See Investment Funds*, *supra* note 27 (listing inception dates of BlackRock ESG funds).

[181] *See, e.g.*, *Larry Fink's 2016 Letter to CEOs*, *supra* note 171.

[182] Hale, *supra* note 179.

narrower population than within the general population. For example, religious funds supported ESG issues before the largest asset managers did, because members of religious institutions affiliated with the funds shared some of the same ESG views. Public pension funds may also support ESG issues before the largest asset managers, because public pension funds only need to worry about the opinions of people in a local geographic area, which may coalesce around an ESG issue before the opinions in the general population do.

Institutional investors that cater to narrower populations can influence institutional investors that cater to broader populations, because the former can be the latter's clients. Conventional asset managers care more about clients with more money. Institutional investors that cater to narrower populations will have amassed more investment capital than the average person. Thus, conventional asset managers will pay more attention to these institutional clients than to the average person.

Institutional investors that cater to narrower populations can use direct feedback to influence conventional asset managers to support ESG issues. For example, pension funds often use external asset managers to manage their money.[183] These pension funds may have an ESG focus and ask the asset managers to similarly have an ESG focus. CalPERS, the U.S.'s largest public pension fund, requires external asset managers to incorporate ESG criteria in investment decisions, including proxy voting.[184] These requirements can influence conventional asset managers to support ESG issues to attract pension funds' money.

In another example, Walden Asset Management, a socially responsible fund and client of Vanguard, brought a shareholder proposal at Vanguard in 2017 seeking a report on proxy voting policies and practices related to climate change and diversity. After discussions, Vanguard detailed plans to announce several governance measures. Satisfied with the result, Walden Asset Management withdrew its shareholder proposal. That same year, Vanguard voted in favor of ESG shareholder proposals against management for the first time, helping turn the tide for the ESG movement.[185]

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[183] Jean-Pierre Aubry & Kevin Wandrei, *Internal vs. External Management for State and Local Pension Plans*, CTR. FOR RET. RSCH. B.C. (Nov. 2020), https://crr.bc.edu/wp-content/uploads/2020/11/SLP75_.pdf.

[184] *See CalPERS' Governance & Sustainability Principles*, CALPERS 2, 5, 10, 14, 16-17, 27-30, 35-36 (Sept. 2019), https://www.calpers.ca.gov/docs/forms-publications/governance-and-sustainability-principles.pdf.

[185] *Shareholder Climate Change Proposal Withdrawn*, VANGUARD (Aug. 14, 2017), https://pressroom.vanguard.com/news/Press-Statement-Shareholder-Climate-Change-Proposal-081417.html; Rosenbaum, *supra* note 63; *Agreement Reached: Walden Withdraws Shareholder Resolution at Vanguard on Proxy Voting*, WALDEN ASSET MGMT. (Aug. 14, 2017), https://www.bostontrustwalden.com/wp-content/uploads/2019/08/StatementVanguardAug2017.pdf.

Thus, conventional asset managers may support ESG issues in order to cater to their institutional clients.

B. The Market Shift

Section III.A.1, *supra*, described how awareness, concern, and energy about ESG issues increased among people. Eventually, a significant number of people were sufficiently energized about particular issues that they were willing to spend time and money in support of the issues. Section III.A.2, *supra*, described how institutional investor support for ESG issues grew as more people became energized about the issues. Eventually, even conventional asset managers supported ESG issues to attract investment both from the general population as well as from institutional investors that serve narrower populations, such as public pension funds.

As a result, institutional investors have voted in favor of ESG shareholder proposals in increasing numbers, and ESG shareholder proposals have passed in increasing numbers. While it was typical for no ESG shareholder proposals to pass within Fortune 250 companies prior to 2016, two ESG shareholder proposals passed in 2016, three in 2017, five in 2018, three in 2019, seven in 2020, and twenty-one thus far in 2021.[186] Socially responsible funds have also proliferated during this time, as annual flows in 2020 ($51.1 billion) were almost ten times the annual flows to socially responsible funds two years prior in 2018 ($5.4 billion).[187]

As more ESG shareholder proposals pass and socially responsible investing options proliferate, the societal norm shifts to embrace ESG investing. Now that institutional investors have voted in favor of ESG shareholder proposals, people expect them to continue supporting ESG issues. Now that money has poured into socially responsible funds, competitors rush in to open their own socially responsible funds. News about institutional investors' support for ESG shareholder proposals and advertisements about their socially responsible funds further keep the topic of ESG investing top of mind for people, and a positive reinforcement cycle develops.

As the societal norm shifts to ESG investing, institutional investors' habits may change. Laggards on ESG investing may feel the pressure to keep up. For example, Fidelity had abstained from voting on ESG shareholder proposals for years, but finally started voting in favor of some ESG shareholder proposals in 2017.[188] Institutional investors may also attempt to distinguish themselves by taking more active steps to support ESG issues. For example, conventional asset managers traditionally never raised ESG shareholder proposals, but instead only engaged with management and voted on a handful of shareholder proposals they

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[186] *Fortune 250 Shareholder Proposals*, *supra* note 3.
[187] Hale, *supra* note 179.
[188] Mueller et al., *supra* note 4.

supported. However, with the growing popularity of ESG investing, some large asset managers such as BNP Paribas have also raised successful ESG shareholder proposals.[189] These shifts in habits may further entrench the market shift toward ESG investing.

