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Will Systematic Stewardship Save the Planet?

Law Working Paper N° 739/2023
Revised September 2025

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Abstract

The largest institutional investors have solidified their status as "universal owners," holding almost eighty percent of the U.S. stock market. The growing influence of these investors over the companies they invest in has sparked optimism among scholars and activists that asset managers will use their clout to steer firms towards Environmental, Social, and Governance (ESG) objectives. But such optimism may be misplaced. Focusing on carbon emission reduction, we argue that universal owners lack the necessary incentives and competence to pressure corporations to lower emissions. Universal owners market ESG investments with conflicting promises of "doing well while doing good." The untenable promise that ESG investments will "do well," or match the returns of non-ESG funds, prevents universal owners from effectively "doing good," or meaningfully compelling corporations to reduce emissions. Furthermore, although climate change is a systematic risk, addressing it requires firm-specific engagement. Universal owners, however, lack the incentive to lead firm-specific campaigns. We further demonstrate that no other actors will emerge to provide the required firm-specific engagement. We argue that universal owners' distorted incentives should concern even those who believe that climate stewardship is necessary, albeit imperfect, in light of government inaction. We explain why extensive disclosure requirement for ESG funds would not eliminate the distortions caused by their contradictory commitments and consider implications for the ESG movement. While universal owners are ill-equipped to direct corporations toward efficient climate solutions, these investors may nudge environmental legislation forward by ensuring that their portfolio companies' lobbying efforts are aligned with their pledges to protect the environment.

Keywords: systematic stewardship, carbon emissions, ESG, ESG funds, universal owners, hedge funds, agency costs

JEL Classification: K22, K32

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The largest institutional investors have solidified their status as "universal owners," holding almost eighty percent of the U.S. stock market. The growing influence of these investors over the companies they invest in has sparked optimism among scholars and activists that asset managers will use their clout to steer firms towards Environmental, Social, and Governance (ESG) objectives. But such optimism may be misplaced. Focusing on carbon emission reduction, we argue that universal owners lack the necessary incentives and competence to pressure corporations to lower emissions.

Universal owners market ESG investments with conflicting promises of "doing well while doing good." The untenable promise that ESG investments will "do well," or match the returns of non-ESG funds, prevents universal owners from effectively "doing good," or meaningfully compelling corporations to reduce emissions. Furthermore, although climate change is a systematic risk, addressing it requires firm-specific engagement. Universal owners, however, lack the incentive to lead firm-specific campaigns. We further demonstrate that no other actors will emerge to provide the required firm-specific engagement.

We argue that universal owners' distorted incentives should concern even those who believe that climate stewardship is necessary, albeit imperfect, in light of government inaction. We explain why extensive disclosure requirement for ESG funds would not eliminate the distortions caused by their contradictory commitments and consider implications for the ESG movement. While universal owners are ill-equipped to direct corporations toward efficient climate solutions, these investors may nudge environmental legislation forward by ensuring that their portfolio companies' lobbying efforts are aligned with their pledges to protect the environment.

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INTRODUCTION

WHILE climate change has become an inescapable global crisis, posing an existential threat to our planet,[1] the ownership of the public corporation has dramatically transformed. "Dispersed ownership"—numerous investors each owning a tiny fraction of public corporations—has transformed into "universal ownership"—a small number of asset managers owning substantial stakes in virtually all publicly traded corporations.[2]

The convergence of a newfound urgency towards environmental issues and the ascendance of universal owners has kindled the hope among academics and activists that universal owners will leverage their power to push companies in their portfolios to advance Environmental, Social, and Governance (ESG) goals.[3]

While some ESG goals may be achieved without sacrificing profits, often the opposite is true. Why would universal owners pursue ESG goals even when they have an adverse effect on companies' bottom lines?[4] There are two groups of leading explanations. The first focuses on asset

1. *See Climate Change: A Threat to Human Wellbeing and Health of the Planet. Taking Action Now Can Secure Our Future*, INTERGOVERNMENTAL PANEL ON CLIMATE CHANGE (Feb. 28, 2022), https://www.ipcc.ch/site/assets/uploads/2022/02/PR_WGII_AR6_english.pdf [https://perma.cc/F7AS-2GM2]; David Vergun, *Defense Secretary Calls Climate Change an Existential Threat*, U.S. DEP'T OF DEF. (Apr. 22, 2021), https://www.defense.gov/News/News-Stories/Article/Article/2582051/defense-secretary-calls-climate-change-an-existential-threat/ [https://perma.cc/89PA-HUF6].

2. *See generally* Matthew Backus, Christopher Conlon & Michael Sinkinson, *Common Ownership in America: 1980–2017*, 13 AM. ECON. J. 273 (2021) (documenting the increase in ownership by institutional investors); Edward Rock, *Institutional Investors in Corporate Governance*, *in* THE OXFORD HANDBOOK OF CORPORATE LAW AND GOVERNANCE 363, 365–67 (Jeffrey N. Gordon & Wolf-Georg Ringe eds., 2018) (describing "the 'de-retailization' of the capital markets"). As a stark demonstration of this transformation, institutional investors now "own between 70% and 85.8%" of the ten largest U.S. companies. *80% of Equity Market Cap Held by Institutions*, PENSIONS & INVS. (Apr. 25, 2017, 1:00 AM), https://www.pionline.com/article/20170425/INTERACTIVE/170429926/80-of-equity-market-cap-held-by-institutions [https://perma.cc/4ZZZ-A9PV].

3. *See* Wolf-Georg Ringe, *Investor-Led Sustainability in Corporate Governance,* 7 ANNALS CORP. GOVERNANCE 93, 95 (2022) (describing the "increasingly broad global consensus that the asset management sector has a vital role to play in helping society solve existential challenges such as the current climate crisis").

4. As we explain in Section II.A *infra*, asset managers often argue that the pursuit of ESG goals will increase performance, especially in the long term. Economists have developed models showing that pursuing ESG goals may be consistent with value maximization. *See, e.g.*, Joscha Nollet, George Filis & Evangelos Mitrokostas, *Corporate Social Responsibility and Financial Performance: A Non-Linear and Disaggregated Approach*, 52 ECON. MODELLING 400 (2016) (explaining corporate social responsibility pays off only above a certain threshold of investment). Several scholars have used the term "enlightened shareholder value" to describe the approach that ESG would maximize long term value. *See, e.g.*, Robert P. Bartlett III & Ryan Bubb, *Corporate Social Responsibility Through Shareholder Governance*, 97 S. CAL. L. REV. 417 (2024); Virginia Harper Ho, *"Enlightened Shareholder Value": Corporate Governance Beyond the Shareholder-Stakeholder Divide*, 36 J. CORP. L. 59 (2010). For a critique of this approach, see Lucian A. Bebchuk, Kobi Kastiel & Roberto Tallarita, *Does Enlightened Shareholder Value Add Value?*, 77 BUS. LAW. 731 (2022). Our analysis, however, focuses on ESG measures that require companies to sacrifice their profits.

managers' competition for clients, who increasingly care about ESG.[5] Under this view, whether they genuinely care about their clients' preferences or use ESG as a marketing ploy, universal owners push companies to advance ESG goals in response to their clients' demand for sustainable investments.

The second group of explanations focuses on threats to the entire economy posed by ESG risks and universal owners' incentives to address these threats. Scholars have advanced two versions of these explanations. The "portfolio primacy" version argues that universal owners care about a specific firm's value only to the extent that it affects the value of their portfolio.[6] Therefore, when one firm inflicts negative externalities on others, universal owners will prefer to sacrifice that firm's value if preventing these externalities increases the value of their portfolio by a greater amount. For example, forcing ExxonMobil to cut emissions might decrease its value, but increase the value of other public companies adversely affected by climate risks created by ExxonMobil's emissions activities.[7]

The second version argues that some ESG concerns are systematic risks: events that would affect the entire market. Universal owners should therefore use their power to push companies in their portfolio to adopt *uniform* measures to tackle systematic ESG risks—such as climate change.[8]

The ESG concept encompasses a variety of issues, with inevitable tradeoffs among them.[9] This has led critics to question investors' competence to effectively promote ESG goals.[10] Moving beyond this critique,

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5. *See* Michal Barzuza, Quinn Curtis & David H. Webber, *Shareholder Value(s): Index Fund ESG Activism and the New Millennial Corporate Governance*, 93 S. CAL. L. REV. 1243, 1249–50 (2020); Dorothy S. Lund, *Asset Managers as Regulators*, 171 U. PA. L. REV. 77, 119–23 (2023).

6. *See infra* Section II.B.

7. As Marcel Kahan and Edward Rock persuasively argue, such explicit tradeoffs are prohibited under Delaware corporate law and other federal laws and regulations. *See* Marcel Kahan & Edward Rock, *Systemic Stewardship with Tradeoffs*, 48 J. CORP. L. 497 (2023).

8. *See* John C. Coffee, Jr., *The Future of Disclosure: ESG, Common Ownership, and Systematic Risk*, 2021 COLUM. BUS. L. REV. 602, 616; Jeffrey N. Gordon, *Systematic Stewardship*, 47 J. CORP. L. 627, 627–29 (2022).

9. The *Environmental* category encompasses climate change, greenhouse gas (GHG) emissions, resource depletion, waste and pollution, water and energy efficiency, deforestation, and biodiversity. The *Social* heading refers to working conditions, equal opportunities, human rights, employee diversity, health and safety, child labor and slavery, community engagement, and philanthropy. And similar considerations fall under the *Governance* heading: business ethics, executive pay, board diversity and structure, bribery and corruption, political lobbying and donations, tax strategy, and compliance. *See* Elizabeth Pollman, *The Making and Meaning of ESG*, 14 HARV. BUS. L. REV. 403 (2024).

10. *See* Lucian A. Bebchuk & Roberto Tallarita, *The Illusory Promise of Stakeholder Governance*, 106 CORNELL L. REV. 91, 129 (2020) (arguing that "trade-offs are inevitable and arise frequently" and that "[c]ompanies constantly face choices that might favor one group at the expense of another and must pick winners and losers"); Alperen A. Gözlügöl, *The Clash of 'E' and 'S' of ESG: Just Transition on the Path to Net Zero and the Implications for Sustainable Corporate Governance and Finance*, 15 J. WORLD

we will focus only on *carbon emissions*. Emissions are a promising target of systematic stewardship. Global warming undoubtedly poses a systematic risk, and greenhouse gas (GHG) emissions can be measured and quantified.[11] Indeed, universal owners have pushed companies to decrease their carbon footprint, which has led politicians to blame universal owners for high gasoline prices.[12] In 2024, the Securities and Exchange Commission (SEC) adopted new climate risk disclosure rules to enable universal owners and other asset managers to price climate risks and push companies to reduce emissions.[13]

This Article argues that, regrettably, the stewardship of universal owners will be ineffective in reducing emissions due to their lack of the necessary *incentives* and *competence*.[14] Universal owners face incentives that may lead them to push transition strategies that are not optimal for the planet. And further, these owners lack the incentive to drive firm-specific decarbonization strategies required for effective emissions reduction. We show that no other champion will emerge to fill this gap, and legal reforms, such as climate risk or fund disclosure, will not solve the issue.

Consider universal owners' incentives. The demand for ESG investments is one of the driving forces of universal owners' pressure on companies to reduce emissions. Fund managers attract clients into ESG funds by promising to advance climate goals, while also insisting that the funds' commitment to these goals will not sacrifice investor returns.[15] "[D]oing well while doing good" is the marketing mantra.[16] Thus, to

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ENERGY L. & BUS. 1, 4 (2022) (discussing the tension between cutting emissions and employee welfare).

11. As we explain below, there are many regimes for disclosing emissions. *See supra* Section III.B.2. Yet, as a matter of principle, carbon emissions can be quantified and measured. *See, e.g.*, BLACKROCK, 2022 GREENHOUSE GAS EMISSIONS REPORT 3–6 (2022), https://www.scribd.com/document/748723319/BlackRock-GHG-report-2022-1712022238 [https://perma.cc/V5UC-AM92] (describing Blackrock's approach to measuring its own emissions and reporting its total emissions for 2022).

12. *See* Dan Mangan, *'That Is Not Capitalism, That Is Abusing the Market:' Sen. Ted Cruz Blasts BlackRock's Larry Fink's 'Woke' ESG Policies*, CNBC (May 24, 2022, 1:10 PM), https://www.cnbc.com/2022/05/24/sen-ted-cruz-blasts-larry-fink-over-woke-shareholder-votes-on-climate.html [https://perma.cc/P86M-Q5BL].

13. *See* The Enhancement and Standardization of Climate-Related Disclosures for Investors; Delay of Effective Date, 89 Fed. Reg. 25804 (Apr. 12, 2024) (to be codified at 17 C.F.R. pts. 210, 229, 230, 232, 239, & 249). The SEC has voluntarily stayed the rule pending a legal challenge. It is unlikely that the SEC under President Trump will endorse this rule. *See* Lesley Clark, *Trump SEC Pick Wants to Ditch Landmark Climate Disclosure Rule*, POLITICO (Dec. 9, 2024, 9:50 AM), https://www.politico.com/live-updates/2024/12/09/congress/paul-atkins-sec-climate-00193254 [https://perma.cc/M3Z9-USHF].

14. To be sure, pressure by powerful institutional investors can lead companies to take steps to reduce emissions. Our claim, however, is that universal owners' stewardship cannot produce the dramatic changes required to meet the global warming challenge and is likely to produce inefficient decarbonization strategies.

15. *See infra* notes 90–91.

16. *See* Sally Hamilton, Hoje Jo & Meir Statman, *Doing Well While Doing Good? The Investment Performance of Socially Responsible Mutual Funds*, FIN. ANALYSTS J., Nov–Dec. 1993, at 62, 64.

attract investors, ESG funds must produce returns on par with competing ESG funds or the benchmark, non-ESG index.

These conflicting commitments, we argue, can distort universal owners' two levers to control their portfolio companies: *exit* and *voice*. *Exit* refers to universal owners' investment and, more importantly, *divestment* decisions. *Voice* refers to universal owners' stewardship of their companies—including their voting and engagement decisions. Fund managers that divest from environmentally unfriendly or "brown" companies lose the benefit of the returns these companies produce. Moreover, these commitments might lead universal owners to support management in pursuing decarbonization strategies that are unlikely to benefit investors or the planet.[17]

This distortion of incentives becomes evident in the crucial challenge facing many major polluters: determining the optimal corporate structure for transitioning to net-zero emissions. Oil majors and other heavy polluters must decide whether to adopt a "pure play" strategy, where polluting and clean activities are separately owned and managed, or an "integrated play," in which revenues from polluting activities are essentially financing investment in clean energy. Vesting management with the power to decide on a firm's decarbonization strategy creates a fertile ground for management agency costs and greenwashing.[18] Specifically, self-interest is likely to lead management to adopt integrated play strategies under which the company produces some green alternative, regardless of whether it is an optimal strategy for the firm or the planet.[19]

We argue that asset managers might support managers' refusal to divest "dirty" assets because a corporate structure that combines clean and dirty activities allows asset managers to enjoy the returns of the fossil fuel business while treating it as a clean investment. A pure-play strategy would require managers of ESG funds to sell the dirty business. In contrast, an integrated-play strategy allows asset managers to enjoy the

17. To be sure, passive funds tracking broad market indices (such as the S&P 500, for example) cannot divest from companies as long as they continue to be part of the index. *See, e.g.*, Jill Fisch, Assaf Hamdani & Steven Davidoff Solomon, *The New Titans of Wall Street: A Theoretical Framework for Passive Investors*, 168 U. PA. L. REV. 17, 21 (2019). Yet, their incentive structure might affect their stewardship decisions.

18. Greenwashing arises when management takes steps that falsely appear to effectively reduce carbon emissions. *See Sustainable Finance Is Rife with Greenwash. Time for More Disclosure*, THE ECONOMIST (May 22, 2021), https://www.economist.com/leaders/2021/05/22/sustainable-finance-is-rife-with-greenwash-time-for-more-disclosure [https://perma.cc/H4DC-WVFY]. Agency costs arise when management, facing investor pressure to meet carbon emission targets, adopts policies that are bad for shareholders, but beneficial for management. Greenwashing concerns also apply to ESG funds themselves. *See* Huw Jones, *Regulators to Tighten Scrutiny of Asset Managers to Stop 'Greenwashing'*, REUTERS (June 30, 2021, 10:25 AM), https://www.reuters.com/business/sustainable-business/regulators-tighten-scrutiny-asset-managers-stop-greenwashing-2021-06-30/ [https://perma.cc/K4Q3-XQWY].

19. Moreover, management likely wants to control the growth rate of sustainable energies that cannibalize their fossil business.

returns of the fossil fuel business while treating it as a clean investment they can continue to hold in their funds.[20]

Thus, managers' agency costs and universal owners' distorted incentives may push polluters to increase investment in renewable energies even when neither the planet nor investors would benefit from integrated-play strategies. The pressure to offer green alternatives may further push public companies toward known alternatives such as wind and solar energy, while unproven technologies that might be more directly related to the expertise of the legacy corporation are not explored.[21]

Moreover, universal owners lack incentives to engage in *firm-specific* stewardship. An effective decarbonization strategy requires firm-specific emission goals, strategies to meet these goals, and means to monitor management. Universal owners, however, are notoriously incapable of leading firm-specific changes.[22] Capital markets rely on activist hedge funds to initiate firm-specific policies designed to increase share value. However, these funds are unlikely to launch firm-specific campaigns to cut emissions.

The systematic risk of climate change cannot be adequately addressed solely through systematic measures, such as climate risk disclosure, industry-specific emission targets, or climate-based compensation.[23] Disclosure alone would not be enough to drive companies to significantly

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20. The text focuses on ESG funds. Our analysis, however, applies to all asset managers driven by the need to attract investors who would like to pressure companies to reduce emissions.

