

# ESG Now Podcast

## “ExxonMobil’s Legal Parry ”

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### Bentley Kaplan

Hello, and welcome to the weekly edition of ESG Now, the show that explores how the environment, our society, and corporate governance affects and are affected by our economy. I'm Bentley Kaplan, your host for this episode. On today's show, we are going to get into the decision of ExxonMobil Corporation to file a legal complaint against two of its own shareholders. And the company did this over a proposal that the shareholders were planning to file at Exxon's upcoming AGM. But even after these two shareholders withdrew their proposal, Exxon looks to be following through with its legal action. So, we're going to look at why all of this is happening and why it's a much bigger story ahead of proxy season. Thanks for sticking around, let's do this.

The relationship between a company's shareholders and the management team running that company has a natural degree of tension. Because sometimes shareholders disagree with the strategic decisions that a management team wants to take. And that can be for lots of different reasons. Maybe there's a proposed acquisition that management thinks will add long-term value, but shareholders think is overpriced and overhyped. Maybe shareholders disagree with the volume of share buybacks and would rather see a company directing cash to dividends instead. And beyond purely financial considerations, questions like, spoiler alert, climate change, but also lobbying human rights, diversity, equity, and inclusion, and executive pay will sometimes see some shareholders on one side and management on the other.

And things can of course get more complicated than this because a company can have thousands of shareholders who don't necessarily agree with one another. And they have different ownership percentages, sometimes intermediate owners like asset managers, and of course a board which serves to represent the interests of these diverse shareholders. But a company needs to keep operating despite all of these tensions, which is exactly why there are a range of company bylaws and market rules that determine when votes happen, what gets voted on, when director elections have to be called, who gets to vote, what their votes count for, and much, much more.

And for the most part, these bylaws and regulations keep tensions in check. But every now and then things can bubble over, and some of that bubbling over is happening at the oil and gas giant ExxonMobil Corporation, or Exxon if you're on a first-name basis. And that's ahead of the company's annual shareholder meeting in May. To tell me more about exactly what's bubbling over, I called Harlan Tufford out of MSCI's Toronto office, who is quickly becoming a veteran guest of the show.

### Harlan Tufford

In January, Exxon filed a lawsuit against two shareholders that submitted a proposal in advance of the company's May 2024 AGM. The two shareholders submitted a proposal supporting Exxon in further

accelerating the pace of emissions reduction in the medium term for its greenhouse gas emissions across Scope 1, 2, and 3.

Exxon, unusually, did not file a no-action letter request. It sidestepped the SEC essentially and went directly to the courts, and filed a lawsuit against the shareholder proponents arguing that they had violated securities law and that the proposal should be invalidated on that basis. This is an unusual move. We typically see companies go to the SEC as the first and final stop for evaluating the appropriateness of the shareholder proposals. The SEC in this role has a reputation as being a fair arbiter of shareholder proposals.

Exxon has not gone that route. They've taken the novel approach of going to the courts in this case because they believe the SEC has grown too lenient in allowing shareholder proposals to go forward. They think that this proposal micromanages the company and that it's too similar to previous proposals that are in low-supported previous AGMs. And those are two of the grounds on which shareholder proposals are considered inadmissible, not properly presented at a meeting.

### **Bentley Kaplan**

Okay. Exxon thinks that their shareholders Follow This and Arjuna Capital have overstepped. Not only is company management saying that their proposal is similar to previous proposals that had low shareholder support, but it was, quote, "driven by an extreme agenda."

And let's pause here because I want to be clear that we are not going to go into the merits of this particular proposal, or of Exxon's climate strategy. We've done a couple of episodes on Exxon already back in February 2021 when we spoke about the company's pledge to step up its carbon capture efforts, and then in May of the same year when we covered the activist shareholder campaign by Engine No. 1. Feel free to go and check those episodes out after this if you so fancy.

Today's episode is really going to be about how a decision by Exxon could have implications for other companies, other shareholders, and other issues. And that's because instead of approaching the SEC to ask for a no-action letter, which would let Exxon exclude the shareholder proposal from their AGM without consequences, the company has opted for a more litigious approach, filing a legal complaint. And even when the two shareholders, Follow This and Arjuna Capital, said they would drop their proposal for Exxon's AGM in May, the company said, okay, thanks, but we're actually going to follow through on our complaint.

And that is a critical piece of this story, because at one level this proposal is just about Exxon and its strategy and ambition to transition towards a low-carbon economy. But at another, deeper level, this is about the rules that determine who can bring a shareholder proposal and when. And Exxon's full legal complaint has the context for this, where the company argues that there is something amiss in how the SEC's shareholder proposal system is being used.

As Harlan explained in, 2021 the SEC revised its guidance around no-action letters. And what followed was a shift in the pattern of shareholder proposals. And seeing this data helps to understand why Exxon may be reluctant to drop the legal complaint.