Developing a social norm of ESG investing may also alleviate the problem of greenwashing. As discussed in Section III.A.2.c.i.a, *supra*, greenwashing occurs when institutional investors say big words about supporting ESG issues (i.e. "cheap talk") without taking meaningful action. Meaningful action would include: (1) voting "for" ESG shareholder proposals; (2) buying stock of companies that support ESG principles and selling stock of companies that do not support ESG principles; and (3) actually influencing company management to change the company to support an ESG issue. When a social norm of ESG investing develops, institutional investors may take more meaningful action toward ESG issues, perhaps because they may fear public retribution when evidence of greenwashing emerges, or perhaps because it is simply normal to support ESG issues. What has happened in Europe may be illustrative. Environmental and social norms are stronger in Europe than in the U.S., and a study found that ESG investing has been more broadly practiced in Europe and is used as more than just a reputational tool to attract investor flows, as is more common in the U.S.[190] Another study found that foreign institutional investors domiciled in countries with social norms supportive of strong ESG commitments improved domestic portfolio companies' ESG performance.[191]

The ESG market shift also makes lower-tier ESG issues easier to support. Right now, the most popular ESG issues are climate change and diversity.[192] A large portion of recent successful ESG shareholder proposals relate to climate change and diversity.[193] As discussed in Section III.A.2.c.i.a, *supra*, conventional asset managers may focus on supporting the most publicly-salient, mainstream issues to attract fund flows. Now that ESG investing is the norm, it may be more acceptable for institutional investors to support ESG issues that are not as publicly-salient and mainstream as climate change and diversity. Institutional investors can also use support for these additional issues to differentiate themselves from their competitors. For example, while many people care about the issues of deforestation and plastic pollution, these issues are not as publicly-salient and mainstream as the

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[189] *See id.*; *Fortune 250 Shareholder Proposals*, *supra* note 3.

[190] Brandon et al., *supra* note 52, at 18, 21, 30.

[191] Alexander Dyck et al., *Do Institutional Investors Drive Corporate Social Responsibility? International Evidence*, 131 J. FIN. ECON. 693, 713 (2019).

[192] ALLIANCE ADVISORS, *2021 Proxy Season Issues and Early Voting Trends*, HARV. L. SCH. F. ON CORP. GOVERNANCE (May 20, 2021), https://corpgov.law.harvard.edu/2021/05/20/2021-proxy-season-issues-and-early-voting-trends/.

[193] *See Fortune 250 Shareholder Proposals*, *supra* note 3.

issue of climate change.[194] While previous shareholder proposals related to deforestation and plastic pollution failed to pass, a 2020 shareholder proposal related to deforestation raised at Procter & Gamble and a 2021 shareholder proposal related to plastic pollution raised at DuPont succeeded with institutional investor support.[195]

IV. CLIMATE CHANGE CASE STUDY

This Part analyzes the climate change movement to illustrate how people's energy about an ESG issue increased over time and drove institutional investors to support an ESG issue in increasing numbers. This Part will also discuss the resulting market shift among institutional investors in support of the climate change movement.

A. The Climate Change Ripple Effect

Climate change has become a major focus of institutional investors, but this was not always the case. It took a century of scientific research and decades of advocacy for the largest institutional investors to put their weight behind the issue. This section will discuss how increasing numbers of people and institutional investors addressed the climate change issue over time—similar to how a ripple increases in size over time. First, it took time for people to become aware of climate change, become concerned that humans were contributing to global warming, and become energized enough about the issue to spend time (e.g. join rallies) and money (e.g. invest in sustainable funds) to support the issue. Second, people's embrace of the climate change issue prompted institutional investors to do the same.

1. People's Views about Climate Change

Scientists have been studying the ability of greenhouse gases to trap heat in the atmosphere since the early 1800s.[196] This research accelerated as the world rapidly industrialized and released additional greenhouse gases from fossil fuels

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[194] *See Views of the major problems facing the country*, PEW RSCH. CTR. (Dec. 17, 2019), https://www.pewresearch.org/politics/2019/12/17/views-of-the-major-problems-facing-the-country/.

[195] *See Fortune 250 Shareholder Proposals*, *supra* note 3.

[196] *Climate Change History*, HISTORY.COM (Nov. 20, 2020), https://www.history.com/topics/natural-disasters-and-environment/history-of-climate-change.

into the atmosphere.[197] By the 1950s, the vast majority of the scientific community had become convinced that human activity could warm up the planet.[198]

Publicity spread this knowledge amongst the people. While climate change was discussed in some government reports and news outlets prior to the 1980s,[199] it did not receive mass public and media attention until 1988.[200] 1988 was the hottest year on record and also brought widespread droughts and wildfires in the U.S.[201] Significantly, the rising heat was linked to global warming.[202] In turn, the media and public began paying closer attention to the issue.[203] In his widely televised 1988 testimony, NASA scientist James Hansen said that he was "99% sure" that global warming was here.[204] That same year, the U.N. formed the Intergovernmental Panel on Climate Change (IPCC) to assess the science of climate change and provide information to governments.[205]

Activism related to climate change ramped up in the 1990s when major environmental organizations became involved in discussions about climate change.[206] Another peak in press coverage occurred in 1997 when developed nations gathered in Kyoto, Japan to address the climate change problem.[207] The resulting international treaty, called the Kyoto Protocol, was a pledge for industrially-advanced countries to reduce emissions by an average of 5% between 2008 and 2012.[208] While President Bill Clinton signed the Kyoto Protocol on behalf of the U.S., it never became official U.S. policy because Congress never ratified

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197 *Id.*; *A brief history of climate change*, BBC (Sept. 20, 2013), https://www.bbc.com/news/science-environment-15874560.

198 *Climate Change Conversations: Causes, Impacts, Solutions*, AM. ARCHIVE OF PUB. BROAD., https://americanarchive.org/exhibits/climate-change/history (last visited June 12, 2021).

199 Alex Kasprak, *Did a 1912 Newspaper Article Predict Global Warming?*, SNOPES (Oct. 18, 2016), https://www.snopes.com/fact-check/1912-article-global-warming/ (March 1912 issue of Popular Mechanics described scientists' predictions for the future effects of global warming).

200 Sophie Yeo, *How the largest environmental movement in history was born*, BBC (Apr. 21, 2020), https://www.bbc.com/future/article/20200420-earth-day-2020-how-an-environmental-movement-was-born; *Climate Change History*, *supra* note 196; Olivia Kestin et al., *12 Important Moments in the History of Climate Action: In Photos*, GLOB. CITIZEN (June 5, 2020), https://www.globalcitizen.org/en/content/important-moments-climate-history-in-photos/; Peter Jackson, *From Stockholm to Kyoto: A Brief History of Climate Change*, U.N., https://www.un.org/en/chronicle/article/stockholm-kyoto-brief-history-climate-change (last visited June 13, 2021).