21. For instance, geothermal drilling is a technology that is based on drilling deep into the ground and exploiting the heat from the center of the earth. Drilling is the expertise of oil companies, but investing in new, yet unproven, technology might require publicly traded fossil fuel companies to incur substantial expenditures without realizing short-term recognition for reducing emissions. This might explain why public companies have thus far declined to invest in this technology. *See* Michael J. Coren, *This Is the Year Oil Companies Finally Invest in Geothermal*, QUARTZ (July 20, 2022), https://qz.com/1958041/oil-companies-may-finally-invest-in-geothermal-in-2021 [https://perma.cc/RG7N-N9ZJ] (stating that as of 2021, only one public company invested in geothermal energy); Jinjoo Lee, *Can the Oil-and-Gas Industry Crack Geothermal Energy?*, WALL ST. J. (Apr. 4, 2023, 7:00 AM), https://www.wsj.com/articles/can-the-oil-and-gas-industry-crack-geothermal-energy-fda62abe [https://perma.cc/Z4LJ-3MQN].

22. *See* 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, 892 (2013) (explaining that "benefit-cost calculation typically will point to de minimis governance expenditures by the diversified intermediary institution"); Dorothy S. Lund, *The Case Against Passive Shareholder Voting*, 43 J. CORP. L. 493, 495 (2018) (arguing that passive investors lack adequate incentives to become informed shareholders); Lucian Bebchuk & Scott Hirst, *Index Funds and the Future of Corporate Governance: Theory, Evidence, and Policy*, 119 COLUM. L. REV. 2029, 2039 (2019) (criticizing the Big Three for their failure to incorporate firm-specific information into their decisions).

23. *See* Giovanni Strampelli, *Can BlackRock Save the Planet? The Institutional Investors' Role in Stakeholder Capitalism*, 11 HARV. BUS. L. REV. 1, 14–15 (2021) (arguing that asset managers lack the resources for firm-specific analysis required for promoting virtuous corporate conduct); Amanda M. Rose, *A Hard Look at Portfolio-Focused Stewardship*, 2024 COLUM. BUS. L. REV. 313, 368–71 (arguing that climate disclosure

reduce emissions. As we explained above, universal owners' incentives may discourage them from divesting from brown companies.[24] And, without actors that champion firm-specific changes, disclosure will have a questionable effect on firms' conduct.[25]

Another systematic measure is uniform emission targets. Investors can require, for example, all corporations in specific industries to reduce emissions by ten percent every year. The surface uniformity belies the wildly different—and perhaps counterproductive—effect this requirement will have on different industries and corporations. As we explain below, a one-size-fits-all emissions target has easily demonstrable shortcomings.[26]

The likely failure of uniform emission targets suggests that *coordination* among universal owners and between universal owners and firms is critical for effectively reducing emissions. Yet, although they "own the market," universal owners cannot engage in meaningful coordination. On the firm level, coordinating firm-specific policies is difficult when universal owners, including different funds managed by the same sponsor, hold different concentrations of shares in specific firms or sectors.[27] And it is even harder when regulatory constraints discourage institutional investors from coordinating firm-specific policies.[28] On the

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will fail to induce climate stewardship by universal owners that lack incentives and competence to engage in firm-specific engagement).

24. The need to ensure the accuracy of stock prices justifies disclosures. Emissions and climate risks, however, are not fully priced by markets. Katharina Pistor, *Green Markets Won't Save Us*, PROJECT SYNDICATE (Mar. 16, 2021), https://www.project-syndicate.org/commentary/green-markets-esg-investments-risky-bet-on-climate-change-by-katharina-pistor-2021-03 [https://perma.cc/8K9G-RNDC]. Our analysis, therefore, focuses on the claim that disclosure should facilitate investors' pressure on polluters by using their "voice" or the threat of "exit."

25. Moreover, firms may respond to disclosure requirements by relying on integrated play strategies and acquiring "green" business rather than cutting emissions. *See* Tong Li, Qilin Peng & Luping Yu, ESG Considerations in Acquisitions and Divestitures: Corporate Responses to Mandatory ESG Disclosure (May 26, 2023) (unpublished manuscript) (https://ssrn.com/abstract=4376676 [https://perma.cc/NDZ6-CWM6]) (finding evidence that firms increase "green" acquisition in response to mandatory ESG disclosure); *see also* Nikolaus Raberger, Felix Rompen, Taimur Tanoli & Mieke Van Oostende, *Creating Value from Green M&A*, MCKINSEY & CO. (Feb. 29, 2024), https://www.mckinsey.com/capabilities/m-and-a/our-insights/creating-value-from-green-m-and-a [https://perma.cc/YNK7-G72P] (discussing the financial and strategic benefits of green M&A for corporate growth and sustainability). Disclosure can serve the interests of other stakeholders. *See, e.g.*, Ann M. Lipton, *Not Everything Is About Investors: The Case for Mandatory Stakeholder Disclosure*, 37 YALE J. ON REG. 499 (2020).

26. *See infra* Section IV.A.

27. *See, e.g.*, Roberto Tallarita, *Fiduciary Deadlock*, 171 U. PA. L. REV. ONLINE 1, 20–23 (2023); Sean J. Griffith & Dorothy S. Lund, *Conflicted Mutual Fund Voting in Corporate Law*, 99 B.U. L. REV. 1151, 1183–84 (2019); Ann M. Lipton, *Family Loyalty: Mutual Fund Voting and Fiduciary Obligation*, 19 TRANSACTIONS: TENN. J. BUS. L. 175, 177 (2017).

28. *See* Einer Elhauge, *Horizontal Shareholding*, 129 HARV. L. REV. 1267, 1302 (2016); Edward B. Rock & Daniel L. Rubinfeld, *Antitrust for Institutional Investors*, 82 ANTITRUST L.J. 221, 224 (2018).

economy-wide level, given the failure of markets to fund green energy,[29] government intervention may be required in the form of subsidies to breakthrough technologies.

Another measure available for universal owners is the structure of executive compensation.[30] Universal owners can require firms to tie executive pay to environmental metrics.[31] However, this measure is unlikely to be effective[32] because, without firm-specific knowledge, universal owners will be unable to ensure that compensation metrics are set to match the emission goals that the firms should aspire to achieve.

Given their business model and regulatory constraints, universal owners will not initiate firm-specific policies for reducing emissions.[33] We argue that, unfortunately, no actor has the incentive and competence to provide the firm-specific expertise required to reduce emissions.

Activist hedge funds are known for devising firm-specific strategies and challenging management to implement them. But profit-driven activists are unlikely to perform this critical role concerning GHG emissions.[34] Unlike universal owners, hedge funds do not benefit from reducing systematic risks. They will launch campaigns only if they expect them to increase the corporation's value (some argue only in the short term).

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29. *See, e.g.*, Naoyuki Yoshino & Farhad Taghizadeh-Hesary, *Alternatives to Private Finance: Role of Fiscal Policy Reforms and Energy Taxation in Development of Renewable Energy Projects*, *in* FINANCING FOR LOW-CARBON ENERGY TRANSITION 335 (Venkatachalam Anbumozhi, Kaliappa Kalirajan & Fukunari Kimura eds., 2018).

30. *See* Neuberger Berman Sustainable Equity Team, *ESG and Shareholder Value: Why Link Environmental, Social, Governance (ESG) Metrics to Executive Compensation?*, NEUBERGER BERMAN (Sept. 3, 2021), https://www.nb.com/en/global/insights/strategy-insights-esg-and-shareholder-value-why-link-esg-metrics-to-executive-compensation [https://perma.cc/2G9E-59YS].

31. *See, e.g.*, Harriet Agnew, *AllianzGI and Cevian Raise Pressure over Linking Pay to Climate Goals*, FIN. TIMES (Feb. 28, 2022), https://www.ft.com/content/025d0de8-4e5c-4eaa-be10-858fb2843206 [https://perma.cc/2V7D-QJYZ] (reporting that "Allianz Global Investors, one of Europe's largest asset managers," urges portfolio companies to adopt this measure).

32. *See* Adam B. Badawi & Robert P. Bartlett, *ESG Overperformance? Assessing the Use of ESG Targets in Executive Compensation Plans* 9 (Stan. L. & Econ. Olin Working Paper, Paper No. 592, 2024), https://papers.ssrn.com/sol3/papers.cfm?abstract_id=4941016 [https://perma.cc/3GVB-T23U]; Lucian A. Bebchuk & Roberto Tallarita, *The Perils and Questionable Promise of ESG-Based Compensation*, 48 J. CORP. L. 37 (2022); David I. Walker, *The Economic (In)significance of Executive Pay ESG Incentives*, 27 STAN. J.L. BUS. & FIN. 318 (2022).

33. Universal owners are even reluctant to support shareholder proposals that are too prescriptive. *See infra* note 160.

34. *See* Coffee, *supra* note 8, at 647 (noting that hedge funds are unlikely to play their traditional role in the context of systematic risks). Sharon Hannes, Adi Libson, & Gideon Parchomovsky have also provided an insightful analysis explaining why activist hedge funds, along with other central actors in the corporate sphere, lack the competence and motivation to integrate ESG policies into their business model. Sharon Hannes, Adi Libson & Gideon Parchomovsky, *The ESG Gap* 3 (U. Pa. Inst. for L. & Econ., Research Paper No. 23-22, 2022), https://papers.ssrn.com/sol3/papers.cfm?abstract_id=4293914 [https://perma.cc/HW6B-K9B8]. Unlike their work, our analysis applies even if hedge fund activists, climate-driven activists, ESG directors, or investor coalitions were to focus on the long-term risks of carbon emissions.

Some activists are motivated not by the desire to make profits, but by a genuine concern for the environment. Can they use the profit-driven activists' playbook and spearhead the effort to dictate firm-specific carbon policies? We find this highly unlikely. Because they do not rely on value-maximizing strategies, these activists will need alternative funding sources. Profit-driven activist funds owe their success to the support of universal owners and other asset managers.[35] Given their exclusive commitment to the environment (and no regard for profits), environmental activists might fail to get support from asset managers who care also about performance (and might face distorted incentives).

Moreover, the lack of firm-specific knowledge makes it difficult for universal owners in "regular" activist campaigns to determine whether to support management or the activist.[36] Yet, they can rely on imperfect signals such as the underperformance of the company's stock price.[37] Market prices, however, do not serve as a signal in the context of not-for-profit activism. Additionally, engaging in activities that would sacrifice firm value to reduce emissions will cause activists to encounter legal and regulatory constraints.[38]

What about the possibility of universal owners appointing designated ESG directors to boards? Regulatory constraints essentially prevent universal owners and other asset managers from actively nominating directors.[39] Moreover, activist directors rely on the support of the fund that nominated them to provide high-quality information and analysis.[40] Universal owners cannot offer similar support to directors even if they represent their interests.[41] Finally, to the extent that they care only about carbon emissions, these directors will run into the same legal difficulties as environmental activists.[42]

Finally, investor coalitions like Climate Action 100+ (Climate Action) pool together the resources of many universal owners to push for measures to reduce carbon emissions.[43] Yet, investor coalitions cannot nominate directors because they rely on their own members to submit proposals.[44] And they will encounter the same difficulties as not-for-profit activists in

35. *See* Gilson & Gordon, *supra* note 22, at 897.

36. *See, e.g.*, Zohar Goshen & Reilly S. Steel, *Barbarians Inside the Gates: Raiders, Activists, and the Risk of Mistargeting*, 132 YALE L.J. 411 (2022).

37. *See* Zohar Goshen & Gideon Parchomovsky, *The Essential Role of Securities Regulation*, 55 DUKE L.J. 711, 714 (2006).

38. *See* Kahan & Rock, *supra* note 7, at 520–21.

39. *See* Bebchuk & Hirst, *supra* note 22, at 2098.

40. *See* Kobi Kastiel & Yaron Nili, *"Captured Boards": The Rise of "Super Directors" and the Case for a Board Suite*, 2017 WIS. L. REV. 19, 36.

41. *See* Assaf Hamdani & Sharon Hannes, *The Future of Shareholder Activism*, 99 B.U. L. REV. 971, 992 (2019).

42. *See supra* text accompanying note 38.

43. *See infra* Section IV.C. For a review of investor climate coalitions, see Amelia Miazad, *Investor Climate Alliances*, 102 WASH. U. L. REV. 797 (2025).

44. Asset managers, and especially universal owners, face regulatory constraints that essentially prevent them from nominating directors to public company boards. *See* John D. Morley, *Too Big to Be Activist*, 92 S. CAL. L. REV. 1407, 1446 (2019).

getting asset managers—including their own members—to vote for their proposals. Indeed, the world's largest universal owner, BlackRock, has stated it will not support shareholder proposals that "in our assessment, implicitly are intended to micromanage companies," acknowledging its inability to gain idiosyncratic knowledge.[45]

Activists and academics should therefore recognize the significant limitations of universal owners as a driving force in the fight against carbon emissions. Investor stewardship is a very poor substitute for environmental regulation. Without an actor that can drive firm-specific changes, universal owners' stewardship will have only a limited effect on emissions. And universal owners' incentives may produce large-scale distortions in the much-needed development of green energy. Moreover, legal reforms, such as extensive disclosure by public companies on climate risks or requirements that ESG funds provide greater transparency about their investment policies,[46] cannot address the concerns that we have identified.

This Article proceeds as follows: Part I describes the rise of universal ownership in the public markets and the theories explaining universal owners' interest in pushing companies to reduce emissions. Part II discusses universal owners' incentives to reduce emissions and the effect of these incentives on owners' voice and exit. Part III uses the challenge of transition strategies to illustrate the real-world effects of our analysis. Part IV explains the need for firm-specific stewardship and coordination to address climate risks. Part V explains other actors are unlikely to engage in firm-specific stewardship. Part VI considers several implications, and a short conclusion ensues.

I. THE ESG PROMISE

For decades, investors have pushed their portfolio companies to maximize shareholder returns.[47] Recently, however, institutional investors appear to have been converted to the cause of climate activism.[48] Large

45. Sandra Boss & Michelle Edkins, *BlackRock on Climate-Related Shareholder Proposals*, HARV. L. SCH. F. ON CORP. GOVERNANCE (May 12, 2022), https://corpgov.law.harvard.edu/2022/05/12/blackrock-on-climate-related-shareholder-proposals/ [https://perma.cc/U5L7-8UQN]; Brooke Masters, *BlackRock's Support for ESG Measures Falls to New Low*, FIN. TIMES (Aug. 21, 2024, 10:34 PM), https://www.ft.com/content/2fbd12f2-a2e1-4fa7-ba63-7344ab274b4f [https://perma.cc/9296-86VF].

46. *See* Allison Herren Lee, *Statement by Commissioner Lee on ESG Disclosures Proposal*, HARV. L. SCH. F. ON CORP. GOVERNANCE (May 26, 2022), https://corpgov.law.harvard.edu/2022/05/26/statement-by-commissioner-lee-on-esg-disclosures-proposal/ [https://perma.cc/4CFG-MRTY].

47. *See* Dorothy S. Lund & Elizabeth Pollman, *The Corporate Governance Machine*, 121 COLUM. L. REV. 2563, 2565–66 (2021) ("A vast array of institutional players—proxy advisors, stock exchanges, ratings agencies, institutional investors, and associations—enshrine shareholder primacy in public markets.").

48. *See, e.g.*, Rodolfo Araujo, Marie Clara Buellingen & Garrett Muzikowski, *Investors Expect Climate Action in 2022*, HARV. L. SCH. F. ON CORP. GOVERNANCE (Mar. 21, 2022), https://corpgov.law.harvard.edu/2022/03/21/investors-expect-climate-action-in-2022/ [https://perma.cc/5EK2-M6X2].

asset managers have sounded the alarm on the climate crisis. BlackRock, the largest institutional investor with assets under management of over $10 trillion, has ramped up public pressure on CEOs to disclose their plans for transitioning to a net-zero economy.[49] Both BlackRock and Vanguard supported activist fund Engine No. 1 in a landmark campaign that unseated three ExxonMobil directors for their failure to adequately reduce emissions and invest in renewable energy.[50]

In this Part, we review the explanations offered by scholars for the apparent change in institutional investors' approach to climate change. Section A summarizes the structural shift in market ownership from dispersed ownership to universal ownership, where few institutional investors dominate the market. Section B outlines the view that universal owners' change in attitude is driven by their need to attract clients with preferences for reducing emissions or advancing other ESG goals. Section C reviews the portfolio primacy approach, which argues that institutions pressure emissions-heavy firms to reduce their emissions, sacrificing some of the value of these firms for the good of the portfolio. We join other scholars' arguments that the portfolio primacy approach is legally infeasible and likely ineffective. Section D then reviews the systematic stewardship approach under which universal owners do not single out individual companies to impose value-reducing changes. Rather, they focus their engagement on broadly applicable policies that address the systematic risks faced by the entire market.

A. *The Rise of Universal Owners*

During the past half-century, one of the most significant trends in the U.S. capital market has been the rise of institutional investors.[51] While public company shares were once predominantly owned by retail investors, institutional investors have gradually increased their holdings

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49. Andrew Ross Sorkin, *BlackRock Chief Pushes a Big New Climate Goal for the Corporate World*, N.Y. TIMES (Jan. 26, 2021), https://www.nytimes.com/2021/01/26/business/dealbook/larry-fink-letter-blackrock-climate.html [https://perma.cc/LPT9-ZAU4]. In response to backlash, BlackRock and other universal owners have recently moderated their climate policies. *See* Jack Pitcher, *BlackRock Withdraws from Climate Coalition, Backpedaling Again on ESG*, WALL ST. J. (Jan. 9, 2025, 6:01 PM), https://www.wsj.com/business/blackrock-withdraws-from-climate-coalition-backpedaling-again-on-esg-0e9ad0f8?reflink=desktopwebshare_permalink [https://perma.cc/Z379-PEYC]; Silla Brush, *World's Largest Money Manager BlackRock Hits Record $10.6 trillion, and It's Thanks to ETFs, CEO Larry Fink Says*, FORTUNE (July 15, 2024, 12:31 PM), https://fortune.com/2024/07/15/blackrock-larry-fink-record-etf-10-6-trilion/ [https://perma.cc/CXD9-TGMR].

50. Thomas Ball, James Miller & Shirley Westcott, *Was the Exxon Fight a Bellwether?*, HARV. L. SCH. F. ON CORP. GOVERNANCE (July 24, 2021), https://corpgov.law.harvard.edu/2021/07/24/was-the-exxon-fight-a-bellwether/ [https://perma.cc/RQE5-DHRQ].