### **Harlan Tufford**

This tension comes, it follows from a change the SEC made in November of 2021. And the change basically of the effect of being more permissive around shareholder proposals, giving more latitude to

shareholders. It changed some of the guidance around what does and does not constitute micromanagement. And it's specifically singled out things like climate targets and timeframes as being valid topics of shareholder proposals, provided again that they don't step into that realm of micromanagement.

The change that the SEC made isn't a change in law exactly, it's a change in guidance. So the letter of the law hasn't really changed, what's changed is the kind of quasi-judicial interpretation of that law by this regulatory agency. That's why it's so fuzzy and why Exxon is trying to take a different course, because they think that interpreted in a different light, the same law gives a different outcome.

Since the November 2021 change we've seen a significant jump in shareholder proposals, particularly ones related to climate change. In all of 2021 we saw 29 shareholder proposals go to a vote that were related to climate change in some way. In 2023 we saw in 96. So this is a significant change in the kinds of proposals that investors are being faced with and the kinds of questions they have to consider when they're going to the ballot for a given company. It's worth noting also that we've also seen a considerable drop in average support for shareholder proposals, as the number of proposals put to a vote has increased.

### **Bentley Kaplan**

Right. In the last two years of proxy seasons, we have seen more shareholder proposals and more proposals on climate-related topics. And shareholder proposals in general are often coming from smaller shareholders like individuals or advocacy groups, and to a much lesser extent from bigger institutions like asset managers or pension funds. But Exxon's choice of filing a legal complaint in response to a shareholder proposal instead of trying to secure a no-action letter from the SEC could lead to a very different ending in a "choose your own adventure" for proxy season.

And from the perspective of Exxon's management, there could definitely be an upside to this option. SEC data found that it can cost a company up to \$100,000 to review a shareholder proposal. But some companies say it's even more than that. And in the context of those costs, maybe the idea of litigation fees as an alternative isn't so daunting. But for small shareholders and individuals, this is not six of one and half a dozen of the other. In the case of Follow This, the company's total budget a couple of years ago was just 20,000 euros, and 5,000 of that was spent on legal fees.

That's not going to go a long way in litigation, where a typical matter can run up to more than \$200,000. In Exxon's complaint the company has asked the court for Follow This and Arjuna Capital to cover its attorney fees and expenses and quote, "other and further relief as the court may deem just and proper." And it's really because of this cost disparity that one company's legal complaint about one proposal at its 2024 AGM could have much broader implications.

### **Harlan Tufford**

If this lawsuit is the shape of things to come and we start seeing a significant number of companies, or just more companies at all pursuing this, I think there's the potential for a real chilling effect on the increase in proposals we've seen in the last few years. I think it's quite possible that that spike in new proposals we've seen since 2021 could reverse quite sharply. If we look at the types of proponents that come forward at AGMs and present shareholder proposals, they tend to be fairly small organizations.

We see, for example, advocacy groups, much like Follow This, one of the two proponents at Exxon. We see typically smaller impact-focused asset managers. We see labor unions. We see public pension organizations. Religious institutions are significant in the US. All of these groups and proponent types can be affected by this to greater or lesser degrees.

### **Bentley Kaplan**

Okay. Harlan reckons that if companies come out swinging, wielding the blunt instrument that is litigation, it could really put a dampener on future shareholder proposals. Proposals that aren't necessarily coming from the well-heeled or the well-resourced.

So to close out the episode I played a little bit of devil's advocate, because a company's management, any company that is, not just Exxon's, may be really hoping for a quiet proxy season, instead of being dragged into complex or uncomfortable proposals, just getting the green light to sort of keep on trucking. So, I asked Harlan why a chilling effect on shareholder proposals should even matter to the broader investment community and not just the individuals or advocacy groups that are making the lion's share of these proposals in the first place.

### **Harlan Tufford**

In the US it's worth remembering that shareholder proposals, they're not binding, they're just a message really. But the way in which, I think, they're useful to capital markets is as a kind of information-surfacing and sharing mechanism. The shareholder proposal differs from holding up a sign in, I think, two important ways. One is that you get that vote result at the end, which is information for companies and for other investors about the degree to which the investor community, the shareholders of the company, may share a certain view or disagree with a certain view.

And shareholder proposals also force dialogue, because management has to give a response to the shareholder proposal, management has to give a voting recommendation on the proposal. And at the same time, asset managers, and to a degree asset owners, have to look at those recommendations, look at the proposal, and make a voting decision. And that exchange, that dialogue that's facilitated by the act of recommending a vote and voting, I think can force everyone in the company, the shareholders and managers, to think critically about these issues. And the outcome may be that no, the status quo is correct, but the outcome may also be that there's an opportunity to improve the way the company is managed.

### **Bentley Kaplan**

And that is it for the week. A massive thanks to Harlan for his take on the news with an ESG twist. And thank you very much for making time in your busy lives to listen to the show. We love bringing you new content, and if you want to hear more, subscribe to the show on your favorite platform, drop us some stars or a kind review just for the hell of it, and we'll keep doing what we do. We've got a special episode planned for next week, so do be sure to tune in. Thanks again, and take care of yourself and those around you.

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