201 *Climate Change History*, *supra* note 196; Kestin et al., *supra* note 200.

202 Kestin et al., *supra* note 200.

203 *Climate Change History*, *supra* note 196.

204 *Id.*; Justin Worland, *Climate Change Used to Be a Bipartisan Issue. Here's What Changed*, TIME (July 27, 2017), https://time.com/4874888/climate-change-politics-history/.

205 Pfeifer & Sullivan, *supra* note 55, at 252-53; *A brief history of climate change*, supra note 197; Jackson, *supra* note 200; Kestin et al., *supra* note 200.

206 *See, e.g.*, Chiara Giorgetti, *From Rio to Tokyo: A Study of the Involvement of Non-Governmental Organizations in the Negotiations on Climate Change*, 7 N.Y.U. ENV'T L. J. 201, 202-06 (1998).

207 Pfeifer & Sullivan, *supra* note 55, at 254; Kestin et al., *supra* note 200.

208 Kestin et al., *supra* note 200; Jackson, *supra* note 200.

it.[209] As awareness of climate change issues rose, so too did voices challenging the science behind climate change and the impact of climate change policies on the economy.[210] By the 2000 election, climate change had become a key political issue.[211]

During the 2000s, several climate-specific organizations were founded, and large-scale demonstrations calling for action on climate change became regular events.[212] For example, around the time of the 2009 United Nations Climate Change Conference in Copenhagen, more than 5,400 rallies and demonstrations took place around the world.[213] In addition, companies took on "green" initiatives, such as integrating renewable technologies into energy portfolios, building hybrid vehicles, and improving energy efficiency.[214] While some "green" initiatives drew criticism as superficial actions that did little more than improve a company's reputation, the initiatives nevertheless generated publicity.[215] Fund managers and pension funds also set up collaborative initiatives to address climate change. These initiatives included the Carbon Disclosure Project, which requested greenhouse gas emission disclosure from Fortune 500 companies, and the Institutional Investor Group on Climate Change, which engaged with companies and policymakers.[216]

The climate movement accelerated in the 2010s. The Paris Climate Agreement generated significant publicity when 197 countries, including the United States, pledged to set targets in greenhouse gas emissions and report progress in order to prevent a global temperature rise of 2 degrees Celsius.[217] The 2010s also saw fossil fuel divestment campaigns through which various universities, foundations, and people pledged to remove fossil fuels from their investment portfolios.[218] Significant media attention surrounded climate change protests as they grew in popularity. In 2014, the People's Climate March had 400,000 participants in New York and several thousand more in other cities as

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209 *Kyoto Protocol - Targets for the first commitment period*, U.N. CLIMATE CHANGE, https://unfccc.int/process-and-meetings/the-kyoto-protocol/what-is-the-kyoto-protocol/kyoto-protocol-targets-for-the-first-commitment-period (last visited June 30, 2021); Kestin et al., *supra* note 200.

210 Worland, *supra* note 204.

211 *Id.*

212 Kestin et al., *supra* note 200.

213 *Climate activists condemn Copenhagen police tactics*, BBC (Dec. 13, 2009), http://news.bbc.co.uk/2/hi/europe/8410414.stm; *International day of demonstrations on climate change*, CNN (Oct. 26, 2009), http://edition.cnn.com/2009/WORLD/europe/10/24/international.climate.change.demonstrations/.

214 Cogan, *supra* note 46, at 1-2.

215 Patterson & Ramkumar, *supra* note 89.

216 Pfeifer & Sullivan, *supra* note 55, at 250.

217 *Climate Change History*, *supra* note 196.

218 Kestin et al., *supra* note 200; Adam Vaughan, *Fossil fuel divestment: a brief history*, GUARDIAN (Oct. 8, 2014), https://www.theguardian.com/environment/2014/oct/08/fossil-fuel-divestment-a-brief-history.

protestors demanded climate action from global leaders gathered for the 2014 United Nations Climate Summit.[219] In 2019, inspired by teenager Greta Thunberg's School Strikes for Climate, over six million protestors around the globe took to the streets around the time of the 2019 United Nations Climate Summit to urge countries to take action on climate change.[220]

Each of the events of the climate change movement, including the events described above, received widespread publicity. This publicity generated awareness, concern, and energy amongst the people. As people became energized by the issue, they joined demonstrations and demanded cleaner energy sources from companies, institutional investors, and governments. These actions would generate additional publicity, and the cycle would repeat. Eventually, climate change was no longer exclusively a special interest; the issue had become a mainstream topic that the majority of Americans believed in. Climate change barely crossed the public mind in the 60s and 70s, but by 2006, a Pew Research poll found that 41% of Americans believed there was "solid evidence" that the earth's warming resulted from human activity.[221] By December 2020, a Yale Center for Climate Change Communications survey found that 58% of Americans believed that humans predominately caused global warming.[222] Another trend was the shifting importance of climate change in the mind of the public. A 2020 Pew Research Center survey showed that the issues of environmental protection and climate change were almost as important as economic growth and jobs in the minds of the public.[223] The majority of Americans have become aware of and concerned about global warming, and a significant number of people have become energized by the issue.

Publicity has particularly energized the younger population. With publicity, knowledge from academic journals has made its way into school textbooks, through which children routinely learn the science of climate change.[224]

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[219] Charlotte Alter, *Hundreds of Thousands Converge on New York to Demand Climate-Change Action*, TIME (Sept. 21, 2014), https://time.com/3415162/peoples-climate-march-new-york-manhattan-demonstration/.

[220] Mathew Taylor, Jonathan Watts & John Bartlett, *Climate crisis: 6 million people join latest wave of global protests*, GUARDIAN (Sept. 27, 2019), https://www.theguardian.com/environment/2019/sep/27/climate-crisis-6-million-people-join-latest-wave-of-worldwide-protests.

[221] Sarah Childress, *Timeline: The Politics of Climate Change*, PBS (Oct. 23, 2012), https://www.pbs.org/wgbh/frontline/article/timeline-the-politics-of-climate-change/.