51. Luis A. Aguilar, Comm'r, U.S. Sec. & Exch. Comm'n, Institutional Investors: Power and Responsibility (Apr. 19, 2013) (transcript available at https://www.sec.gov/news/speech/2013-spch041913laahtm [https://perma.cc/9J5D-JTEE]) ("Simply stated, institutional investors are dominant market players . . . .").

to the point where they have collectively become the dominant market players.[52]

To illustrate, as of 1965, three groups of institutional investors—mutual funds, pension funds, and insurance companies—collectively controlled approximately 14% of the U.S. stock market.[53] Their ownership has grown to about 25% by 1980[54] and over 50% by 2016.[55] Fifty years ago, the so-called "Big Three" institutional investors—BlackRock, Vanguard, and State Street Global Advisors—did not exist.[56] Today, they have assets under management of over $24 trillion in total,[57] equivalent to approximately a quarter of the global GDP.[58]

The meteoric rise of passively managed funds has driven the increasing market share of large asset managers. Passive funds are mutual funds

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52. *See* Jay Clayton, Chairman, Sec. & Exch. Comm'n, Proxy Voting—Reaffirming and Modernizing the Core Principles of Fiduciary Duty and Transparency to Provide for Better Alignment of Interest Between Main Street Investors and the Market Professionals Who Invest and Vote on Their Behalf (July 22, 2020) (transcript available at https://www.sec.gov/newsroom/speeches-statements/clayton-open-meeting-2020-07-22 [https://perma.cc/PS7Y-U3ZK]) ("Institutional investors, including the funds that hold retail investments, own approximately 72 percent of the domestic stock market value.").

53. *See* BD. OF GOVERNORS OF THE FED. RSRV. SYS., FINANCIAL ACCOUNTS OF THE UNITED STATES: HISTORICAL ANNUAL TABLES 1965–1974, at 95 tbl.L.213 (2014) [hereinafter FEDERAL RESERVE TABLES 1965–1974], http://www.federalreserve.gov/releases/z1/20140306/annuals/a1965-1974.pdf [https://perma.cc/XQT5-8EZA] (presenting the U.S. stock ownership of different types of investors). Ownership of U.S. corporate shares not held by institutional investors rested with either dispersed public shareholders or large holders, including controlling shareholders. *See* John C. Coates IV, *Measuring the Domain of Mediating Hierarchy: How Contestable Are U.S. Public Corporations?*, 24 J. CORP. L. 837, 848 (1999) (analyzing patterns of corporate ownership in the United States and highlighting the significant presence of controlling shareholders in a substantial portion of the economy).

54. *See* James M. Poterba & Andrew A. Samwick, *Stock Ownership Patterns, Stock Market Fluctuations, and Consumption*, BROOKINGS PAPERS ON ECON. ACTIVITY, no. 2, 1995, at 295, 313 tbl.5 (tracing the shifting landscape of stock ownership in the United States over the last thirty years).

55. *See* BD. OF GOVERNORS OF THE FED. RSRV. SYS., FINANCIAL ACCOUNTS OF THE UNITED STATES: HISTORICAL ANNUAL TABLES 2005–2015, at 123 tbl.L.223 (2016), https://www.federalreserve.gov/releases/z1/20160609/annuals/a2005-2015.pdf [https://perma.cc/HDZ4-TLB4].

56. *See Who We Are*, VANGUARD, https://corporate.vanguard.com/content/corporatesite/us/en/corp/who-we-are/sets-us-apart/index.html [https://perma.cc/3E6E-BBWC] (last visited May 24, 2025) (noting that Vanguard was founded in 1975); *History*, BLACKROCK, https://www.blackrock.com/corporate/about-us/blackrock-history [https://perma.cc/QC6L-NCAR] (last visited May 24, 2025) (noting that BlackRock was founded in 1988); *Our History*, STATE ST. INV. MGMT., https://www.ssga.com/us/en/individual/etfs/about-us/our-history [https://perma.cc/65GV-FS6Q] (last visited May 24, 2025) (noting that State Street Investment Management, the asset management arm of State Street, was founded in 1978).

57. *See Leading Fund Managers Worldwide in January 2025, by Assets Under Management*, STATISTA (Jan 7, 2025), https://www.statista.com/statistics/255864/top-global-fund-groups-worldwide-by-assets/ [https://perma.cc/Y7E3-EPSX].

58. *See Global Gross Domestic Product (GDP) at Current Prices from 1985 to 2029*, STATISTA (Jan. 10, 2025), https://www.statista.com/statistics/268750/global-gross-domestic-product-gdp/ [https://perma.cc/5F7U-K49V].

and exchange-traded funds that hold all the companies in an index.[59] Torrents of capital have flowed from active strategies—which seek to own the few companies that will outperform the index—to passive funds that hold the entire index. The passively managed share of the market has exploded from 3% in 1995 to 14% in 2005,[60] to 42.9% in March 2021.[61]

The index fund industry itself is concentrated, as the Big Three manage 80% of index fund assets. The result is that the Big Three alone now hold upwards of 20% of every company in the S&P 500,[62] and are projected to hold over 40% in 2039.[63] These investors are sometimes referred to as "universal owners" due to their holdings of a significant stake in nearly all public companies.

Universal owners' holdings translate into significant voting power. As of year-end 2015, the Big Three, considered collectively, were the "single" largest shareholder of almost half of all publicly listed U.S. companies (1,662 out of approximately 3,900 firms) and 88% of S&P 500 companies (438 out of 500 firms).[64] As of year-end 2017, the Big Three controlled 25% of voting shares of S&P 500 companies.[65] Institutional investors thus control an increasingly significant proportion of public stocks, leading to dominant voting power on virtually all issues of corporate governance.

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59. Investors have become devotees of Modern Portfolio Theory, which posits that to maximize risk-adjusted returns, investors must diversify their portfolio. In other words, in a market as efficient as the public equity markets, it is difficult to consistently outperform the broader index while taking the same amount of risk.

60. *See* Kenechukwu Anadu, Mathias Kruttli, Patrick McCabe & Emilio Osambela, *The Shift from Active to Passive Investing: Potential Risks to Financial Stability?* 2 (Fed. Rsrv. Bd. Fin. & Econ. Discussion Series, Paper No. 2018-060, 2018), https://www.federalreserve.gov/econres/feds/files/2018060r1pap.pdf [https://perma.cc/6Z97-G7Q2].

61. *See* James Seyffart, *Passive Likely Overtakes Active by 2026, Earlier if Bear Market*, BLOOMBERG PRO. SERVS. (Mar. 11, 2021), https://www.bloomberg.com/professional/blog/passive-likely-overtakes-active-by-2026-earlier-if-bear-market/ [https://perma.cc/2R7V-LNQQ].

62. David McLaughlin & Annie Massa, *The Hidden Dangers of the Great Index Fund Takeover*, BLOOMBERG (Jan. 9, 2020, 1:40 PM), https://www.bloomberg.com/news/features/2020-01-09/the-hidden-dangers-of-the-great-index-fund-takeover [https://perma.cc/7CDC-X7BH] (finding that the Big Three own 22% of the shares of the typical S&P 500 company).

63. *See* Lucian Bebchuk & Scott Hirst, *The Specter of the Giant Three*, 99 B.U. L. REV. 721, 724 (2019).

64. *See* Jan Fichtner, Eelke M. Heemskerk & Javier Garcia-Bernardo, *Hidden Power of the Big Three? Passive Index Funds, Re-Concentration of Corporate Ownership, and New Financial Risk*, 19 BUS. & POL. 298, 311–13 (2017).

65. *See* Bebchuk & Hirst, *supra* note 63, at 737–40; *see also* Renaud de Planta, *The Hidden Dangers of Passive Investing*, FIN. TIMES (May 30, 2017), https://www.ft.com/content/15dd3552-3fad-11e7-82b6-896b95f30f58 [https://perma.cc/UR8G-4Z96] (indicating that passive funds now control about 20% of U.S. large-cap companies, and if they "were to continue their present growth trajectory, they would own all listed stocks by 2030").

B. *Client Preferences and ESG Funds*

What explains the change in universal owners' approach to climate risks and other ESG goals? One group of explanations focuses on universal owners' need to attract and cater to clients with strong preferences for sustainable investments. One version focuses on the investment preferences of millennials. Knowing that the millennial generation is, on average, more concerned than their parents' generation about social issues, institutional investors signal their virtuous stewardship philosophies in the hopes that this will draw more assets under their management.[66] Another version focuses on institutional clients, such as public pension funds.[67] On a more cynical note, one might argue that universal owners' change in attitude is no more than a marketing ploy.

Another version focuses on the rise of a new asset class: ESG funds, which consider ESG factors when choosing firms to invest in.[68] Passive ESG funds often start with a general index, such as the S&P 500, and then eliminate from the list companies that fail certain ESG metrics.[69] In return for providing clients with a socially conscious portfolio, institutions charge significantly higher fees for ESG funds relative to other index funds.

ESG investments became increasingly popular in the early 2020s.[70] Under this view, pushing companies to reduce emissions signals a commitment to sustainable investing that could attract more investors to the ESG funds offered by asset managers. Moreover, pressuring companies to reduce emissions or pursue other stakeholder goals might be required by the funds' commitments to ESG principles.

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66. *See* Barzuza, Curtis & Webber, *supra* note 5, at 1249–50.

67. *See* Lund, *supra* note 5, at 83–84.

68. *See, e.g.*, *ESG Investing*, VANGUARD, https://investor.vanguard.com/investment-products/esg [https://perma.cc/B4ML-UPCM] (last visited May 24, 2025). ESG funds can include a wide range of investment strategies. *See* Quinn Curtis, Jill Fisch & Adriana Z. Robertson, *Do ESG Funds Deliver on Their Promises?*, 120 MICH. L. REV. 393, 399 (2021) ("ESG funds range from single-issue funds that address water conservation or religious values to those that incorporate screening criteria into the construction of a broad-based index.").

69. *See* Dana Brakman Reiser & Anne Tucker, *Buyer Beware: Variation and Opacity in ESG and ESG Index Funds*, 41 CARDOZO L. REV. 1921, 1935–38 (2020).

70. *See* Adeline Diab & Gina Martin Adams, *ESG Assets May Hit $53 Trillion by 2025, a Third of Global AUM*, BLOOMBERG PRO. SERVS. (Feb. 23, 2021), https://www.bloomberg.com/professional/blog/esg-assets-may-hit-53-trillion-by-2025-a-third-of-global-aum/ [https://perma.cc/57ML-HL6F]; *Where is Sustainability Headed in 2024*, J.P. MORGAN CHASE & CO. (Jan. 29, 2024), https://www.jpmorgan.com/insights/sustainability/carbon-transition/green-economy-outlook-sustainability-trends-for-2024 [https://perma.cc/TE34-C34V] (highlighting continued growth in ESG investment trends and investor expectations for companies to transition to low-carbon practices).

C. *Portfolio Primacy*

As the science of climate change—and its source in human industrial activity—has become more certain, the gravity of the risk it poses to the global economy has also become increasingly clear. The precise future path of climate change is uncertain. The annual mean global near-surface temperature for each year between 2023 and 2027 is predicted to be between 1.1°C and 1.8°C higher than the 1850-1900 average.[71] This warming is expected to impact the economy through a myriad of second-order effects, such as the rise in sea levels, higher frequency of extreme weather events, disruption in food production, biodiversity loss, increased rates of disease, and decreased efficiency of electric power grids. These climate-induced events will also have severe economic effects. While the ultimate cost of climate change reflected in the loss of global GDP is contingent on various factors, the effect is likely to be acute, comparable to a severe global recession. One recent study estimated that the global GDP loss could be between 4% (if the Paris Agreement targets are met, and temperatures increase by less than 2°C) and 18% (if no mitigating actions are taken, and temperatures rise by 3.2°C).[72]

Firms currently lack sufficient incentives to cut emissions. Each firm gains substantially more by imposing its emissions externalities on the rest of the market than it would lose due to the long-term effects of climate change. A firm focused on maximizing value for shareholders will not volunteer to put itself at a competitive disadvantage by reigning in its emissions while its competitors do not. GHG emissions have therefore been characterized as "the biggest market failure the world has seen."[73] Given the persistent failure of the government to impose rules that would reduce carbon emissions, scholars are understandably enthusiastic over the prospect that a paradigm shift in market ownership structure may lead investors to be rationally concerned with social and economic externalities.

To demonstrate how the rise of universal ownership might change investors' positions on externalities, consider a firm like ExxonMobil, which is single-handedly responsible for 1.4% of global GHG emissions.[74] ExxonMobil continues to emit large amounts of GHG into the

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71. *See* Press Release, World Meteorological Organization, Global Temperatures Set to Reach New Records in Next Five Years (May 17, 2023), https://wmo.int/news/media-centre/global-temperatures-set-reach-new-records-next-five-years [https://perma.cc/WC89-VGJ6].

72. *See* Press Release, Swiss Re Group, World Economy Set to Lose Up to 18% GDP from Climate Change if No Action Taken, Reveals Swiss Re Institute's Stress-Test Analysis (Apr. 22, 2021), https://www.swissre.com/media/news-releases/nr-20210422-economics-of-climate-change-risks.html [https://perma.cc/9FTC-SHEG].

73. *See* Nicholas Stern, *The Economics of Climate Change*, AM. ECON. REV., May 2008, at 1, 1.

74. *See* PAUL GRIFFIN, THE CARBON MAJORS DATABASE: CDP CARBON MAJORS REPORT 2017, at 15 (2017), https://cdn.cdp.net/cdp-production/cms/reports/documents/000/002/327/original/Carbon-Majors-Report-2017.pdf?1501833772 [https://perma.cc/P8L8-8KDH].

atmosphere because it is a net-positive action: the company is making more profit from producing and selling fossil fuels than the relatively small amount of economic harm it is likely to suffer from climate change. In theory, ExxonMobil shareholders' incentives are aligned with the company's—everyone will rationally wish to maintain ExxonMobil's current level of emissions. Climate change may, of course, have severe implications for other firms. ExxonMobil shareholders, however, have no financial incentive to care about the climate change externalities imposed on these firms.

Enter universal owners, who own the entire market, usually in proportion to the market capitalization of each company. From their perspective, the argument goes, Exxon's emissions are a net-negative: All companies in their portfolio will lose more from climate change costs caused by these emissions than the profits Exxon makes from selling fossil fuels. Since they internalize the externalities of heavy emitters, universal owners are therefore rationally motivated to minimize those externalities to avoid future losses to their portfolios.[75]

This change from a single-firm focus to a portfolio focus may be a descriptive explanation for investors' recent concern about ESG more broadly—and climate change in particular. But it arguably has normative implications for where investors, activists, and scholars should focus their energy in attempting to avert climate catastrophe. According to this theory, the incentives of universal owners and society are largely aligned on climate change, and universal owners have the clout and expertise to pressure corporations to scale back their emissions and prepare for a carbon-zero future. If this is true, we should place considerable trust in investors as a substitute for government action, and perhaps even enhance their power over corporations as the ideal leverage point in the push to net zero.

The "portfolio primacy" approach assumes that universal owners are focused on maximizing the value of their diversified portfolio rather than the value of individual firms.[76] Consequently, they are willing to inflict losses on individual firms, provided they result in a larger increase in the share price of the rest of the portfolio. To mitigate the threat of climate change to their entire portfolio, universal owners should prevail upon heavy emitters to reduce their emissions, sacrificing the value of these firms for the benefit of the broader portfolio.[77]

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75. *See* Madison Condon, *Externalities and the Common Owner*, 95 WASH. L. REV. 1 (2020); Luca Enriques & Alessandro Romano, *Rewiring Corporate Law for an Interconnected World*, 64 ARIZ. L. REV. 51 (2022). For an older model showing that diversified investors would like to minimize externalities, see Robert G. Hansen & John R. Lott, Jr., *Externalities and Corporate Objectives in a World with Diversified Shareholder/Consumers*, 31 J. FIN. & QUANTITATIVE ANALYSIS 43 (1996).

76. *See* Condon, *supra* note 75, at 13–15.

77. Madison Condon, for example, proposes the following model of institutional investor campaign. Just two oil companies—ExxonMobil and Chevron—are responsible for over 2% of global carbon emissions. More than a quarter of the equity in both companies is controlled by six institutional investors. Under the

Others, however, have pointed out the legal and practical flaws underlying this approach. To begin, it is impossible to implement without significant legal risks under both state corporate law and federal laws and regulations.[78] It is black letter Delaware law that directors owe fiduciary duties to the company and its shareholders, rather than shareholders of the broader market.[79] Delaware courts do not take kindly to directors at one firm having divided loyalties to other corporations. Moreover, a corporation must be managed for the benefit of all its shareholders, to the extent that controlling majority shareholders owe fiduciary duties to minority shareholders.

Institutional investors openly using their influence to impose drastic emissions reductions on some companies to increase the profits of their broader portfolios would be openly prioritizing the benefit of diversified shareholders at the expense of a corporation's other shareholders. Both the directors and the universal owners would face significant legal risks. The directors could be liable for violating their fiduciary duties, while universal owners themselves might be sued for aiding and abetting the directors' breaches of fiduciary duties.[80]

Moreover, asset managers owe their investors fiduciary duties, which require fund managers to maximize the value of each of their funds. These duties present asset managers with significant complexities when different funds with varying investment strategies hold shares in the same corporation.[81]

"portfolio primacy" framework, institutional investors should force ExxonMobil and Chevron to drastically cut emissions, perhaps by curtailing new exploration and committing to keeping some of their reserves in the ground. This would be worthwhile from the universal owner perspective, notwithstanding the hit to ExxonMobil and Chevron's share prices, because of the climate change costs they would be averting for the other firms in their portfolio. Using a simplified model incorporating the forecasted climate change costs and the size of BlackRock's stakes in publicly traded firms, Condon estimates that ExxonMobil and Chevron lowering their emissions by 40% would result in BlackRock saving $9.7 billion in averted climate costs. Even if the costs associated with lowering emissions would result in a 20% plunge in the share prices of ExxonMobil and Chevron, that price decline would only cost BlackRock $6.3 billion. BlackRock would thus end up earning an estimated $3.4 billion in portfolio value by forcing heavy carbon emitters to internalize their carbon externalities. *Id.* at 45–48.

78. *See* Kahan & Rock, *supra* note 7.