[222] *Explore Climate Change in the American Mind*, YALE CTR. FOR CLIMATE CHANGE COMMC'N, https://climatecommunication.yale.edu/visualizations-data/americans-climate-views/ (last visited June 13, 2021).

[223] *As Economic Concerns Recede, Environmental Protection Rises on the Public's Policy Agenda*, PEW RSCH. CTR. (Feb. 13, 2020), https://www.pewresearch.org/politics/2020/02/13/as-economic-concerns-recede-environmental-protection-rises-on-the-publics-policy-agenda/.

[224] *See, e.g.*, Sydney Johnson, *Teachers and students push for climate change education in California*, EDSOURCE (Oct. 8, 2019), https://edsource.org/2019/teachers-and-students-push-for-climate-change-education-in-california/618239.

While this education is not universal, a significant number of children have grown up believing that climate change is real and human-caused.[225] As a result, younger generations have believed in human-caused climate change on a greater scale than older generations. A 2019 Washington Post-Kaiser Family Foundation survey found that 86% of teenagers believe human activity has caused climate change compared with 79% of adults.[226] A December 2020 Yale Center for Climate Change Communications survey found that 64% of adults aged 18-34 years old with a bachelor's degree believed that human-caused climate change is happening compared with 55% of adults over 55 years of age with a bachelor's degree.[227] Not only does a greater proportion of younger people believe in human-caused climate change than older adults, but publicity has also led younger generations to actively support the issue. The Greta Thunberg-inspired climate marches catered to a wide swath of the population, but part of the message was that climate change affects young people's futures the most.[228] Millions of school children participated in school strikes for climate change and larger protests.[229] Moreover, young people's use of social media has further energized the population, as friends and influencers publicly declare their support for the issue and influence each other to care about the issue in a positive feedback loop.[230] As young people grow up and future generations of young people receive climate change education, are influenced by social media, and hear about and join climate change movements, the population may become even more aware, concerned, and energetic about the climate change issue.

2. Institutional Investor Support for the Climate Change Movement

When people first started becoming aware of, concerned about, and energized by the climate change movement in the 1980s and 1990s, religious funds, foundations, socially responsible funds, and public pension funds began raising and

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225 *See, e.g.*, *id.*; Livia Albeck-Ripka, *In Fight Over Science Education in Idaho, Lawmakers Move to Minimize Climate*, N.Y. TIMES (Feb. 7, 2018), https://www.nytimes.com/2018/02/07/climate/idaho-climate-change.html.

226 Liz Hamel, Lunna Lopes, Cailey Muñana & Mollyann Brodie, *The Kaiser Family Foundation/Washington Post Climate Change Survey*, KAISER FAM. FOUND. (Nov. 27, 2019), https://www.kff.org/report-section/the-kaiser-family-foundation-washington-post-climate-change-survey-main-findings/.

227 *Explore Climate Change in the American Mind*, *supra* note 222.

228 Ben Arnoldy, *Greta and 15 Kids Just Claimed Their Climate Rights at the UN*, EARTHJUSTICE (Sept. 23, 2019), https://earthjustice.org/blog/2019-september/greta-thunberg-young-people-petition-UN-human-rights-climate-change.

229 Taylor, Watts & Bartlett, *supra* note 220.

230 Emma Marris, *Why young climate activists have captured the world's attention*, NATURE (Sept. 18, 2019), https://www.nature.com/articles/d41586-019-02696-0.

supporting shareholder proposals regarding climate change.[231] As more of these specialized institutional investors lent their support, climate change shareholder proposals rose from single-digit to low double-digit approval, but never achieved more than 50% approval.[232]

As more people became energized by the climate change movement, people began demanding green investments like never before.[233] Conventional asset managers realized that they could attract or retain clients who are sensitive to environmental concerns—including pension funds and younger investors—by supporting the movement.[234] Conventional asset managers began to tout their climate-friendly products, services, and shareholder proposal voting policies because publicity about such actions could improve their reputations and drive fund flows.[235] In a survey of institutional investors by Philipp Krueger, Zacharias Sautner, and Laura Starks, institutional investors reported that one of the primary reasons institutional investors incorporated climate change into portfolio decisions was to protect their reputations.[236]

Asset management giant Invesco began supporting climate change shareholder proposals in 2012, while State Street began supporting climate change shareholder proposals in 2013.[237] State Street ramped up its support for climate change shareholder proposals in 2016, including voting for at least 20 shareholder proposals at 16 companies.[238] That same year, State Street supported shareholder proposals at ExxonMobil and Occidental Petroleum, both of which asked for reports on the portfolio impact of policies to meet a two-degree scenario under the Paris Accord.[239] Concurrently, BlackRock and Vanguard rejected all climate change shareholder proposals.[240] In 2017, BlackRock and Vanguard changed sides

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[231] Cogan, *supra* note 46, at 16; *Fortune 250 Shareholder Proposals*, *supra* note 3 (listing proponents of shareholder proposals).

[232] *See Fortune 250 Shareholder Proposals*, *supra* note 3.

[233] *See* Patterson & Ramkumar, *supra* note 89.

[234] José Azar et al., *Are Large Institutional Investors Actually Effective in Getting Companies to Reduce Their CO2 Emissions?*, PROMARKET (Dec. 22, 2020), https://promarket.org/2020/12/22/institutional-investors-companies-reduce-co2-emissions-ceo-climate-change/.

[235] *See, e.g.*, Sorkin, *supra* note 167.

[236] Krueger, Sautner & Starks, *supra* note 12, at 1070.

[237] *See, e.g.*, PowerShares Exchange-Traded Fund Trust, Annual Report of Proxy Voting Record (Form N-PX) (Aug. 22, 2012) (containing proxy voting records for Invesco exchange-traded funds); SPDR Index Shares Funds, Annual Report of Proxy Voting Record (Form N-PX) (Aug. 27, 2013) (containing proxy voting records for State Street exchange-traded funds).

[238] *See* SPDR Index Shares Funds, Annual Report of Proxy Voting Record (Form N-PX) (Aug. 30, 2016).

[239] *Id.*

[240] *See, e.g.*, Vanguard Index Funds, Annual Report of Proxy Voting Record (Form N-PX) (Aug. 30, 2016); iShares Trust, Annual Report of Proxy Voting Record (Form N-PX) (Aug. 26, 2016) (containing proxy voting records for BlackRock exchange-traded funds); Posner, *supra* note 4; Mueller et al., *supra* note 4.

and voted for climate change proposals for the first time.[241] BlackRock and Vanguard also supported similar shareholder proposals at ExxonMobil and Occidental Petroleum that State Street supported in 2016, and the proposals ultimately passed in 2017.[242] Ever since 2017, conventional asset managers have continued to support environmental proposals in increasing numbers.[243] Nowadays, more and more asset managers promote their environmental stewardship measures, including JPMorgan Investment Management, Wellington Management, Legal & General Investment Management, and Pacific Investment Management Co., some of which vote for climate change shareholder proposals 100% of the time.[244]

B. The Climate Change Market Shift

With the support of some of the largest asset managers, 2017 marked a tipping point in the climate change movement. For the first time in the Fortune 250, three climate change shareholder proposals passed with more than 50% approval at ExxonMobil, Occidental Petroleum, and PPL Corporation.[245] In 2018, many portfolio companies saw the shift in institutional investor activity, so many portfolio companies engaged with institutional investors to reach an agreement before shareholders voted. At least 11 shareholder proposals were withdrawn after companies committed to producing a report on strategies for responding to a two-degree scenario under the Paris Accord.[246] Of the shareholder proposals that made it to vote in 2018, four proposals at three companies seeking reports on climate change and sustainability passed.[247] In 2020, a proposal at Chevron seeking a report on climate change lobbying passed.[248] That same year, following dialogue and shareholder proposals over several years, Southern Company, one of the largest electric producers in the U.S., pledged to set a goal of net zero emissions by

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[241] *Id.*

[242] *Id.*

[243] *See* Munk, *supra* note 148.

[244] MAJORITY ACTION, *supra* note 172, at 24.

[245] *Fortune 250 Shareholder Proposals*, *supra* note 3; Posner, *supra* note 4; Andrew Logan, *The Hidden Story of Climate Proposals in the 2018 Proxy Season,* CERES (May 29, 2018), https://www.ceres.org/news-center/blog/hidden-story-climate-proposals-2018-proxy-season.

[246] Mara Lemos Stein, *Shareholder Join Chorus Demanding "Green" Disclosures*, WALL ST. J. (May 31, 2018), https://www.wsj.com/articles/kinder-morgan-anardarko-shareholders-are-latest-to-demand-green-disclosures-1527786149; David S. Rauf, *Powerful Investors Push Big Companies to Plan for Climate Change*, SCIENTIFIC AMERICAN (May 3, 2018), https://www.scientificamerican.com/article/powerful-investors-push-big-companies-to-plan-for-climate-change/.

[247] *Fortune 250 Shareholder Proposals*, *supra* note 3.

[248] *Id.*; Rachel Koning Beals, *For first time ever, majority of shareholders push oil giant Chevron to align with Paris climate pact*, MARKETWATCH (June 24, 2020), https://www.marketwatch.com/story/for-first-time-ever-majority-of-shareholders-push-oil-giant-chevron-to-align-with-paris-climate-pact-2020-06-23.

2050.[249] Despite these successes, newspapers criticized BlackRock and Vanguard for overall decreasing support for environmental shareholder proposals.[250] This negative publicity may have contributed to the two asset managers increasing their favorable shareholder votes in 2021.[251] Indeed, 2021 has seen an explosion in successful shareholder proposals related to climate change in the Fortune 250, as evidenced by proposals passing at Chevron, ConocoPhillips, Delta Air Lines, ExxonMobil, General Electric, Norfolk Southern, Phillips 66, and United Airlines.[252]

Institutional investors know that the climate change movement is here to stay, and support for climate change initiatives has become the new norm. The successful shareholder proposals show that climate change shareholder proposals can pass, and it empowers people to continue supporting the issue. Now that a new norm has been established, portfolio companies and institutional investors have pushed the boundaries past their traditional actions. While company management typically opposes ESG shareholder proposals, General Electric management supported a shareholder proposal seeking details of how the company will achieve net-zero emissions, leading to a 98% favorable vote.[253] An extraordinary event occurred when ExxonMobil lost three board seats to an activist investor, Engine No. 1, which called for ExxonMobil to make significant investments in clean energy.[254] This victory stemmed from the support of numerous institutional investors, including public pension funds and conventional asset managers.[255] Engine No. 1 capitalized on its victory by setting up a new socially responsible fund, which has raised $226 million in net assets in four months since inception.[256] As a result of this successful board fight, companies are more wary of future successful board fights and may engage more seriously with institutional investors regarding climate change issues.

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[249] Beals, *supra* note 248.

[250] *See, e.g.*, Attracta Mooney, *BlackRock criticised over drop in climate votes*, FIN. TIMES (Oct. 4, 2020), https://www.ft.com/content/7a80f33b-a0ed-4dea-b2d3-ce56381f4084; Alastair Marsh & Saijel Kishan, *BlackRock, Vanguard Fall Short on Climate Voting, Report Says*, BLOOMBERG (Sep. 22, 2020), https://www.bloomberg.com/news/articles/2020-09-22/blackrock-vanguard-fall-short-on-climate-voting-report-says.

[251] Lim, *supra* note 175; Jackie Cook & Lauren Solberg, *Hints of Sea Change in Big Fund Company ESG Proxy Votes*, MORNINGSTAR (May 12, 2021), https://www.morningstar.com/articles/1039244/hints-of-sea-change-in-big-fund-company-esg-proxy-votes.

[252] *Fortune 250 Shareholder Proposals*, *supra* note 3.

[253] Lubber, *supra* note 176.