79. *See* McRitchie v. Zuckerberg, 315 A.3d 518, 564 (Del. Ch. 2024) (holding that directors' fiduciary duties require them to maximize the value of their corporation and not the value of diversified investors' portfolios).

80. Institutions may attempt to get around this issue by dressing up their portfolio-motivated campaigns in the guise of single firm focus, but this subterfuge is unlikely to succeed. Active investors with concentrated positions will recognize that significant reductions in emissions or drastic changes in strategy are only worthwhile from the perspective of index investors who will reap the gains across their portfolios.

81. *See supra* note 27.

Finally, such a campaign might also run afoul of federal antitrust law. Under Section 1 of the Sherman Act, an agreement to restrict output is a per se violation of federal law.[82] Institutional investors who use their influence over corporations to limit the supply of fossil fuels could thus subject the fund managers and corporate management to the risk of antitrust liability, notwithstanding their prosocial motivations.[83]

We have discussed only the doctrines that seem to present an insurmountable obstacle to the portfolio primacy approach. But, as others have pointed out, its overall effect on emissions would be questionable, even if the legal issues were to be resolved, because private corporations and other entities not subject to the universal owners' control would increase their fossil fuel output.[84]

D. *Systematic Stewardship*

"Systematic stewardship" takes a subtler approach to focusing on the portfolio rather than the individual firm, thereby avoiding the significant legal challenges of portfolio primacy. Under this approach, universal owners should not inflict damage on one company for the sake of the portfolio. Instead, they should treat climate as a systematic risk and address it with uniform policies across their portfolios.[85]

We start with some background on the difference between idiosyncratic and systematic risk. Idiosyncratic risk is a risk particular to one firm or industry, while systematic risk is a risk that affects all or most of the market. A star CEO departing to join a competitor, or the work-from-home revolution negatively impacting occupancy rates in the commercial real estate sector are idiosyncratic risks. Inflation, on the other hand, is a systematic risk affecting all firms. Universal owners are not very concerned about idiosyncratic risk because they hold a diversified portfolio—one firm might lose as another one might win—but they are more likely to be affected by systematic risks. Thus, as Jeff Gordon argues,[86] these funds should focus on mitigating systematic risks that cannot be diversified away.

Some systematic risks are beyond the control of investors. Universal owners, for example, lack the capacity to analyze how each firm in their portfolio should conduct its business to avoid the negative effects of inflation. Reducing the systematic risk of inflation is best left to the Federal

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82. Section 1 of The Sherman Act prohibits unreasonable restraints of trade. 15 U.S.C. § 1.

83. *See* Damian G. Didden, *Antitrust and ESG*, HARV. L. SCH. F. ON CORP. GOVERNANCE (Jan. 31, 2023), https://corpgov.law.harvard.edu/2023/01/31/antitrust-and-esg/ [https://perma.cc/MPB3-YG7R].

84. *See* Roberto Tallarita, *The Limits of Portfolio Primacy*, 76. VAND. L. REV. 511, 517–19 (2023).

85. *See* Gordon, *supra* note 8, at 628–31.

86. *Id.* at 648.

Reserve, through its policy of raising interest rates. However, there are other systematic risks that universal owners can address on their own, such as the risk of management agency costs (i.e., the risk of lost firm value due to disloyal managers). Institutional investors deal with this systematic risk by crafting uniform policies that they apply to all firms. In the case of agency costs, institutional investors uniformly favor strong governance arrangements that empower shareholders to hold managers accountable. Institutional investors have developed a list of good governance practices that academic research suggests would increase the value of the portfolio. They have then used their immense clout to institute these governance policies market-wide.[87]

One prominent example is institutional investors' aversion to the staggered board, a governance structure in which only one third of a company's board stands for reelection at each annual shareholder meeting, as opposed to all directors. A staggered board tends to protect managers from being removed by disapproving shareholders, as they cannot completely wrest control away from management in one election. Although the effects of a staggered board on a firm's share price vary, institutional investors are focused on the average effect across their entire portfolio. Relying on research that suggests that having non-staggered boards would increase the value of their portfolios on average, institutional investors have largely eradicated staggered boards from public companies.

Institutional investors enjoy economies of scale in favoring uniform policies—a single policy will be applied across their multi-trillion-dollar portfolio—and economies of scope—they accumulate transferrable expertise through researching various issues related to systematic risk.

In the climate change context, argue systematic stewardship proponents, universal owners should prioritize how the systematic risks associated with climate change will affect their portfolios over the short-term profits of specific industries, such as the fossil fuel industry. Universal owners can, for instance, adopt a policy requiring firms across their portfolios to adopt emissions targets to reduce the risk to the portfolio on average, notwithstanding that this may also negatively affect some firms that depend on emissions for most of their profits. In this way, universal owners are not targeting a single company and forcing it to overturn its business model for the good of the market. Rather, they are indiscriminately applying a policy that is calculated to reduce risk on average across their portfolio.

According to this view, there is no reason to think systematic stewardship cannot have the same positive effects—on average—in the fight against climate change. Universal owners could use their power, through voting and direct engagement, to craft and institute a policy that maximizes the value of the entire portfolio by reducing greenhouse gas

87. *Id.* at 645.

emissions, notwithstanding that the effect on individual companies may be mixed.

Exploring whether universal owners can cope with greenhouse gas emissions through uniform policies and systematic stewardship is the focus of this Article. As we will show, unfortunately, universal owners lack the necessary incentives and competence to be able to reduce carbon emissions. Next, in Part II, we discuss incentives, and in Part III, we will discuss competence.

II. UNIVERSAL OWNERS: INCENTIVES

Asset managers have two main levers to control their portfolio companies: *exit* and *voice*. *Exit* refers to fund managers' investment, and more importantly, *divestment* decisions regarding their ownership of stock. In the context of profit-maximization, financial economists have shown that fund managers can exert pressure on companies by selling their shares, for example. *Voice* refers to fund managers' stewardship of their portfolio companies. Fund managers vote on director elections, shareholder proposals, and other issues. They also "engage" with management on various issues that may be of concern to investors.

The previous Part discussed the prevailing explanations for universal owners' interest in pushing companies to reduce emissions. In this Part, we take a closer look at universal owners' incentives and their likely effect on universal owners' exit and voice.

We start by identifying the fundamental tension underlying ESG investments and analyzing its implications for universal owners' incentives. We then focus on the incentive structure and regulatory constraints that discourage universal owners from engaging in firm-specific stewardship.

A. *The ESG Tension*

One explanation for universal owners' interest in reducing emissions is their need to cater to their own investors' demand for sustainable investments.[88] Indeed, the pressure of asset managers on companies to reduce emissions coincided with the increase in the fraction of assets managed by universal owners that were held in ESG funds. These funds charge higher fees on their assets under management and are therefore more profitable for fund managers.[89] Optimists believe that client demand for sustainable investments induce universal owners to push companies to reduce emissions (or pursue other ESG goals) even when doing so will require firms to sacrifice profits. Fund managers, however,

88. *See infra* Section II.B.

89. *See* Ringe, *supra* note 3, at 135 ("[S]pecialized ESG indices . . . allow fund managers to charge higher fees that drive up revenues.").

insist that their commitment to sustainable investments will not sacrifice fund returns[90] and might even increase them.[91]

We argue that sponsors of ESG funds (and other asset managers that pursue ESG strategies to satisfy client demand) face a complex set of incentives. These incentives are likely to distort fund managers' decisions concerning the two primary methods available to universal owners: *exit* (investment and divestment) and *voice* (voting and engagement). As we explain below, universal owners may favor climate policies that do not align with maximizing the efficiency of sustainable energy innovation.

Fund managers' business model is based on collecting fees for managing investors' assets. Fund managers' fees are normally a fraction of assets under management.[92] To increase the size of their assets under management and the corresponding fees, fund managers need to attract investors. In the case of ESG funds, this requires fund managers to pursue two goals that, we argue, are in tension.

First, to appeal to investors interested in sustainable investments, fund managers must commit to pursue ESG goals. Indeed, evidence suggests that mutual fund investors are attracted to funds with higher sustainability ratings.[93]

Second, fund managers seek to produce competitive returns. Maximizing fund performance is important even when catering to client demand for sustainable investments or attracting investors to ESG funds. Evidence suggests investors in ESG funds are sensitive to funds' financial returns.[94] Fund managers, therefore, strive to generate returns that would favorably compare with competing ESG funds or perhaps even the

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90. *See* Kenneth P. Pucker & Andrew King, *ESG Investing Isn't Designed to Save the Planet*, HARV. BUS. REV. (Aug. 1, 2022), https://hbr.org/2022/08/esg-investing-isnt-designed-to-save-the-planet [https://perma.cc/C6QU-4HGW] ("Marketing materials of ESG funds often make lofty statements about social or environmental aspirations, but the fine print reveals that the real goal is to assure shareholder profits."); Paul Brest, Ronald J. Gilson & Mark A. Wolfson, *How Investors Can (and Can't) Create Social Value*, 44 J. CORP. L. 205, 208 (2018) (noting that the literature published by asset managers manifests considerable optimism that they can create social value without sacrificing financial returns); *see, e.g.*, Lund & Pollman, *supra* note 47, at 2566 ("[M]any investors favor ESG funds, not for moral reasons or a prosocial willingness to sacrifice profits, but because ESG is thought to provide sustainable long-term value or higher risk-adjusted returns for shareholders.").

91. *See, e.g.*, *Larry Fink's 2021 Letter to CEOs*, BLACKROCK, https://www.blackrock.com/corporate/investor-relations/2021-larry-fink-ceo-letter [https://perma.cc/JE7S-LF3T] (last visited May 25, 2025) ("During 2020, 81% of a globally-representative selection of sustainable indexes outperformed their parent benchmarks."). At least for some funds, the claim that their commitment to sustainability does not sacrifice fund returns may reflect concerns about their fiduciary duties.

92. *See* Jonathan Lewellen & Katharina Lewellen, *Institutional Investors and Corporate Governance: The Incentive to Be Engaged*, 77 J. FIN. 213 (2022).

93. *See* Samuel M. Hartzmark & Abigail B. Sussman, *Do Investors Value Sustainability? A Natural Experiment Examining Ranking and Fund Flows*, 74 J. FIN. 2789 (2019).

94. *See, e.g.*, Paulo Trevisani, *Analysis: ESG ETFs Lose Flows as Turbulent Markets Focus on Returns*, WALL ST. J. (Apr. 3, 2023, 11:27 AM), https://www.wsj.com/articles/esg-etfs-lose-flows-as-turbulent-markets-focus-on-returns-726339dc [https://perma.cc/9LS6-PVMB].

benchmark, non-ESG index. To increase the value of their portfolios, fund managers must either use their influence to increase the value of the companies they hold in their portfolio or invest in companies that will appreciate independently.[95]

These twin objectives are in conflict when reducing emissions requires firms to sacrifice profits.[96] We explore the implications of this inevitable tension for universal owners' policies on both exit and voice.

Exit. A prime example of this contradiction is evident if we focus on fund managers' decisions to limit their investments to green companies only. A policy to divest from all brown companies may be consistent with fund managers' green commitments. However, categorically excluding some investments from their portfolios challenges fund managers' ability to produce competitive returns in the long run.[97] To be sure, green investments can sometimes produce superior returns.[98] Yet, because it is hard to predict winners and losers, fund managers have an incentive to expand the universe of companies that can be considered green. Moreover, to avoid negative comparisons with their benchmark (say the S&P 500), ESG fund managers will seek to replicate the sector's representation as closely as possible. In 2022, for example, the energy sector returned 65.7%, compared with a negative 18.1% for the S&P 500.[99] Excluding oil and gas companies wholesale would result in ESG funds lagging an

95. *See* Marcel Kahan & Edward B. Rock, *Index Funds and Corporate Governance: Let Shareholders Be Shareholders*, 100 B.U. L. REV. 1771, 1784 (2020).

96. *See* James Mackintosh, *ESG Investing Can Do Good or Do Well, but Don't Expect Both*, WALL ST. J. (Jan. 24, 2022, 9:08 AM), https://www.wsj.com/articles/esg-investing-can-do-good-or-do-well-but-dont-expect-both-11643033321 [https://perma.cc/P5EF-DLZ4].

97. *See* Bradford Cornell & Aswath Damodaran, *Valuing ESG: Doing Good or Sounding Good?*, J. IMPACT & ESG INVESTING, Fall 2020, at 76, 84, 87 ("[I]f investors have a preference for highly rated ESG stocks, then those stocks will offer lower average excess returns" and "the notion that adding an ESG constraint to investing increases expected returns is counterintuitive."); Ľuboš Pástor, Robert F. Stambaugh & Lucian A. Taylor, *Sustainable Investing in Equilibrium*, 142 J. FIN. ECON. 550, 551 (2021) (developing a model showing that "agents with stronger ESG preferences, whose portfolios tilt more toward green assets and away from brown assets, earn lower expected returns"); Yigit Atilgan, K. Ozgur Demirtas, Alex Edmans & A. Doruk Gunaydin, *Does the Carbon Premium Reflect Risk or Outperformance?* 6 (Eur. Corp. Governance Inst., Finance Working Paper No. 940/2023, 2024), https://ssrn.com/abstract=4573622 [https://perma.cc/G8TR-65EW] (showing through statistical analysis a positive correlation between surprise earnings and increased emissions, suggesting a carbon premium for "brown" firms that is not being properly priced in the market).

98. *See* Ľuboš Pástor, Robert F. Stambaugh & Lucian A. Taylor, *Dissecting Green Returns*, 146 J. FIN. ECON 403 (2022).

99. *See* Chris Hudgins & Umer Kahn, *S&P 500 Logs Its Worst Annual Performance Since 2008*, S&P GLOBAL (Jan. 4, 2023), https://www.spglobal.com/marketintelligence/en/news-insights/latest-news-headlines/s-p-500-logs-its-worst-annual-performance-since-2008-73687583 [https://perma.cc/839M-N5VY]; Jesse Pound & Samantha Subin, *Stocks Fall to End Wall Street's Worst Year Since 2008, S&P 500 Finishes 2022 Down Nearly 20%*, CNBC (Dec. 30, 2022, 5:23 PM), https://www.cnbc.com/2022/12/29/stock-market-futures-open-to-close-news.html [https://perma.cc/QU9V-HHTM].

ESG-blind index fund. Instead of accepting these reduced returns, it is an open secret that many ESG funds invest in fossil fuel companies.[100]

But there is another, subtler reason why avoiding investment in dirty companies is expected to adversely affect returns. One rationale behind asset managers' divestment from brown companies is that this strategy will put pressure on polluters to cut emissions by raising their cost of capital. In other words, managers of green companies are promised access to larger pools of capital at a lower cost. This promise, though, also suggests that polluters' cost of capital will increase, which in turn will increase expected returns for other, "regular" investors who are willing to invest in these firms.[101]

Thus, while divestment from brown companies may appear aligned with ESG goals, it often undermines fund managers' ability to deliver competitive returns. The combination of pressures to match benchmark performance and the unintended consequence of increasing polluters' returns for other investors make full reliance on exit strategies both impractical and counterproductive.

Voice. Fund managers often claim that *voice* is more effective than *exit* in pushing companies to decarbonize.[102] Yet, the incentive problem we have identified is not limited to funds' investment decisions. It may also affect universal owners' stewardship and make these fund managers support portfolio companies in adopting strategies that are ineffective in reducing emissions but allow universal owners to satisfy their twin commitments. Fund managers that wish to retain exposure to brown companies might push these companies to adopt green policies. Relatedly, fund managers wishing to demonstrate measurable progress in decarbonizing their portfolios might push companies to make green investments. In both cases, as we explain in the next Part, the concern is that fund managers would push companies to adopt policies that facilitate management's greenwashing and agency costs.

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100. *See* Akane Otani, *ESG Funds Enjoy Record Inflows, Still Back Big Oil and Gas*, WALL ST. J. (Nov. 11, 2019), https://www.wsj.com/articles/top-esg-funds-are-all-still-invested-in-oil-and-gas-companies-11573468200 [https://perma.cc/5FZB-4XU5]; Phillip Inman, *Green Investment Funds Pushing Money into Fossil Fuel Firms, Research Finds*, THE GUARDIAN (May 2, 2023, 1:00 PM), https://www.theguardian.com/business/2023/may/02/green-investment-funds-pushing-money-into-fossil-fuel-firms-research-finds [https://perma.cc/U3K2-UYHN]; Aneesh Raghunandan & Shiva Rajgopal, *Do ESG Funds Make Stakeholder-Friendly Investments?*, 27 REV. ACCT. STUD. 822, 822 (2022) (noting "ESG funds hold portfolio firms" with "worse track records for compliance with labor and environmental laws, relative to portfolio firms held by non-ESG funds"); INFLUENCEMAP, CLIMATE FUNDS: ARE THEY PARIS ALIGNED? 3 (2021) ("[A] large portion of climate-themed equity funds . . . exhibit climate misalignment levels similar to those of market indices.").

101. *See* Cornell & Damodaran, *supra* note 97; Pástor, Stambaugh & Taylor, *supra* note 97; Alon Brav & J.B. Heaton, *Brown Assets for the Prudent Investor*, 12 HARV. BUS. L. REV. ONLINE, art. 2, 2021, at 1.

102. *See* Eleonora Broccardo, Oliver Hart & Luigi Zingales, *Exit Versus Voice*, 130 J. POL. ECON. 3101 (2022).

We have focused on ESG funds, but our account applies to all asset managers to the extent that their need to attract climate-conscious investors is what drives them to pursue ESG goals. These asset managers' need to satisfy investors' demands for green investments while maximizing returns (either to attract investors or increase fees on assets under management) might distort their stewardship and investment policies.

As a result, while fund managers may claim that voice is more effective than exit in pushing companies to decarbonize, the underlying tensions previously discussed often lead them to support strategies that prioritize returns over meaningful environmental action. The pressure to attract climate-conscious investors while maintaining financial performance distorts both investment and stewardship decisions, making it difficult to effectively balance ESG goals with competitive returns.

B. *Firm-Specific Stewardship*

Another explanation for investors' interest in pushing companies to reduce emissions is universal owners' incentive to address the systemic risk of climate change. Climate change is indeed a systemic risk. As we explain in Part IV, however, it cannot be addressed only by systematic solutions. An effective decarbonization strategy requires firm-specific emission goals, strategies to meet these goals, and means to monitor management. Unfortunately, universal owners lack the incentives to engage in firm-specific climate stewardship.

As Ronald Gilson and Jeffrey Gordon explain, large asset managers lack incentives to invest in the measures required to devise firm-specific measures.[103] Gilson and Gordon focus their analysis on firm-specific initiatives required to maximize shareholder returns, but the same logic applies to firm-specific measures required to transition to net zero. Universal owners' unwillingness to initiate firm-specific measures stems from their business model, incentive structure, and regulatory constraints.

First, universal owners' business model does not incentivize them to invest considerable resources in firm-specific research. Universal owners manage very large passive funds that own essentially the entire market. These funds compete against other passive funds that track the same index, not based on the performance of their portfolio—since the funds hold the same index—but primarily on how low their fees are. Given these slim margins, universal owners have very limited incentives to incur high costs through investment in firm-specific stewardship.

To understand how thinly institutional investors' resources are spread, consider the scale of their participation in corporate governance in comparison to their fees. Based on a widespread interpretation

103. *See* Gilson & Gordon, *supra* note 22, at 892 (explaining that "benefit-cost calculation typically will point to de minimis governance expenditures by the diversified intermediary institution"). Dorothy Lund argues that, because they lack the competence to make firm-specific decisions, passive investors should not vote their shares. *See* Lund, *supra* note 22, at 495–97.

of Department of Labor (DOL) and SEC rules, institutional investors consider themselves obligated to vote on all issues at every shareholder meeting of their portfolio companies. For example, BlackRock voted on 169,220 separate issues at 18,359 shareholder meetings in 2024,[104] but its average expense ratio in that year was a mere 0.1%.[105] The disparity is even starker at Vanguard: its funds voted on 182,241 separate issues at 13,433 shareholder meetings in 2024,[106] but their average expense ratio is a measly 0.07%.[107] These fractional fees, and the miniscule incremental gains investors might reap, cannot justify the human capital required for Vanguard and BlackRock to tailor their voting records at each company to effect firm-specific ESG policies.

Second, universal owners and other institutional investors face a variety of legal constraints that further discourage them from adopting some measures required to engage in firm-specific stewardship. Securities laws discourage institutional investors from gaining access to nonpublic information about specific companies and from nominating directors. Additionally, antitrust and securities laws might prevent fund managers from coordinating with other investors or attempting to take an active role in directing management.

In response to these financial, practical, and legal impediments to firm-specific stewardship, universal owners tend to support market-wide measures. However, as Part IV will explain, there is no conceivable one-size-fits-all policy that is likely to result in lower emissions across their entire portfolio.

III. TRANSITION STRATEGIES

In this Part, we address the implications of universal owners' incentives for a crucial challenge currently facing many large polluters: determining the best corporate structure for making the transition to net zero. We analyze the respective roles of universal owners, corporate managers, and activist hedge funds. Section A presents the choice between integrated and pure-play strategies. Section B describes the concern that managers engage in greenwashing or adopt inefficient policies for reducing emissions to serve their own interests (agency costs). Section C explains that activist hedge funds may launch costly campaigns to oppose

104. *See* BLACKROCK, 2024 GLOBAL EXPENSE VOTING SPOTLIGHT: VOTING IN OUR CLIENTS' LONG-TERM FINANCIAL INTERESTS (2024), https://www.blackrock.com/corporate/literature/publication/2024-investment-stewardship-voting-spotlight.pdf [https://perma.cc/T7QM-ZCK9].

105. *See iShares S&P 500 Index Fund*, BLACKROCK, https://www.blackrock.com/us/individual/products/251378/blackrock-s-p-500-stock-fundinstl-class-fund [https://perma.cc/29E3-WYXK] (last visited May 25, 2025).

106. VANGUARD, INVESTMENT STEWARDSHIP: 2024 ANNUAL REPORT (2024), https://corporate.vanguard.com/content/dam/corp/advocate/investment-stewardship/pdf/policies-and-reports/2024_investment_stewardship_annual_report.pdf. [https://perma.cc/4C6L-7RW8].

107. *See Costs, Fees & Minimums*, VANGUARD, https://investor.vanguard.com/client-benefits/investment-fees [https://perma.cc/5CT8-TJHL] (last visited July 17, 2025). For a detailed analysis, see Bebchuk & Hirst, *supra* note 22.

management's efforts to adopt inefficient strategies. Section D argues that universal owners' incentives might lead them to support management's inefficient strategies.

A. *Integrated v. Pure-Play Structures*

A timely dilemma for many companies and their investors is the corporate structure of the transition to renewable energy.[108] For simplicity, we will focus on firms' choice between two stylized paths for reducing emissions: the pure-play and integrated play strategies. For example, compare Tesla and Volkswagen. Tesla specializes only in electric vehicles. This is a pure-play strategy that focuses only on renewable-energy vehicles. Volkswagen, on the other hand, has adopted an integrated play approach: a combination of a legacy business that manufactures internal combustion engine cars and a unit that develops electric vehicles.

As a matter of theory, there is no clear rule about which strategy will maximize profits or prove most effective in reducing emissions; each has costs and benefits.[109] For some companies, it may be more efficient to be integrated, so that the cash flow from the legacy, carbon-intensive business can support the research and development (R&D) and other capital expenditures of the innovative, clean one as it builds up to scale and develops product-market fit. In other cases, a pure-play strategy might be better, as it has the advantages of: (1) concentrating the focus of the organization around a core mission of innovation, which requires a radically different orientation than managing a century-old legacy business; (2) enabling the company to react nimbly to political and regulatory changes common in emerging industries; (3) allowing the company to benefit from its innovative brand in attracting talent; and (4) allowing investors to choose their exposure, avoiding vehement tugs-of-war between shareholders on the future trajectory of the company, which can result in a lower share price.

Many of these considerations are important also for those concerned about rapid decarbonization. For example, if they have distinct knowledge or skills that are valuable for the renewable energy sector, oil and gas companies should diversify to renewable energy. On the other hand, if new entrants are better positioned than oil majors to make clean energy innovations, investments in renewable energies should be pursued by pure-play actors. Indeed, when it comes to sustainability innovation, some anecdotal evidence indicates that the pure-play approach may prove superior.[110]

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108. *See, e.g.*, Matthias J. Pickl, *The Renewable Energy Strategies of Oil Majors—From Oil to Energy?*, ENERGY STRATEGY REVS., November 2019, art. 100370, at 1; Hongfang Lu, Lijun Guo & Yitong Zhang, *Oil and Gas Companies' Low-Carbon Emission Transition to Integrated Energy Companies*, 686 SCI. TOTAL ENV'T 1202 (2019).

109. *See* Arthur A. van Benthem, Edmund Crooks, Stefano Giglio, Eugenie Schwob & Johannes Stroebel, *The Effect of Climate Risks on the Interactions Between Financial Markets and Energy Companies*, 7 NATURE ENERGY 690, 693 (2022).

110. *See, e.g.*, Vaska Atta-Darkua, Simon Glossner, Philipp Krueger & Pedro Matos, *Decarbonizing Institutional Investor Portfolios: Helping to Green the Planet or Just*

Another climate consideration is the effect of ownership structure on carbon emissions. There are claims that public companies' divestment from carbon-intensive activities might lead to more emissions.[111] While selling their polluting activities allows companies to satisfy investor demands for cleaner operations, the new owners of brown activities might increase emissions, because they might be private companies or governments that are not subject to pressure by universal owners to reduce emissions.[112]

This raises the question of how universal owners use their influence, either through *voice* (engagement) or *exit* (divestment), to guide companies toward the most effective strategy. For example, investors might use *voice* to push integrated firms like Volkswagen to adopt more aggressive emission-reduction strategies, or they might threaten *exit* by divesting from companies that fail to decarbonize quickly enough. Ideally, for investors that care about both performance and climate, each company should choose a strategy that is most effective for reducing emissions and most efficient. As we explain below, however, this is unlikely to happen.

B. *Management*

Universal owners and other asset managers increasingly require public companies to reduce carbon emissions. Management of each public company then has the task of devising firm-specific strategies for reducing emissions. Management will decide, for example, whether to reduce emissions and whether to meet emission targets by increasing investment in clean energy ventures, selling dirty assets, or using carbon offsets.

Greening Your Portfolio? (Swiss Fin. Inst. Research Paper Series, Paper No. 25-42, 2023), https://papers.ssrn.com/abstract=4212568 [https://perma.cc/E28J-P55X] (finding evidence suggesting that climate-conscious investors do not lead companies to make green innovations).

111. *See* GABRIEL MALEK, ANDREW BAXTER, DOMINIC WATSON, ANDREW HOWELL, MARK DAVIS, GANI SAGINGALIYEV, GRANT SWARTZWELDER & CLARE STAIB-KAUFMAN, ENV'T DEF. FUND, TRANSFERRED EMISSIONS: HOW RISKS IN OIL AND GAS M&A COULD HAMPER THE ENERGY TRANSITION, https://business.edf.org/files/Transferred-Emissions-How-Oil-Gas-MA-Hamper-Energy-Transition.pdf [https://perma.cc/2C5U-RA5K]; John C. Coffee, Jr., *Climate-Risk Disclosures and "Dirty Energy" Transfers: "Progress" Through Evasion*, THE CLS BLUE SKY BLOG (Jan. 25, 2022), https://clsbluesky.law.columbia.edu/2022/01/25/climate-risk-disclosures-and-dirty-energy-transfers-progress-through-evasion/ [https://perma.cc/9L2X-3GCX] (suggesting that institutional investors demand public companies "not sell significant emissions-creating assets unless the buyer agrees to observe a 'net zero' emissions pledge roughly comparable to its seller's"); John Armour, Luca Enriques & Thom Wetzer, *Dark and Dirty Assets: Greening Climate-Driven Asset Partitioning*, OXFORD BUS. L. BLOG (June 14, 2022), https://blogs.law.ox.ac.uk/business-law-blog/blog/2022/06/dark-and-dirty-assets-greening-climate-driven-asset-partitioning [https://perma.cc/XKT9-J8HH] (calling on investors to impose restrictions on buyers of dirty assets or new entities formed to own them).

112. *See, e.g.*, Anjli Raval, *A $140bn Asset Sale: The Investors Cashing in on Big Oil's Push to Net Zero*, FIN. TIMES (July 6, 2021), https://www.ft.com/content/4dee7080-3a1b-479f-a50c-c3641c82c142 [https://perma.cc/5LSG-XW5J] (reporting on a private company eager to buy fossil fuel assets sold by oil and gas companies).

Ideally, a company would meet carbon emission targets set by its investors while relying on management to use its expertise to tailor a path to zero emissions based on the firm's business environment and specific needs.

Unfortunately, managers might use their discretion to advance their interests rather than those of investors by adopting measures that will prove ineffective at reducing carbon emissions, lead to inefficient corporate structures, or both. We focus on two concerns that arise in the climate context: *greenwashing* and *agency costs*.

1. *Greenwashing*

The premise underlying the new optimism about the role of universal owners in reducing emissions is that universal owners, who are concerned about attracting green investors, systemic risks, and externalities impacting their portfolios, will push firms to lower emissions even if effective decarbonization measures do not maximize shareholder value. However, managers may possess differing interests. Their compensation, for instance, is often tied to stock or stock options awards.[113] Alternatively, they may perceive considerable investment in emission reduction as a long-term strategy that could negatively affect stock prices in the short term. As a result, managers might be more likely to prioritize profits over reducing emissions.

Managers might respond to investor pressure to reduce emissions by adopting measures that appear to reduce carbon emissions without significantly affecting profits. This could involve "Net Zero" pledges with no credible commitment to meet this ambitious goal,[114] or using carbon offsets or other contentious strategies instead of implementing more effective (but costlier) emission reduction methods. Broadly speaking, companies may introduce policies that enhance their reputation as sustainable businesses in order to appease institutional investors, while their total emissions remain unchanged or even increase.[115]

The greenwashing phenomenon has been extensively documented. One study indicates that while fossil fuel companies have amplified their sustainability rhetoric over the past decade through disclosures, pledges, and highlighting clean energy investments, their actions reveal a lack of genuine commitment to sustainability. Major oil companies continue to lobby governments to undermine carbon pricing policies and

113. *See* John Armour, Luca Enriques & Thom Wetzer, *Green Pills: Making Corporate Climate Commitments Credible*, 65 ARIZ. L. REV. 285, 314–15 (2023); Bebchuk & Tallarita, *supra* note 10, at 148–53.

114. *See* Armour, Enriques & Wetzer, *supra* note 113, at 287–88.

115. For instance, ESG scoring reflects a company's level of disclosure relative to peers. "In other words, companies that are willing to report ESG performance, and do so more thoroughly than others, tend to score higher," regardless of the company's actual environmental impact. RILEY CLUBB, YOSHI TAKAHASHI & PETE TIBURZIO, EVALUATING THE RELATIONSHIP BETWEEN ESG AND CORPORATE FIXED INCOME 15 (2016), https://mitsloan.mit.edu/sites/default/files/2018-10/Breckinridge_Capital-Report-2016.pdf [https://perma.cc/6JAW-6YES].

environmental regulations, with no tangible moves toward abandoning their fossil fuel production focus in favor of more sustainable business models.[116] For example, these companies may publish disclosures or launch costly marketing campaigns that emphasize their sustainable activities while obscuring the detrimental effects of their core business.[117]

The issue of greenwashing is well exemplified by Federal Trade Commission settlements with major retailers such as Walmart and Kohl's.[118] These companies were fined for falsely marketing products as "eco-friendly" and "sustainable" when, in reality, the items were made from rayon, a material processed with harmful chemicals, rather than the bamboo fibers that had been advertised. This case highlights the broader problem of companies engaging in misleading environmental claims to enhance their public image while failing to make genuine sustainability improvements. For universal owners, this serves as a cautionary tale—without firm-specific scrutiny, managers might introduce superficial sustainability initiatives that appease investors but fail to address the root environmental issues.

The responsibility of establishing firm-specific sustainability policies cannot be entrusted solely to management. As we explain in the next Part, universal owners attempting to impose climate discipline without appropriate understanding of individual firms and their firm-specific needs are likely to be fooled by firms that talk sustainability with no intention to walk sustainability.[119] Moreover, as we explain immediately below, agency costs might lead managers to react by making green investments under the same corporate umbrella as the legacy business.

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116. *See* Mei Li, Gregory Trencher & Jusen Asuka, *The Clean Energy Claims of BP, Chevron, ExxonMobil and Shell: A Mismatch Between Discourse, Actions and Investments*, PLOS ONE (Feb. 16, 2022), https://journals.plos.org/plosone/article?id=10.1371/journal.pone.0263596 [https://perma.cc/89Q8-NX6K].

117. *See, e.g.*, Myles McCormick, *Chevron Accused of 'Greenwashing' in Complaint Lodged with FTC*, FIN. TIMES (Mar. 16, 2021), https://www.ft.com/content/2985e18a-fdcb-4cd2-aee3-d5a0fe4cdab2 [https://perma.cc/NJK7-5QKP] ("The activists groups want the FTC—the government agency tasked with protecting consumer interests—to take action against Chevron for 'egregiously misleading consumers' by exaggerating its investments in clean energy.").

118. *See* Press Release, Fed. Trade Comm'n, FTC Uses Penalty Offense Authority to Seek Largest-Ever Civil Penalty for Bogus Bamboo Marketing from Kohl's and Walmart (Apr. 8, 2022), https://www.ftc.gov/news-events/news/press-releases/2022/04/ftc-uses-penalty-offense-authority-seek-largest-ever-civil-penalty-bogus-bamboo-marketing-kohls [https://perma.cc/QH4Q-5TZ7].

119. Mandating climate risk disclosure is unlikely to eliminate greenwashing. An effective disclosure regime will make it difficult to hide the magnitude of the company's existing carbon emissions. But it will not assist investors in assessing plans for reducing emissions, firm-specific reasons for failing to meet targets, or coping with strategies such as carbon offsets. For the problem of too optimistic net zero pledges and a proposal to address it, see Armour, Enriques & Wetzer, *supra* note 113.

2. *Agency Costs*

Managers might use their discretion in managing the corporation to promote their own interests over those of the company's true owners, the investors. The costs associated with such disloyal behavior are known as agency costs.[120] The risk of agency costs is present even when the primary objective of management is to maximize profits. However, this risk intensifies when management is expected to balance profits and climate risks (or other ESG objectives).[121] In this context, we define agency costs as those that arise when management, in response to investor pressure to achieve carbon emission targets, implements inefficient policies that impose substantial costs on shareholders while benefiting management. This is distinguished from greenwashing, where management promotes ineffective policies at little to no cost to the shareholders.

The climate transition decision presents a significant risk of agency costs. For instance, managers may be driven by self-serving considerations to expand the size of their corporations by making inefficient acquisitions.[122] A recent example that illustrates the agency cost concern is Equinor's acquisition of a 9.8% stake in Orsted, a wind energy developer, in October 2024.[123] Consequently, managers are likely to favor integrated play strategies—acquiring clean energy sources and retaining dirty assets, for example—even when a pure-play strategy is more efficient or effective in reducing emissions.[124]

Furthermore, management may be motivated to protect their profitable legacy dirty activity. Given that the clean activity will cannibalize its dirty legacy business, adopting an integrated play strategy enables management to control the growth rate of the clean activity by slowing down clean innovation. In fact, for some companies, the clean part of the business essentially competes with the legacy dirty business for funds, human

120. For an analysis of the different sources of managerial agency costs, see Zohar Goshen & Richard Squire, *Principal Costs: A New Theory for Corporate Law and Governance*, 117 COLUM. L. REV. 767 (2017).

121. *See* Bebchuk & Tallarita, *supra* note 32.

122. *See* Afra Afsharipour & J. Travis Laster, *Enhanced Scrutiny on the Buy-Side*, 53 GA. L. REV. 443 (2019).

123. *See* Nora Buli & Jacob Gronholt-Pedersen, *Equinor Buys 9.8% Stake in Offshore Wind Developer Orsted*, REUTERS (Oct. 7, 2024, 1:58 PM), https://www.reuters.com/markets/deals/equinor-buys-98-stake-orsted-2024-10-07/ [https://perma.cc/29Q4-AHR4].