[254] Pippa Stevens, *Activist firm Engine No. 1 claims third Exxon board seat*, CNBC (June 2, 2021), https://www.cnbc.com/2021/06/02/activist-firm-engine-no-1-claims-third-exxon-board-seat-.html.

[255] *Id.*; Matt Phillips, *Exxon's Board Defeat Signals the Rise of Social-Good Activists*, N.Y. TIMES (June 9, 2021), https://www.nytimes.com/2021/06/09/business/exxon-mobil-engine-no1-activist.html.

[256] *Engine No. 1 Exchange Traded Funds*, ENGINE NO. 1, https://etf.engine1.com/ (last visited Oct. 24, 2021).

Many institutional investors also invest in the debt markets, and the momentum for climate issues has also influenced financing on the debt side. For example, CalPERS has a defined set of ESG considerations that it systematically factors into underwriting real assets.[257] Banks have financed fossil fuel companies for years, but now they see increased financial and reputational risk from doing so. The two largest U.S. banks pledged $4 trillion in climate-oriented financing over the next decade. While investors and banks still finance carbon-intensive industries, such financing is often more expensive than before. On the other hand, money continues to pour into “green bonds” that promise to finance green projects. Companies and governments issued nearly $315 billion in green and sustainable bonds and other debt securities in Q1 2021, more than three times the amount from a year earlier. Investors are willing to pay a premium for such bonds, which lowers borrowing costs.[258]

The market has shifted to embrace the climate change movement, and institutional investor support for climate change initiatives has become the new norm, both in the equity and debt markets.

V. ADDITIONAL CONSIDERATIONS

This Part discusses some additional considerations. Section A explains that once people coalesced around an ESG issue, it was easy for institutional investors to find the motivation to support that issue and overcome barriers. In particular, institutional investors frame their ESG efforts as improving long-term value to comply with their fiduciary duty to improve economic value for their clients and beneficiaries. Section B notes that opposition to ESG initiatives exists, but such opposition can be overcome with greater support for ESG initiatives. Section C shows that momentum for ESG issues can fade, but sustained energy and support for ESG issues can revive that momentum. Section D discusses the effectiveness of institutional investors’ various tools to support ESG issues. It also notes that institutional investors must continue to monitor their investments and may resort to more drastic measures, such as replacing board members, to pressure their portfolio companies to adopt ESG measures.

A. Fiduciary Duty to Create Value for Clients and Beneficiaries

As discussed in Section II.A.1, *supra*, institutional investors have a fiduciary duty to act in their clients and beneficiaries’ best interests. “Best interests” has often been interpreted as “best *financial* interests.” Commentators

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[257] Hazel Bradford, *Public funds taking the lead in spectacular boom of ESG*, PENSIONS & INVS. (Aug. 19, 2019), https://www.pionline.com/special-report-esg-investing/public-funds-taking-lead-spectacular-boom-esg.

[258] Patterson & Ramkumar, *supra* note 89.

have suggested that institutional investors can still comply with their fiduciary duties by supporting ESG issues so long as supporting ESG issues maximizes their clients and beneficiaries' return on investment.[259]

As discussed in Part III, *supra*, institutional investors may support ESG issues to cater to the views of the people who matter to them. Conventional asset managers may create value for themselves by supporting ESG issues and attracting fund flows from current and future clients. However, this does not necessarily create *economic* value for their *clients and beneficiaries*, as fiduciary duty requires. For economic value to flow to clients and beneficiaries, the value of portfolio companies must increase, which will increase the stock price of the portfolio company and, correspondingly, the value of the fund that holds the portfolio company. As discussed in Section II.B, *supra*, while theoretically ESG initiatives may improve the long-term value of a portfolio company, this is not always the case. Even if ESG initiatives generate long-term value, long-term value is often difficult to measure because, unlike a steady revenue stream, an ESG initiative often has uncertain benefits that may not materialize for years.

However, because institutional investors are motivated to support ESG issues to cater to the people who matter to them, they have found a way to comply with their fiduciary duty to increase economic value by altering their messaging. Instead of saying that they support climate change shareholder proposals for the sake of improving the environment, institutional investors say that they support climate change to improve shareholder value.[260] Institutional investors often frame ESG initiatives in terms of improving long-term value, even though it may be difficult to measure and may not always exist. For example, they claim that support for climate change initiatives mitigates long-term risk, including: (1) the risk of extreme weather events that can physically damage a company's supply chain; and (2) the risk that more stringent carbon regulations can decrease a company's profits. They also claim that support for climate change offers long-term opportunities, including: (1) increased consumer demand for green products; and (2) increased government support for green technologies.[261]

Ultimately, institutional investors have found motivation to support ESG issues—namely to cater to the people that matter to them. They can work past barriers to support ESG issues when they have a reason to act. In the case of

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[259] *See* Schanzenbach & Sitkoff, *supra* note 70, at 385-86 (analyzing fiduciary duty law and concluding that ESG investing is permissible by a fiduciary only if: "(1) the trustee reasonably concludes that the ESG investment program will benefit the beneficiary directly by improving risk-adjusted return; and (2) the trustee's exclusive motive for adopting the ESG investment program is to obtain this direct benefit").

[260] *See, e.g.*, *Larry Fink's 2021 letter to CEOs*, BLACKROCK, https://www.blackrock.com/corporate/investor-relations/larry-fink-ceo-letter (last visited Aug. 8, 2021); *Climate Change*, CalPERS, https://www.calpers.ca.gov/page/investments/sustainable-investments-program/climate-change (June 3, 2021).

[261] *See id.*

fiduciary duty, they have found ways to justify their ESG initiatives in terms of creating long-term value.