124. Indeed, there is growing demand by oil and gas companies to acquire renewable energy companies. *See* Seth Kerschner, Dongho Lee & Clare Connellan, *ESG Pressures Fuel Dealmaking*, HARV. L. SCH. F. ON CORP. GOVERNANCE (Apr. 19, 2022), https://corpgov.law.harvard.edu/2022/04/19/esg-pressures-fuel-dealmaking/ [https://perma.cc/B332-362T] (reporting that "global energy players . . . are using M&A to help reach their [ESG] goals"); Floris Busscher, Nadine Janecke, Florian Kühn, Boris Reznicek, Christina Schmidhuber & Raffael Winter, *Ready, Set, Grow: Winning the M&A Race for Renewables Developers*, MCKINSEY & CO. (Dec. 9, 2022), https://www.mckinsey.com/industries/electric-power-and-natural-gas/our-insights/ready-set-grow-winning-the-m-and-a-race-for-renewables-developers [https://perma.cc/P4ES-X2NU].

resources, management attention, and clients. Managers' self-interest may lead them to disfavor the more innovative, clean business, particularly if this activity falls outside their legacy expertise (as solar and wind do for managers of oil and gas corporations).

Agency costs can also hinder efforts to reduce emissions in other ways. For instance, agency costs might lead to short-term thinking that prompts management to divert resources from more efficient long-term sustainable energy production methods to less efficient but more immediately promising methods. The most prominent fossil fuel alternatives today are wind and solar, both of which have significant drawbacks. Solar energy can only be collected during the day, and current battery technology is insufficient to make solar an efficient and affordable energy source at night. Wind energy is only collected when it is windy, and the recent prolonged period of still weather in Europe has contributed to a sharp rise in energy prices.[125]

In contrast, geothermal energy, which captures the heat energy inside the earth by drilling deep down and circulating fluid beneath the surface, does not suffer from the drawbacks of solar and wind. The earth's core heat is present regardless of the time of day or weather conditions. More importantly, advanced geothermal energy is significantly more abundant and affordable. Estimates are as low as one cent per kilowatt-hour, compared with over six cents for solar or five cents for wind.[126] Fossil fuel companies might also have a competitive advantage in the drilling innovation required to make advanced geothermal a reality. However, even if developing advanced geothermal is the most effective long-term approach to producing clean energy, management concerned about retaining their position in the face of investor pressure to cut emissions might prefer a safe, expedient way to satisfy investor demands.[127]

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125. Friderike Kuik, Jakob Feveile Adolfsen, Eliza Magdalena Lis & Aidan Meyler, *Energy Price Developments In and Out of the COVID-19 Pandemic—from Commodity Prices to Consumer Prices*, EUR. CENT. BANK (Apr. 2022), https://www.ecb.europa.eu/pub/economic-bulletin/articles/2022/html/ecb.ebart202204_01~7b32d31b29.en.html [https://perma.cc/MC6D-M5DJ]; Matthias Williams & Kate Abnett, *'Feels like Summer': Warm Winter Breaks Temperature Records in Europe*, REUTERS (Jan. 4, 2023, 2:00 PM), https://www.reuters.com/business/environment/feels-like-summer-warm-winter-breaks-temperature-records-europe-2023-01-04/ [https://perma.cc/Y6ZX-KLAL].

126. *See* Mary Davis, *Geothermal Energy Costs – Breaking Down Its True Price*, UNDERSTAND SOLAR (Sep. 7, 2017), https://understandsolar.com/geothermal-energy-costs/ [https://perma.cc/KDV5-4VAG].

127. Kewen Li, Huiyuan Bian, Changwei Liu, Danfeng Zhang & Yanan Yang, *Comparison of Geothermal with Solar and Wind Power Generation Systems*, 42 RENEWABLE & SUSTAINABLE ENERGY REVS. 1464, 1473 (2015) ("Geothermal power has been left behind wind and solar in terms of both growth rate and installed capacity. The main reasons may be high initial investment, long payback time and construction time . . . ."). These barriers to short-term profits dissuade profit-focused institutional investors from lending serious financial backing to the risky technology.

C. *Activist Hedge Funds*

Activist hedge funds specialize in initiating firm-specific changes to company strategy and taking actions, including confronting management and launching proxy fights, to change the company's direction. Such activism could help hold accountable managers incurring agency costs at the expense of investors. Profit-motivated hedge funds, like Third Point, build concentrated stakes in specific companies when they detect underperformance that they believe can be corrected within a relatively short timeframe. They are rewarded with substantial gains if they persuade the company to adopt their proposed business changes and if their thesis proves accurate. They do not hold enough votes to force their will on companies (they typically own less than 10% of the shares). Instead, they rely on support from institutional investors and, most importantly, universal owners. The question arises: Will activist hedge funds play a similar role in pushing companies to reduce carbon emissions?

Activist hedge funds do not hold a diversified portfolio. Their business model relies on their ability to increase the share value of specifically targeted firms. Thus, they will not initiate campaigns aimed at reducing emissions (or any other ESG goal) unless it results in a positive short-term impact on the *target*'s share price.[128] Recall that one explanation for universal owners' willingness to push companies to reduce emissions is the portfolio perspective that incentivizes them to push one company to act against its self-interest as long as such action will increase the value of other companies in the portfolio.[129] Activist hedge funds, in contrast, have a single-firm focus.[130]

More generally, the assumption underlying this Article—and much of the literature on investor-led ESG—is that institutional investors' interest in pushing companies to reduce emissions is driven by the desire to have companies sacrifice at least some of their profits to save the planet. It is commonly believed that a firm's actions to reduce emissions are not

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128. *See* Patrick Bolton & Marcin T. Kacperczyk, *Firm Commitments* 3 (Eur. Corp. Governance Inst., Finance Working Paper No. 990/2024, 2025), https://papers.ssrn.com/abstract=3840813 [https://perma.cc/5M74-HUYW] (finding that "protection against short-term activist actions matters to induce companies to focus more on their long-term climate impact"). Scholars disagree whether a short-term increase in share value can take place even when an activist campaign destroys value in the long term. *Compare* Goshen & Steel, *supra* note 36, at 415 n. 11 (explaining that value in the short term can exist despite decreased value in the long term), *with* Lucian A. Bebchuk, *The Myth that Insulating Boards Serves Long-Term Value*, 113 COLUM. L. REV. 1637, 1668 (2013) (arguing activist interventions benefit companies in the short and long term).

129. *See supra* Section II.B.

130. TCI Fund Management, an activist investor, was one of the leading proponents of an initiative that called on companies to adopt a "say-on-climate" vote. Note, however, that this is not a typical firm-specific activist campaign. *See* Attracta Mooney & Billy Nauman, *'Say on Climate' Campaign Faces First Big Test at Investor Meetings*, FIN. TIMES (May 18, 2021), https://www.ft.com/content/cc409667-e048-4246-808c-9cdf8e41ac77 [https://perma.cc/GK7U-QYF3].

fully priced by the market.[131] However, the business model of hedge fund activists requires that they concentrate solely on firm-specific campaigns that will improve each firm's bottom line and cause a significant and immediate effect on its share price.

Nevertheless, while they are unlikely to invest costly resources to push companies to sacrifice profits to reduce emissions, activist hedge funds may be relied upon to contain managerial agency costs, such as when self-interest drives management to pursue an inefficient path to reduce emissions. For example, an activist hedge fund may launch a campaign when management adopts an integrated play strategy although a pure-play structure is the most efficient way to reduce emissions. Indeed, if a pure-play strategy can increase share value, activist hedge funds can be expected to initiate a campaign for breaking up the company.

The belief that managers create significant inefficiencies by adopting integrated play strategies might be why activist hedge funds have launched campaigns to push companies to separate dirty from green assets. Consider, for example, the well-publicized spat at Royal Dutch Shell. This company was the first major oil company to respond positively to ESG pressures to transition its business from fossil fuels toward green energy. Some observers argue that its plans are the closest to compliance with the Paris Agreement.[132] Shell has generally structured its business as an integrated play: It uses the earnings from its fossil fuel arm to fund its green activities.[133]

The market has responded with a yawn: Shell's stock has not benefited from any premium for its reduced transition risk and ostensibly more promising green business. Third Point, an activist hedge fund led by Dan Loeb, purchased a significant stake and argued that Shell should be split into two companies: a "Green Shell," focused on developing a competitive edge in green technology, and a "Dirty Shell," aimed at paying large dividends to investors in the waning years of its legacy business.[134] Third Point clearly believes managers have adopted an inefficient strategy (with a negative effect on stock prices). Moreover, Third Point is backing its belief with a concentrated financial bet.

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131. Some argue that this is because climate risks are too long-term. *See, e.g.*, Armour, Enriques & Wetzer, *supra* note 113, at 297–99. Activists, however, rely on short term increase in share value to get their return on their investment.

132. *See* James Mackintosh, *Shell Is the Greenest Big Oil Company. Look What That Got It.*, WALL ST. J. (Oct. 31, 2021, 12:43 PM), https://www.wsj.com/articles/shell-is-the-greenest-big-oil-company-look-what-that-got-it-11635698403 [https://perma.cc/VW8L-M37J].

133. Shell did exit some of its oil assets. *See* Collin Eaton, *ConocoPhillips Bets Big on American Oil Production with $9.5 Billion Deal*, WALL ST. J. (Sept. 21, 2021, 4:21 PM), https://www.wsj.com/articles/conocophillips-bets-big-on-american-oil-production-with-9-5-billion-deal-11632248517 [https://perma.cc/ESA2-CCU7] (reporting the sale of Shell's Permian Basin's oil assets).

134. *See* Sarah McFarlane & Cara Lombardo, *Shell Argues Against Activist Investor's Call to Split*, WALL ST. J. (Oct. 28, 2021, 1:05 PM), https://www.wsj.com/articles/shell-aims-to-halve-carbon-emissions-by-2030-as-activist-calls-for-breakup-11635409750 [https://perma.cc/H9G6-9X93].

Similar concerns can explain attempts by other activist funds to challenge fossil fuel energy companies' integrated play strategies. Elliott Management tried to pressure Scottish generator and network operator SSE to spin off its renewables business into a separate entity, claiming that the move could unlock "£5bn of value."[135] London's Bluebell Capital Partners campaigned for Glencore, an Anglo-Swiss commodity trading conglomerate, to spin off its thermal coal business.[136]

If the activists urging pure-play spinoffs in heavy-emissions industries are correct (and the financial bets made by these funds suggest they might be), universal owners' pressure on companies to reduce emissions could ultimately result in large-scale agency costs. As discussed earlier, management has numerous incentives to maintain integrated structures, including expanding the size of the corporation, controlling the growth rate of the competing clean energy sector, and enveloping the entire company in the ESG mantle to comply with ESG funds' requirements. However, activist hedge funds may rightly perceive that integrated play leads to confused objectives, challenges in attracting and retaining talent, and a lower share price as the company cannot benefit from the sustainability premium. This cannot, then, be the optimal approach for managing the economy-wide transition to a net zero future.

D. *Universal Owners*

Interestingly, all activist hedge fund campaigns discussed above have failed. As we previously discussed,[137] universal owners' incentives might lead them to favor policies that do not align with maximizing the efficiency of sustainable energy innovation. Specifically, sponsors of ESG funds might be inclined to support integrated strategies, regardless of uncertainty regarding the effectiveness of such strategies in mitigating climate change. If oil and gas companies decide to adopt a pure-play strategy under which all dirty assets will be owned by separate corporate entities, ESG funds will be forced to divest from the companies that own the dirty assets (and give up on their potential higher returns). However, this might undermine funds' twin commitments: sustainability and competitive returns. An integrated strategy, in contrast, allows ESG funds to continue ownership of large polluters while complying with their ESG mandate.

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135. *See* Andrew Dykes, *Breaking Up Is Hard to Do: Energy Majors and Activist Investors*, ENERGY VOICE (Dec. 28, 2021, 2:00 PM), https://www.energyvoice.com/renewables-energy-transition/376077/breaking-up-is-hard-to-do-energy-majors-and-activist-investors/ [https://perma.cc/DB88-FM6P]; *SSE Rejects Activist Investor Elliott's Call to Break Up*, IRISH TIMES (Nov. 17, 2021, 8:07 AM), https://www.irishtimes.com/business/energy-and-resources/sse-rejects-activist-investor-elliott-s-call-to-break-up-1.4731124 [https://perma.cc/R48P-9PYN].

136. *See* Tom Wilson, *Oil Majors Under Pressure as Activist Investors Circle*, FIN. POST (Dec. 23, 2021), https://financialpost.com/commodities/energy/oil-gas/oil-majors-under-pressure-as-activist-investors-circle [https://perma.cc/6VCA-MMTR].

137. *See supra* Section II.A.

In other words, universal owners are incentivized to defend corporate policies that "purify" legacy energy companies and render them ESG compatible, even if they end up not serving the best interests of shareholders and the environment.[138] Universal owners might be willing to acquiesce to firms' questionable environmental plans so they can include as many successful firms in their funds as possible to closely replicate the returns of the index.

One might suggest an alternative, benign explanation for universal owners' support for management: that the strategies advocated by hedge funds are perhaps good for share price but not for the environment. The argument being that while selling dirty assets might enable the *selling company* to *reduce* its emissions, the *buyer* of these assets might *increase* emissions.[139] For instance, if ExxonMobil were to sell oil reserves, the buyer might be a private corporation or a foreign sovereign fund unconcerned with emissions and not subject to the discipline of universal owners. Thus, the argument goes, it is better to allow ExxonMobil to keep the reserves and remain under universal owners' influence.

This argument is coherent but largely irrelevant. Hedge fund activists had often asked oil and gas companies to separate the clean from the dirty energy division by making them two independent public corporations. At the end of the process, there would be two public corporations: one that owned polluting energy and another that owned clean energy. While ESG funds could only hold the clean energy corporation, universal owners' regular index funds could hold both, and thus could continue to exert influence on the dirty energy corporation. In short, this explanation does not justify universal owners' suboptimal choices between pure-play and integrated strategies.

To be sure, as we explained earlier, there is no clear consensus on which strategy—integrated or pure-play—is generally superior. And strategies that work for one company may not be suitable for others. Yet, we find it odd that universal owners have thus far not supported any activist campaigns to adopt a pure-play strategy. Recall that activists make significant financial bets and launch campaigns only if they expect them to increase corporate performance. The universal hesitation to back these more decisive approaches raises significant doubts about the incentives of universal owners. While *voice* (engagement) and *exit* (divestment) offer universal owners the tools to address greenwashing and agency costs, these methods are often underutilized due to the tension between ESG goals and financial performance.

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138. For simplicity, we treat universal owners as having the same incentive structure across all funds within the same fund complex. In some cases, however, different funds within the same fund family might have different considerations shaping their voting. *See supra* note 27.

139. *See supra* notes 111–112.

IV. FIRM-SPECIFIC SOLUTIONS AND COORDINATION

In this Part, we assume that universal owners have the incentives to address the systemic risks associated with carbon emissions. However, as explained in Part II, universal owners' business model and regulatory environment prevent them from undertaking firm-specific campaigns to maximize profits or reduce emissions. Against this background, we contend that systematic carbon stewardship is unlikely to be effective. Although climate change is a systematic risk, it cannot be addressed only by systematic measures. Universal owners also lack the competence to "systematically steward" the entire economy towards net zero. In this vein, section A argues that effectively limiting carbon emissions is an intense industry- and firm-specific process that cannot be carried out through across-the-board measures. Section B demonstrates that effectively transitioning to net zero also requires significant coordination across the economy to increase the supply of sustainable energy and wind down the use of dirty energy. Universal owners have neither the skill nor the reach necessary to coordinate the transition to net zero.

A. *Systematic Risks, Firm-Specific Solutions*

What is the most effective way for each firm to reduce emissions? How should the firm balance profits and carbon risks? Once a path is chosen for each firm, how should it be monitored to ensure that management works according to plan? Although the risks of climate change are indeed systematic, the solutions are highly idiosyncratic and context dependent. Pushing firms to reduce carbon emissions is an immense firm-specific task. Whether we care about share value, the most effective way to reduce emissions, or the best way to balance profits and emissions, the optimal path for each firm must be suited to its competitive environment and business strategy.

To demonstrate the likely failure of uniform policies, this Article examines three central systematic measures currently endorsed by commentators and some universal owners: emission targets, climate risk disclosure, and tying executive compensation to meeting emission targets.

1. *Setting Targets*

At first glance, the best systematic strategy is setting targets for firms. For example, universal owners could pressure all portfolio companies to reduce emissions to an extent that makes a 1.5° future possible—say, a reduction of 10% per year. Facially, this seems like a promising policy. Universal owners can use their scarce voting research resources to find an accurate answer to one question: how fast do public companies need to reduce emissions to limit warming to 1.5°? The tough decisions on implementation are left to management, who have greater expertise in their businesses.

As we discussed in the last Part, affording management discretion on how to meet emission targets may result in agency costs

and greenwashing.[140] However, even if management were to comply, implementing a single emissions-reduction policy across diverse companies—without the ability to assess each company's strategy for complying with its target or the impact of emission reductions in each industry and for each company—sets the stage for an ineffective policy. To demonstrate the potential second- and third-order negative consequences of a uniform emissions reduction policy that can overshadow the initial positive effects, we will explore the likely outcomes in two industries.

Fossil Fuels. The most obvious way for fossil fuel companies to reduce their emissions would be to cut back on fossil fuel production and exploration. Limiting production would constrain the oil supply, leading to increased prices. Some might argue that this is the desired outcome because higher prices discourage consumption.[141] However, given that sustainable energy generation and storage technology are currently inadequate to meet global energy needs, this strategy could ultimately prove counterproductive.

First, the rise in prices would make oil production more profitable. Private entities, such as private equity firms or closely held corporations, are not subject to universal owners' demands.[142] They would quickly seize the opportunity to either purchase oil reserves from existing public firms or establish their own exploration and production ventures, capitalizing on the potential for higher returns.[143]

Second, and relatedly, increased prices would ensure that more capital-intensive fuel production methods like fracking or tar sands remain profitable. These methods are also more environmentally harmful. Research shows that natural gas obtained through fracking "yield[s] 20% more global warming per unit than coal."[144] And tar sand extraction is also considerably more deleterious to the environment than traditional production, emitting between five and fifteen percent more GHG and threatening the world's largest boreal forest and the habitat of dozens of endangered species. Ultimately, limiting supply causes higher prices, which leads to higher net GHG emissions.

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140. *See* Albert C. Lin, *Making Net Zero Matter*, 79 WASH. & LEE L. REV. 679, 698–702 (2022) (discussing difficulties associated with companies' net zero pledges).

141. *See, e.g.*, Peter Erickson, *Oil Companies Say Reducing Their Production Won't Reduce CO2 Emissions. Here's the Reality.*, STOCKHOLM ENV'T INST. (May 26, 2021), https://www.sei.org/perspectives/oil-companies-reducing-production-co2-emissions/ [https://perma.cc/F6NJ-Z4TJ].

142. *See* Kahan & Rock, *supra* note 7; Tallarita, *supra* note 84.

143. There is evidence that hedge funds, for example, buy energy stock sold by large asset managers. *See* Laurence Fletcher & Derek Brower, *Hedge Funds Cash in as Green Investors Dump Energy Stocks*, FIN. TIMES (Oct. 7, 2021), https://www.ft.com/content/ed11c971-be02-47dc-875b-90762b35080e [https://perma.cc/FHC3-LLRT]. These private actors have few regulatory disclosure obligations relative to public companies, so their activities will be less transparent and likely entail more GHG emissions per barrel of oil.

144. *Study Shows Natural Gas Fracking More Harmful than Coal*, THE CLIMATE CTR. (Apr. 14, 2011), https://theclimatecenter.org/energy-efficiency/study-shows-natural-gas-fracking-more-harmful-than-coal/ [https://perma.cc/JW9T-EUNQ].

Third, higher prices will also prompt increased domestic political pressure and backlash. Energy price inflation disproportionately impacts low-income individuals. People who have difficulty coping with rising energy prices due to climate change activism by universal owners are likely to support politicians who will target institutional influence on the oil industry.[145] Prematurely raising energy prices without the necessary coordination on sustainable energy infrastructure and innovation will engender a backlash that impedes a successful transition to net zero.

Transportation. Any reduction in emissions in the transportation industries could have economy-wide second-order effects that might overshadow the emissions reduction. Consider an airline attempting to comply with emissions reduction requirements. Given the limitations of current battery technology, aircraft large enough to replace commercial aircraft are likely at least a decade away.[146] Thus, any significant reduction in emissions would require drastically reducing the frequency of flights.

Limiting the supply of flights would drive up the price of flying. This would undoubtedly impact consumers' travel decisions: less affluent travelers may no longer be able to afford short-range flights and would be forced to drive instead. Thousands of people driving their ICE vehicles down the East Coast to Miami each winter would emit more GHG than their flights would. Limited flights would also increase the cost of air freight, which would then be shipped on ICE trucks, again resulting in higher net emissions.

In short, corporate reductions in GHG emissions made to comply with a uniform mandate would affect the economy in complex ways, likely increasing emissions elsewhere as consumers scrambled to adapt to output limitations by seeking out substitute forms of transportation. These negative secondary and tertiary effects might outweigh the positive effects of the original emissions reduction policy. The solution is to have firm-specific knowledge and create a tailored emissions reduction plan that considers the intricacies of the industry and the firm's position within it, the state of sustainable replacements for the firm's energy usage, and how the emissions from consumer reactions to GHG reduction will compare to current emissions. As we have explained, universal owners cannot be expected to conduct research at this level of granularity.

2. *Disclosure*

The next uniform measure that many universal owners have supported is requiring public companies to disclose their emissions and the risks and opportunities that climate change poses to its business.

145. For discussion of the link between the potential impact on energy prices and the backlash against climate stewardship by asset managers, see Zohar Goshen, Assaf Hamdani & Alex Raskolnikov, *Poor ESG: Regressive Effects of Climate Stewardship*, 51 BYU L. REV. (forthcoming 2026).

146. *See* Jennifer Korn, *Alice, the First All-Electric Passenger Airplane, Prepares to Fly*, CNN BUSINESS (Jan. 31, 2022, 10:14 PM), https://www.cnn.com/2022/01/31/tech/alice-eviation-test-flight/index.html [https://perma.cc/MMP4-3QFN].

Climate-related disclosure, the argument goes, will enable (active) investors to incorporate these risks and opportunities into their capital allocation strategies. Investors could better price climate risks, and green investors, for example, could make better decisions about avoiding companies that refuse to cut emissions. The underlying logic is that incorporating climate-related risks into equity would create incentives for management to reduce these risks.

Unfortunately, investor-driven climate disclosure is unlikely to work effectively. Current "sustainability disclosures" made by corporations tend to be more an exercise in puffery and image management than one of sober evaluation of financial risks.[147] It is also unclear what corporations should disclose, and what metrics they should use. There are over 600 sustainability disclosure standards on offer from different organizations.[148] Five prominent Non-Governmental Organizations (NGOs) each have their own standards: the CDP, CDSB, GRI, IIRC, and SASB. Each of these standards measures different variables in different ways, making it impossible for investors to compare climate risks and opportunities from one company to another.[149]

A solution to the standardization and enforcement problems is having the SEC promulgate mandatory disclosure standards and use its enforcement powers to ensure compliance. Indeed, in 2024 the SEC adopted a new climate risk disclosure rule (and then voluntarily stayed it pending a legal challenge).[150] However, setting aside the debate over the SEC's authority to promulgate these disclosure requirements and its willingness to do so under President Trump, significant issues would remain.[151]

By itself, disclosure about emissions and climate is unlikely to push firms to reduce emissions to the socially optimal level. And it does not address the fundamental incentive problems faced by universal owners: they are constrained by the conflicting imperative of "doing well while doing good," leading them to prioritize policies that offer only the appearance of sustainability. Consequently, these investors may continue to support strategies that comply superficially with disclosure

147. *See* Eitan Arom, Note, *Hidden Value Injury*, 121 COLUM. L. REV 937 (2021); *see also* Virginia Harper Ho, *Nonfinancial Risk Disclosure and the Costs of Private Ordering*, 55 AM. BUS. L.J. 407 (2018) (discussing the difficulties associated with the private ordering approach to sustainability disclosure); Jill E. Fisch, *Making Sustainability Disclosure Sustainable*, 107 GEO. L.J. 923 (2019).

148. *See* Elizabeth Meager, *A Guide to Sustainable Reporting Standards*, CAPITAL MONITOR (Apr. 12, 2021), https://capitalmonitor.ai/institution/a-guide-to-sustainable-reporting-standards/ [https://perma.cc/8B7A-SN94]; Javier El-Hage, *Fixing ESG: Are Mandatory ESG Disclosures the Solution to Misleading ESG Ratings?*, 26 FORDHAM J. CORP. & FIN. L. 359, 365–68 (2021).

149. *See* Meager, *supra* note 148.

150. *See supra* note 13.

151. *See, e.g.*, Bernard S. Sharfman, *The Ascertainable Standards that Define the Boundaries of the SEC's Rulemaking Authority*, 3 U. CHI. BUS. L. REV. 193 (2023) (arguing that the SEC has exceeded its authority in in promulgating its proposed rule on climate-related disclosures).

requirements without compelling firms to undertake meaningful decarbonization efforts.

Disclosure might serve two groups of investors. The first group is primarily concerned with profits and, accordingly, accurate pricing of climate risks. Some believe that because climate risks are expected to materialize far into the future, their present expected value is likely to be low. Under this view, disclosure would not have a sufficiently meaningful effect on stock prices to affect management behavior.

Our focus in this Article, however, is on the second group of investors: those who would arguably rely on better disclosure to pressure firms to reduce emissions even if doing so reduces profits. These investors rely on climate risk disclosure to shape firms' behavior using two strategies: exit (divestment) and voice (engagement).

The divestment strategy aims to create negative pressure on stock price by *selling* shares, overriding the true discounted value of the actual disclosed climate risk. By driving the price of green companies up and that of brown companies down through supply and demand of investment capital, investors hope to encourage managers to change their behavior to obtain lower cost of capital. However, research has shown that divesting from polluters into green companies might fall short of inducing firms to reduce emissions. To begin, reducing the cost of capital for green companies might not lead them to further reduce emissions.[152] When climate-concerned investors sell shares of properly priced brown firms, it makes these firms' shares cheaper and thus more attractive for investors that care only about financial returns.[153] This problem, in turn, further exacerbates fund managers' difficulty in pursuing their conflicting goals of sustainability and competitive returns, as we discussed earlier.

Indeed, recent empirical analyses suggest that channeling capital to green companies through ESG-focused funds does not meaningfully affect corporate behavior.[154] The correlation between ESG fund holdings and more socially responsible corporate behavior is attributable to selection effects rather than changes induced by socially conscious investing.

The second strategy that disclosure could facilitate is "voice," which refers to engagement by universal owners or other investors. Ideally,

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152. *See* Samuel M. Hartzmark & Kelly Shue, Counterproductive Sustainable Investing: The Impact Elasticity of Brown and Green Firms (Oct. 2024) (unpublished manuscript) (https://papers.ssrn.com/abstract=4359282 [https://perma.cc/3DUK-FBCN]).

153. *See* Broccardo, Hart & Zingales, *supra* note 102, at 3119–23.

154. *See* Davidson Heath, Daniele Macciocchi, Roni Michaely & Matthew C. Ringgenberg, *Does Socially Responsible Investing Change Firm Behavior?* (Eur. Corp. Governance Inst., Working Paper No. 762/2021, 2023), https://papers.ssrn.com/sol3/papers.cfm?abstract_id=3837706 [https://perma.cc/SMN4-E24R]; Jonathan B. Berk & Jules H. van Binsbergen, *The Impact of Impact Investing* (Stan. Univ. Graduate Sch. of Bus., Research Paper No. 3981, 2021), https://papers.ssrn.com/sol3/Delivery.cfm/SSRN_ID4132764_code38880.pdf?abstractid=3909166&mirid=1 [https://perma.cc/WW6D-LQPS].

an effective regime of climate-risk disclosure would be used by investors to target companies and managers with unsatisfactory decarbonization strategies. In other words, firm-level climate disclosure would facilitate firm-specific stewardship by universal owners. Universal owners, however, lack incentives to engage in firm-specific campaigns. Unfortunately, as we explain in the next Part, there are no other actors with the necessary incentives and competence to initiate firm-specific engagement on decarbonization.

3. *Compensation*

The structure of executive compensation is another measure available to universal owners to incentivize management to prioritize environmental goals. Universal owners can require firms to tie executive pay to environmental metrics.

However, this measure, by itself, is unlikely to be effective.[155] For this measure to work, compensation metrics should match the emission goals that firms aspire to achieve. The risk is that management will find ways to set self-serving performance goals and manipulate the metrics to increase their pay.[156] Making climate-based compensation work requires considerable firm-specific knowledge for both setting performance goals (emission targets) and ensuring that management does not manipulate the metrics set for measuring progress. Without effective firm-specific knowledge, climate-based compensation might lead to higher-paid management teams, but very little in the way of actual emissions reduction progress.

B. *Coordination*

Apart from the mismatch between universal owners' thinly spread resources and the firm-specific effort required to steward the entire market's transition to net zero, a universal owner-led emissions reduction program is fundamentally lacking in another crucial respect that is not the outcome of fund managers' incentives. Universal owners are missing the ability to coordinate. Scholars have already identified the problem of coordinating firm-specific actions among universal owners. However, a larger issue not yet addressed in the literature is the inability of universal owners to coordinate across the entire economy. We start with the inability to coordinate firm-specific actions.

Coordination Over Firm-Specific Actions. Crafting an effective policy to reduce emissions requires coordination among large institutional investors owning the shares of a polluting corporation. As Marcel Kahan, Edward Rock, and Roberto Tallarita have shown, universal owners use hundreds of different indices as benchmarks, many of which focus on

155. *See* Bebchuk & Tallarita, *supra* note 32.

156. With conventional performance metrics, managers have been known to accelerate revenue recognition or postpone discretionary expenses to maximize earnings per share metrics.

companies in particular industries or characteristics.[157] Therefore, while universal owners may agree on systemic measures to reduce emissions risks, their differing and sometimes conflicting interests may hinder consistent coordination on decarbonization plans for specific firms. Furthermore, fiduciary duties and self-interest may motivate each asset manager (or fund manager within a single fund family) to favor different policies based on their holdings in a given industry or firm.

Finally, regulatory constraints and current antitrust law may impede coordination efforts among universal owners that relate to firm-level decisions, inviting regulatory scrutiny and making such coordination difficult or even illegal.[158] Any solution relying solely on universal owners would thus lack the crucial element of reliable coordination around firm-specific measures.[159]

Coordination Across the Economy. Managing an effective transition from fossil fuel to sustainable energy requires coordination across the economy. Coordination is essential when it comes to financing the gradual transition from polluting to greener energy sources. From an emissions standpoint, we know that oil is preferable to coal; natural gas and nuclear energy are superior to oil; and sustainable technologies like solar and wind outperform gas and nuclear. As a result, it is more urgent to support energy producers transitioning from coal to natural gas than, for instance, a shift from nuclear to solar. However, orchestrating this transition is bound to fail when, due to pressure from universal owners, banks compete to fund the cleanest projects and shy away from financing initiatives that are not entirely sustainable.

Second, coordination between regulation and innovation is essential. As previously mentioned, imposing excessively burdensome regulations on fossil fuels before sustainable alternatives are sufficiently available is likely to backfire. Instead, regulators must remain aware of advances in sustainable energy for specific applications and gradually phase out polluting energy sources in proportion to the availability of sustainable

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157. *See* Kahan & Rock, *supra* note 7; Tallarita, *supra* note 84.

158. *See* Rochelle Toplensky, *Antitrust Threats Cloud Business Cooperation on Climate Action*, WALL ST. J. (Jan. 4, 2023, 1:30 PM), https://www.wsj.com/articles/antitrust-threats-cloud-business-cooperation-on-climate-action-11672857017 [https://perma.cc/3M3N-MAJE].

159. The Chair of the FTC stressed that there is no exception to antitrust laws for ESG. *See* Lina Khan, *ESG Won't Stop the FTC*, WALL ST. J. (Dec. 21, 2022, 5:10 PM), https://www.wsj.com/articles/esg-wont-stop-the-ftc-competition-merger-lina-khan-social-economic-promises-court-11671637135 [https://perma.cc/PLS3-9GMR] ("The antitrust laws don't permit [the FTC] to turn a blind eye to an illegal deal just because the parties commit to some unrelated social benefit."). Interestingly, the European Union recently took a step in this direction and adopted a more lenient approach to "sustainability agreements" between competitors. *See* Kenza Bryan, *EU Relaxes Antitrust Guidelines on Green Initiatives*, FIN. TIMES (June 2, 2023), https://www.ft.com/content/97fbacfa-cc95-47ac-874e-75cb79ec6c7d [https://perma.cc/KLF7-DBRC]. For a review on the motivation for this change, see Jurgita Malinauskaite, *Competition Law and Sustainability: EU and National Perspectives*, 13 J. EUR. COMPETITION L. & PRAC. 336 (2022).

alternatives. This approach ensures a smooth transition without causing unintended disruptions to the economy or energy supply. Importantly, the phasing out of fossil energy should apply to all types of actors, whether publicly traded or privately owned, in order to prevent a shift from public polluters to private polluters. By ensuring that all actors are held accountable and subject to the same regulations, an efficient and comprehensive transition towards sustainable energy can be achieved.

The coordination required for the economy-wide transition does not involve the systematic coordination of overarching governance policies, an area where universal owners might excel. Instead, it demands highly specific, idiosyncratic coordination on an industry-by-industry and perhaps even firm-by-firm basis. Unfortunately, universal owners lack the necessary expertise and incentives to engage effectively in this form of coordination.

V. NEW CHAMPIONS?

Given their business model and regulatory constraints, universal owners will not initiate firm-specific policies for effectively reducing emissions.[160] At best, they can push firms to adopt uniform climate policies. However, managers' agency costs and differences across firms in optimal decarbonization strategies make uniform, market-wide solutions insufficient for effectively cutting emissions.

We have shown earlier that profit-driven hedge funds will not supply the monitoring required to make companies adopt the best strategy for reducing emissions. In this Part, we argue that, unfortunately, no other actor can provide the firm-specific guidance that is crucial for reducing carbon emissions. Specifically, we show that climate-driven activist funds, ESG directors, and investor coalitions lack the necessary competence and incentives to fill the role traditionally played by activist hedge funds. Ultimately, the only actor well positioned to fulfill this role is the predictable choice: environmental regulators.

A. *Climate Activists*

The successful campaign led by the Engine No.1 fund against ExxonMobil has led many commentators to believe that a new type of activism has emerged.[161] Motivated primarily by concerns about climate rather

160. Indeed, they are even reluctant to support shareholder proposals that are too prescriptive when it comes to steps that a firm should take to reduce emissions. *See, e.g.*, Boss & Edkins, *supra* note 45 (noting that BlackRock is not likely to support shareholder proposals that are "intended to micromanage companies. This includes those that are unduly prescriptive and constraining on the decision-making of the board or management, [or] call for changes to a company's strategy or business model").

161. *See, e.g.*, Michal Barzuza, Quinn Curtis & David H. Webber, *The Millennial Corporation: Strong Stakeholders, Weak Managers*, 28 STAN. J.L. BUS. & FIN. 255, 289–92 (2023).

than financial gain, these climate-driven activists are expected to borrow from the profit-driven activists' playbook to compel companies to reduce emissions, even when doing so might sacrifice profits.

We find it highly unlikely that climate-driven activists will emerge to fill this role. To begin, these funds will need to obtain the resources needed for firm-specific research and launching costly campaigns. Unlike profit-driven funds, however, climate activists cannot rely on an increase in stock price as a reward for their costly efforts. Consequently, they would need to rely on donors or investors willing to provide financial support for the cause without expecting the traditional returns associated with profit-driven investments.[162] This funding model will present challenges in attracting sufficient resources. In the absence of adequate funding for devising firm-specific strategies for effectively reducing emissions, climate activists risk resorting to one-size-fits-all proposals, which may not yield the desired results.