B. Opposition to ESG Investing

Not all investors support ESG investing. For example, Danone, a maker of yogurts and drinks, had been profitable for years, espoused ESG principles, and was in the process of converting its subsidiaries into B Corps to better support its ESG efforts. However, activist investors thought that the company's profits had not grown as quickly as its competitors' and wanted the company to cut less profitable segments, focus on its core business, and spend fewer resources on ESG initiatives. Their efforts were successful in pushing out the Chairman and CEO who spearheaded the B Corp designation efforts, and, in turn, the company has sold pieces of its business.[262]

In another example, some groups have arisen to directly counter the ESG movement. In 2018, a group called Main Street Investors Coalition formed to voice concerns that funds voting on behalf of retail investors exploited the proxy to advance their agenda on environmental and social issues.[263] In these situations, the big question is which movement is stronger: pro-ESG or anti-ESG? The countermovement to the ESG movement has not been able to stop an ever-increasing flow of money from pouring into ESG funds, nor has it been able to stop institutional investors from promoting ESG issues.

The question of whether opposition to ESG investing succeeds depends on which force is stronger. In the case of Danone and B Corp status, the force against ESG investing was stronger. In the case of the ESG movement overall, the force for ESG investing has proven stronger.

C. Wavering Momentum for ESG Issues

Momentum for ESG issues is not a constant. When support for ESG issues is not sustained, then the momentum for ESG issues can die down.

ESG issues are often hot topics when the economy is booming, as people have time and money to support ESG issues, and companies have money to spare. During a recession, the focus shifts to survival, and ESG issues diminish in importance. To illustrate the latter, the corporate social responsibility movement gained ground in the 1990s, but then lost public attention when the tech bubble burst, the economy went into a recession, and the U.S. entered a war on terrorism. However, after the economy recovered and the freshness of the war on terrorism

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[262] Sarah White & Gwénaëlle Barzic, *Danone board ousts boss Faber after activist pressure*, REUTERS (Mar. 14, 2021), https://www.reuters.com/article/us-danone-management/danone-board-ousts-boss-faber-after-activist-pressure-idUSKBN2B60PN.

[263] Stein, *supra* note 246.

waned, another wave of momentum for corporate social responsibility came. Then, the 2007 financial crisis hit. Companies, asset managers, and people were focused on surviving the economic downturn. After the economy recovered, however, corporate social responsibility came back into focus. Banks, including many asset managers, received blame for starting the financial crisis out of greed, and began to support ESG issues to repair their reputations.[264]

Sometimes, momentum for ESG issues wanes, and ESG issues are no longer on people's minds or institutional investors' agendas. However, after momentum for ESG issues wanes, it can pick back up with renewed energy.

D. Effectiveness of Institutional Investor Support for ESG Issues

As discussed in Section I.C, *supra*, institutional investors have three primary tools they can use to support ESG issues: (1) engage with management; (2) buy and sell stock; (3) and raise and vote on shareholder proposals.

Engaging with management is more effective when management faces consequences for failing to carry out the institutional investors' demands. For example, the threat of a successful shareholder proposal can lead management to engage with an institutional investor. Management may commit to changes to encourage the institutional investor to withdraw the shareholder proposal. Prior to 2017, some of the largest asset managers, including BlackRock, only engaged with management without any threats of supporting shareholder proposals, and as a result, did not lead companies to change their actions.[265]

Buying and selling stock only matters if enough stock is bought and sold that the stock price changes. For example, the movement for institutional investors to divest from fossil fuel companies brought significant publicity to the issue and energized the climate change movement. However, while many university endowment funds and other institutional investors committed to divest, the vast majority of institutional investors did not make this commitment. Thus, the stock merely changed hands to other investors willing to have fossil fuel stocks in their portfolios, as divestment did not lead to a noticeable change in stock price and U.S. oil companies did not change their operations.[266]

Raising and voting on shareholder proposals also has limitations. First, institutional investors must have enough collective voting power for the shareholder proposal to pass. Particularly with portfolio companies that have controlling shareholders or dual class shares, institutional investors may not have

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[264] Paul Pellizzari, *Hard Rock exec reflects: Where will COVID-19 take sustainable capitalism?*, GREENBIZ (Apr. 27, 2020), https://www.greenbiz.com/article/hard-rock-exec-reflects-where-will-covid-19-take-sustainable-capitalism.

[265] Posner, *supra* note 4; Mueller et al., *supra* note 4.

[266] William MacAskill, *Does Divestment Work?*, NEW YORKER (Oct. 20, 2015), https://www.newyorker.com/business/currency/does-divestment-work.

enough voting power to make a difference. For example, Facebook has Class A shares, each of which provides one vote, and Class B shares, each of which provides ten votes. Mark Zuckerberg, Facebook's CEO, owns 75% of Class B shares, which gives him control of 58% of the total vote. Thus, unless Zuckerberg votes for a shareholder proposal, the shareholder proposal cannot succeed.[267]

Second, as discussed in Section II.A.2, *supra*, SEC rules and regulations limit the content of shareholder proposals. Due to these rules, shareholder proposals remain precatory, and proponents of shareholder proposals cannot micromanage and interfere with a company's day-to-day operations.

To comply with SEC rules and regulations, many shareholder proposals only ask that a company produce a report on an ESG issue. However, reports have limited use, especially when the company resists change.[268] For example, a shareholder proposal asking for a report related to gun control at gun manufacturer Sturm Ruger passed. However, the CEO of Sturm Ruger refused to engage further with any institutional investors and said that the company would issue the report and nothing else; it would not take further action to change its operations in any way.[269]

Beyond shareholder proposals seeking reports, ESG shareholder proposals may also *ask* a company to set a goal, so long as the shareholder proposal does not *require* the setting of a goal or a specific timeframe for setting the goal.[270] For example, in 2021, among the Fortune 250, shareholder proposals asking companies to set greenhouse gas emissions reduction targets passed at Chevron, ConocoPhillips, and Phillips66.[271] Ultimately, it is up to the company whether it will set an ESG goal and take steps to meet the goal.[272]

Disclosure is only one step in the ESG movement, and goal-setting is only a second step. Institutional investors realize that continued monitoring and action must take place to achieve change. In particular, institutional investors can take action using other corporate governance measures to make their portfolio companies take ESG issues seriously. Other corporate governance measures

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[267] Betsy Atkins, *Facebook Strong Arms Investors Who Want Zuckerberg Out*, FORBES (June 7, 2019), https://www.forbes.com/sites/betsyatkins/2019/06/07/facebook-strong-arms-investors-who-want-zuckerberg-out/?sh=3c9f55f05901.

[268] Patrick Bolton & Marcin Kacperczyk, *Signaling through Carbon Disclosure* (Dec. 26, 2020) (unpublished manuscript), https://papers.ssrn.com/sol3/papers.cfm?abstract_id=3755613 (finding that carbon disclosure did not discipline companies to reduce their emissions).

[269] Bill Chappell, *Sturm Ruger Will Track Gun Violence, After Shareholders Back 'Activist Resolution'*, NPR (May 10, 2018), https://www.npr.org/sections/thetwo-way/2018/05/10/610019218/sturm-ruger-will-track-gun-violence-after-shareholders-back-activist-resolution.

[270] *See* Section II.A.2, *supra* (discussing precatory shareholder proposals).

[271] *Fortune 250 Shareholder Proposals*, *supra* note 3.

[272] *See, e.g.*, Shariq Kahn, *Chevron investors back proposal for more emissions cuts*, REUTERS (May 26, 2021), https://www.reuters.com/business/energy/chevron-shareholders-approve-proposal-cut-customer-emissions-2021-05-26/.

include voting "no" during elections of the company's directors or proposing alternate directors to replace current directors.[273] Directors afraid of losing their board seats may pay more attention to ESG concerns and implement ESG policies at their companies.

For example, in response to a successful 2017 shareholder proposal, ExxonMobil produced a report detailing risk to the company under stricter regulatory conditions correlating to a two-degree scenario under the Paris Accord. ExxonMobil concluded that the company faced no financial risk even under the most progressive climate policies, and shareholders criticized the report for being overly optimistic. ExxonMobil's 2019 report was similarly optimistic and stated that the company expected continued strong demand for its fossil fuel products, irrespective of countries' efforts to cut emissions.[274] Through its reports, ExxonMobil signaled that it would not change its climate change position, and investors grew impatient. BlackRock announced that it would vote against company directors who failed to act on climate change disclosures.[275] In 2021, investors, including the Big Three, voted to replace three of ExxonMobil's board of directors, partly to pressure the company to address climate change.[276] Now, some board members have expressed support for a carbon neutrality pledge, and ExxonMobil is considering making a commitment to go carbon neutral by 2050, which would require selling oil and gas assets—actions it has resisted taking for years.[277]

CONCLUSION

ESG shareholder proposals had seemed like a lost cause until recently. Within the Fortune 250, it was historically rare for even a single ESG shareholder proposal to pass any given year. However, recently, ESG shareholder proposals have started passing every year and, in general, in increasing numbers. Within Fortune 250 companies, two ESG shareholder proposals passed in 2016, three in

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[273] *See, e.g.*, BlackRock's Global Executive Committee, *Net zero: a fiduciary approach*, BLACKROCK (2021), https://www.blackrock.com/corporate/investor-relations/blackrock-client-letter.

[274] Rauf, *supra* note 246; Marianne Lavelle, *Exxon Shareholders Approve Climate Resolution: 62% Vote for Disclosure*, INSIDE CLIMATE NEWS (May 31, 2017), https://insideclimatenews.org/news/31052017/exxon-shareholder-climate-change-disclosure-resolution-approved/ (discussing Exxon Mobil report); Ailworth, *supra* note 58; Olson, *supra* note 59.

[275] BlackRock's Global Executive Committee, *supra* note 273.

[276] Stevens, *supra* note 254.

[277] Christopher M. Matthews & Emily Glazer, *Exxon Considers Pledging 'Net Zero' Carbon by 2050*, WALL ST. J. (Aug. 5, 2021), https://www.wsj.com/articles/exxon-considers-pledging-net-zero-carbon-by-2050-11628161201.

2017, five in 2018, three in 2019, seven in 2020, and an astounding twenty-one thus far in 2021.[278]

Many commentators have attributed the success of recent ESG shareholder proposals to the support of the largest institutional investors, including the Big Three. Having historically voted against or abstained on ESG shareholder proposals, some of the largest institutional investors, including BlackRock and Vanguard, started voting in favor of some ESG shareholder proposals in 2017.[279] However, this Article shows that the story of the success of the ESG movement started long before the largest institutional investors joined in. The largest institutional investors joined the movement only after it had already arrived and change was inevitable.

This Article describes how momentum for ESG issues began with people. It took time for people to learn, care, and become energized about ESG issues. People who became energized about an ESG issue took actions that energized others, such as joining marches and demonstrations. Eventually, more and more people became aware of, concerned about, and energized by an ESG issue until the issue became mainstream.

Institutional investors care about the people who matter to them. As awareness, concern, and energy about an issue spread among people, institutional investors that catered to the narrowest audiences began to support the ESG issue. These institutional investors included religious funds, non-profits, and socially responsible funds that served a narrow group of people who shared similar views on an ESG issue. As more and more people became energized about an issue, institutional investors that served broader groups of people began to support the ESG issue. These institutional investors included public pension funds who cared not only about their beneficiaries, but also cared about the voting population in affiliated cities and states. Eventually, when an issue became mainstream, institutional investors that cared about the opinions of the general population also began to support the ESG issue. This included conventional asset managers, such as the Big Three, that sought to attract investment from the general population, particularly people with larger amounts of money to invest. Conventional asset managers also invested the money of institutional investors that served narrower groups of people, such as pension funds and certain socially responsible funds; thus, narrower funds also influenced conventional asset managers to support ESG issues.

As institutional investor support for ESG issues increased, ESG shareholder proposals began to pass. As more shareholder proposals passed, a new norm of institutional investors supporting ESG issues developed. Institutional investors felt the pressure to continue to conform to the new norm and more

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[278] *Fortune 250 Shareholder Proposals*, *supra* note 3.
[279] Posner, *supra* note 4; Mueller et al., *supra* note 4.

actively support ESG issues, such as by raising ESG shareholder proposals and voting against directors who did not take ESG seriously. The market has shifted to embrace ESG investing, and more money than ever before pours into socially responsible funds. Momentum for ESG issues has now reached a tipping point, and it continues to build.