Second, climate activists' strong commitment to environmental causes may lead them to advocate for policies that expressly require firms to sacrifice shareholder value to reduce emissions. Even universal owners and other institutional investors who claim to care about both climate *and* profits would hesitate to support these policies, especially if climate activists lack firm-specific knowledge. Furthermore, if activist-backed candidates succeed in getting appointed to the board, implementing such policies would put these directors in conflict with prevailing corporate law rules. This situation would create additional legal challenges for both the directors and the activist funds that appointed them in their efforts to achieve meaningful change.

Indeed, several years after the celebrated appointment of three directors to the board of ExxonMobil by Engine No. 1, it remains unclear what significant changes to strategy these directors have initiated to facilitate ExxonMobil's decarbonization plans.[163] This highlights the challenges and limitations faced by climate activists in achieving substantial progress within the complex landscape of corporate governance and emissions reduction.

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162. For instance, in September 2022, Bloomberg launched an $85 million campaign against the petrochemical industry. *See* Valerie Volcovici, *Bloomberg to Spend $85 Million Against U.S. Plastic, Petrochem Buildout*, REUTERS (Sept. 21, 2022, 3:04 PM), https://www.reuters.com/world/us/bloomberg-spend-85-million-against-us-plastic-petrochem-buildout-2022-09-21/ [https://perma.cc/9LF2-JH9Z].

163. *See* Justin Jacobs, *What Is Really Driving ExxonMobil's Clean Energy Commitments?*, FIN. TIMES (May 8, 2023), https://www.ft.com/content/b79a9804-4f28-4945-a4bd-1144eb729e78 [https://perma.cc/CRP7-WFZM] (noting that one of the backers of Engine No. 1's campaign stated that is unclear whether the company's strategy "is just an exercise in messaging and PR or whether there's real commitment to a new strategy"). Indeed, Engine No. 1 recently teamed up with Chevron to build fossil fuel plants. *See* Jamie Smyth, *Exxon Foe Engine No. 1 to Build Fossil Fuel Plants with Chevron*, FIN. TIMES (Jan. 28, 2025), https://www.ft.com/content/ac6fb239-b957-4408-a66c-33c917836e04 [https://perma.cc/4M3K-RGHS].

B. *ESG Directors*

Other candidates for spearheading firm-specific initiatives to reduce emissions are ESG *Directors*. In theory, universal owners and other institutional investors can use their voting power to nominate directors with industry expertise and a commitment to climate to the board. Under this view, all the universal owners need to do is vet candidates for director positions, which presumably would be less resource-intensive than determining the optimal emissions reduction policy for each company. By appointing knowledgeable and dedicated ESG directors, these investors would hope to drive meaningful change in emissions reduction strategies within individual firms while maintaining a focus on both environmental goals and shareholder value.

Certainly, institutional investors can use their voting power to push companies to include climate experts on their boards. However, expertise alone is not enough. What we envision is directors who will act like those appointed by activist hedge funds—using their seat on the board and their access to non-public information to drive change. Unfortunately, several factors prevent ESG directors from performing the same function as directors appointed by hedge fund activists.

Activist directors do not operate in a vacuum. Rather, they rely on continuous interaction with the hedge fund that nominated them. It is the hedge fund that nominates directors and runs a proxy contest if necessary. After their appointment, activist directors continuously rely on the fund's resources and expertise to collect information and analyze it independently of management.[164] To utilize the fund's resources, activist directors share with it the nonpublic information they receive from the company. This information sharing allows the fund to refine its firm-specific vision for the company. It also significantly improves its ability to monitor the directors it appointed to the board (to the extent that they are not employees of the fund). This symbiotic relationship between activist directors and the nominating hedge fund is crucial for driving change and ensuring effective oversight of the company's strategic direction.

Understanding the nature of the interaction between activist directors and activist funds highlights the difficulties of any attempt to replicate activist directors by universal owners and ESG directors. Regulatory constraints and other reasons discourage universal owners from nominating directors (and from coordinating on identifying the candidates to be nominated).[165] Even if ESG directors are appointed, regulatory constraints and lack of incentives would discourage institutional investors from investing in the infrastructure to support these directors.[166] This would hinder the ESG directors' ability to access the same level of

164. *See* Kastiel & Nili, *supra* note 40; Hamdani & Hannes, *supra* note 41.

165. *See* Morley, *supra* note 44.

166. *See* Ronald J. Gilson & Jeffrey N. Gordon, *Board 3.0: An Introduction*, 74 BUS. LAW. 351 (2019); Hamdani & Hannes, *supra* note 41.

resources and expertise that activist directors enjoy and impede their ability to influence company strategy effectively.

In the early 1990s, when institutional investors started to become more powerful, Ronald Gilson and Reinier Kraakman envisioned a regime in which institutional investors would use their clout to appoint professional outside directors to company boards, thereby significantly improving the market for directors.[167] These directors, so their argument goes, would develop a reputation for leading change at companies and would therefore be appointed by fund sponsors whenever the need arises. Their vision, however, has only been partially realized. The rise of institutional investors' influence has led to activist directors' appointments to public company boards. These directors, however, have been nominated by activist hedge funds, and not by mutual funds and other institutional investors. For the reasons discussed above, universal owners still will not appoint ESG directors.

ESG directors would face other challenges. Directors driven only by climate concerns might advocate for policies that sacrifice their firms' value to protect the planet, thereby raising legal questions about the nature of their fiduciary duties.[168] Moreover, their ability to influence corporate strategy would be limited so long as a majority of board members continue to prioritize profits over environment goals. In contrast, "professional" directors might become subject to agency costs. Because they are appointed to "solve" the emission problem, they would push for non-optimal strategies such as integrated play.

C. *Investor Coalitions*

Investor coalitions may have the resources and perhaps the incentives to craft firm-specific climate policies. Climate Action 100+, for example, is a global investor initiative launched in 2017 that brings together more than 600 institutional investors.[169] It describes its aim as ensuring that "the world's largest corporate greenhouse gas emitters take appropriate action on climate change."[170] Climate Action 100+ uses different engagement strategies to encourage portfolio companies to adopt climate policies like reducing greenhouse gas emissions, terminating efforts to influence greenhouse gas regulations, and disclosing climate-related risks.[171] It has had some notable successes: it has facilitated votes on

167. *See* Ronald J. Gilson & Reinier Kraakman, *Reinventing the Outside Director: An Agenda for Institutional Investors*, 43 STAN. L. REV. 863 (1991).

168. *See, e.g.*, Cynthia A. Williams, *Fiduciary Duties and Corporate Climate Responsibility*, 74 VAND. L. REV. 1875 (2021).

169. *See About Climate Action 100+*, CLIMATE ACTION 100+, https://www.climateaction100.org/about/ [https://perma.cc/S998-67QT] (last visited May 26, 2025). For an analysis of investor climate coalitions, see Miazad, *supra* note 43.

170. *About Climate Action 100+*, *supra* note 169.

171. Miazad, *supra* note 43. Another framework for cooperation is the Collaboration Platform provided by the Principles for Responsible Investment (PRI). *See* Elroy Dimson, Oğuzhan Karakaş & Xi Li, *Coordinated Engagements* (Eur. Corp.

climate-related shareholder proposals at over 100 multinational companies, including oil producers such as British Petroleum, Royal Dutch Shell, and ConocoPhillips, as well as other multinational corporations such as food conglomerate Nestlé and shipping giant Maersk.

Climate Action 100+ states that its principal demands from companies are to establish ambitious targets for reducing emissions, enhance their climate-related disclosure, and strengthen their climate governance.[172] But while investor coalitions are a promising vehicle for advocating systemic measures, these measures are unlikely to be effective in reducing emissions. Most important, investor coalitions cannot initiate and campaign for firm-specific climate measures.

Investor coalitions could pool the resources needed for crafting firm-specific policies, but they cannot overcome the regulatory barriers to climate activism by their members. Assume that Climate Action 100+ comes up with a well-researched proposal requiring a specific firm to follow a certain course of action. Such a plan, however, would have to be backed by the threat of a proxy fight to appoint directors to the board. After all, shareholders cannot simply instruct boards how to act, and many institutional investors have a policy against supporting proposals that dictate to the board what to do.

Climate Action 100+ would need to rely on one of its members to nominate directors.[173] As we explained earlier, however, regulatory constraints essentially prevent institutional investors from nominating directors. Moreover, institutional investors' fiduciary duties prevent them from blindly supporting Climate Action 100+ proposals (even if they provide it with funding). Universal owners would need to invest their own resources to evaluate the proposal initiated by Climate Action 100+ and assess it against the vision offered by management.

Finally, joining a coordinated vote over firm-specific policies (especially if they reduce the supply of fossil energy and thus affect prices) might pose a risk of an antitrust violation. In November 2024, a group of state attorneys general filed a lawsuit in a federal court alleging that the universal owners BlackRock, State Street and Vanguard violated antitrust laws through climate activism that increased energy prices.[174]

Governance Inst., Finance Working Paper No. 721/2021, 2025), http://ssrn.com/abstract_id=3209072 [https://perma.cc/58BN-WSTC] (studying the structure of collaborative engagements that relied on this platform).

172. *The Three Goals*, CLIMATE ACTION 100+, https://www.climateaction100.org/the-three-goals/ [https://perma.cc/RC5X-6NF6] (last visited May 26, 2025).

173. *See* CLIMATE ACTION 100+ NET ZERO COMPANY BENCHMARK 2.1: 2024 RESULTS (2024) [hereinafter CLIMATE ACTION 100+: 2024 RESULTS], https://www.climateaction100.org/wp-content/uploads/2024/10/2024_10_14-October-Final-Summary-Report-Slides.pdf [https://perma.cc/Y98H-DKU6] ("Climate Action 100+ and its investor networks do not act or speak on behalf of each other or Climate Action 100+ Signatories.").

174. *See* Jonathan Stempel & Carolina Mandl, *BlackRock, Vanguard, State Street Sued by Republican States over Climate Push*, REUTERS (Nov. 29, 2024, 9:49 AM), https://www.reuters.com/legal/blackrock-state-street-vanguard-sued-by-republican-states-over-climate-accords-2024-11-27/ [https://perma.cc/V9JK-DRCU].

The lawsuit criticized the defendants' membership in investors' climate coalitions, including Climate Action 100+.[175] These issues explain why Climate Action 100+ proposes only systemic solutions and why it expressly states that it does not make vote recommendations.[176]

VI. LESSONS AND IMPLICATIONS

We have argued that universal owners lack the required incentives and competence to effectively reduce carbon emissions. In this Part, we consider several implications for both climate stewardship and ESG more generally. In section A, we argue that universal owners' distorted incentives should concern even those who believe that climate stewardship, albeit imperfect, is necessary given the government's failure to act. We also explain why subjecting ESG funds to extensive disclosure would not eliminate the distortions arising from their contradictory commitments. Section B considers implications for the ESG movement more generally and reconsiders the role that universal owners should play.

A. *Climate Stewardship*

This Article has identified two related shortcomings that significantly call into question universal owners' effectiveness in driving companies to reduce emissions. First, universal owners' need to produce competitive returns while satisfying their green commitments, which might push polluters to invest in renewable energies even when both the planet and investors would benefit from pure-play strategies. Second, while climate risks cannot be mitigated solely through systematic stewardship measures, universal owners will not engage in firm-specific climate stewardship.

Government Inaction and Imperfect Solutions. One could respond to our analysis by conceding that climate stewardship is indeed inferior to environmental regulation. Yet, in the face of government inaction on climate,[177] universal owners will arguably at least have some positive effect, albeit imperfect, on carbon emissions.

This approach would be convincing if systematic stewardship by universal owners reduced emissions without otherwise undermining the effort to produce a rigorous regime of environmental regulation. In other words, this argument assumes that the likelihood of government action to reduce emissions is independent of climate action by universal owners and their portfolio companies. Yet, lofty and well publicized statements by fund managers and public companies about their commitment to decarbonization

175. *See id.*

176. *See* CLIMATE ACTION 100+: 2024 RESULTS, *supra* note 173 (stating that Climate Action 100+ neither facilitates nor requires collective investment decisions and does not recommend divestment, voting, or other investor actions).

177. *See* Max Bearak, *Trump Orders a U.S. Exit from the World's Main Climate Pact*, N.Y. TIMES (Jan. 29, 2025), https://www.nytimes.com/2025/01/20/climate/trump-paris-agreement-climate.html [https://perma.cc/5UCX-54Z6] (reporting Trump's executive order to withdraw from the Paris Agreement).

and their impressive progress in meeting their emission goals might reduce the public pressure on governments to act on climate.[178] This concern is bolstered by the fact that, as we have shown, both managers and universal owners share an interest in overstating their effect on emissions.

The second concern focuses on the negative consequences of misallocating capital to clean energy. Specifically, the reliance on universal owners and their climate stewardship of public companies may *undermine* the effort to overcome the immense global challenge of funding the transition to a carbon free economy. Achieving decarbonization on a large scale requires massive investment, including in green energy and breakthrough technologies.[179] Against this background, universal owners' distorted incentives have two drawbacks.

First, as explained above, universal owners' need to satisfy their often-conflicting commitments of maximizing returns and reducing emissions leads fund managers to push large polluters to invest in green technologies even when a pure-play strategy is more appropriate. This in turn may hinder innovation by more promising upstarts and slow the development of breakthrough technologies that are critical to facilitate rapid decarbonization.[180]

Second, universal owners' twin commitments create a risk that investment by large polluters in green energy will be unsustainable in the long term. Inefficient investment of capital in renewable energy might undermine firm performance without producing measurable decarbonization benefits. The negative effect on firm performance or changes in clients' demand for ESG funds might lead fund managers to backtrack and pressure mixed-play companies to cut investment in green energy. Indeed, recent developments at BP provide anecdotal support for this concern.[181]

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178. *See* Lindsay Hooper, *ESG is Dead. Long Live ESG*, FIN. TIMES (Sept. 19, 2024), https://www.ft.com/content/47b334a9-69eb-4cd0-af22-6ad0b92c0ef6 [https://perma.cc/YF3D-Q589] ("[T]here is a risk that the broad ESG or corporate sustainability sector is contributing to our collective inadequate progress by giving the impression that we're doing fine.").

179. *See* WORLD ECONOMIC FORUM, FINANCING THE TRANSITION TO A NET-ZERO FUTURE 4 (2021), https://www3.weforum.org/docs/WEF_Financing_the_Transition_to_a_Net_Zero_Future_2021.pdf [https://perma.cc/58QY-CFVT] ("Approximately $50 trillion in incremental investments is required by 2050 to transition the global economy to net-zero emissions and avert a climate catastrophe.").

180. *See* MARK AZOULAY, JOSEBA ECEIZA, SONJA GIBBS, ANNA LAZZARIN, ELODIE MUCHEMBLED, JEREMY MCDANIELS, DANIEL MIKKELSEN & DANIEL STEPHENS, MCKINSEY & CO., FINANCING THE NET-ZERO TRANSITION: FROM PLANNING TO PRACTICE 8 (2023), https://www.mckinsey.com/~/media/mckinsey/business%20functions/risk/our%20insights/financing%20the%20net%20zero%20transition%20from%20planning%20to%20practice/financing-the-net-zero-transition-from-planning-to-practice.pdf [https://perma.cc/5YPU-FBAQ] ("The technologies that require the most investment to reach net-zero emissions by 2050 are currently in the early-adoption stage or in the final stages of commercial-viability testing.").

181. *See* Gaurav Sharma, *Why a Scaling Down of Renewable Energy Plans by BP Was Inevitable*, FORBES (June 28, 2024, 11:00 AM), https://www.forbes.com/sites/gauravsharma/2024/06/28/why-a-scaling-down-of-renewable-energy-plans-by-bp-was-inevitable/ [https://perma.cc/CW5L-4B4W] (highlighting that while BP's commitment to green investment was "partially welcomed by green advocacy

Disclosure. Another potential response to our analysis is that it merely calls for modernizing disclosure requirements for ESG funds. Will subjecting universal owners, and especially ESG funds, to an improved disclosure regime address the incentive problems discussed in this Article?

The spectacular ascent of ESG funds has sparked demand for heightened regulation of this sector. The considerable variation in how fund managers define ESG and incorporate ESG considerations into their investment and stewardship decisions often confuses investors and prevents them from finding investment products that align with their preferences for sustainable investments.[182] Critics also have raised concerns about greenwashing by fund managers,[183] *i.e.*, the extent to which ESG funds uphold their ESG commitments when selecting investments or engaging with portfolio companies.[184]

Against this background, in 2022 the SEC proposed new disclosure rules for ESG funds,[185] which would have required more reporting from funds and advisers about their ESG methodologies and impact.[186] The EU, for its part, has adopted an extensive disclosure regime for ESG funds.[187]

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groups, the company's stance was deemed to be widely out of sync with what BP's shareholders wanted - a focus on its core oil and gas business along with a slightly tempered approach to the energy transition").

182. *See* Reiser & Tucker, *supra* note 69, at 2001–02.

183. *See Sustainable Finance Is Rife with Greenwash. Time for More Disclosure*, *supra* note 18; Amy D. Roy, William T. Davison & Robert A. Skinner, *Litigation Risks Posed by "Greenwashing" Claims for ESG Funds*, HARV. L. SCH. F. ON CORP. GOVERNANCE (Apr. 25, 2022), https://corpgov.law.harvard.edu/2022/04/25/litigation-risks-posed-by-greenwashing-claims-for-esg-funds/ [https://perma.cc/4ZZ6-TCW7] (reporting "public criticism from various quarters, particularly claims of greenwashing leveled against climate-focused funds").

184. *See supra* note 100. *But see* Shane S. Dikolli, Mary Margaret Frank, Zhe Michael Guo & Luann J. Lynch, *Walk the Talk: ESG Mutual Fund Voting on Shareholder Proposals*, 27 REV. ACCT. STUD. 864, 880 (2022) (detailing that ESG mutual funds are more likely to support shareholder proposals on environmental and social issues); Curtis, Fisch & Robertson, *supra* note 68 (finding that ESG funds offer increased ESG exposure and vote their shares differently from non-ESG funds).

185. *See* Press Release, U.S. Sec. & Exch. Comm'n, SEC Proposes to Enhance Disclosures by Certain Investment Advisers and Investment Companies About ESG Investment Practices (May 25, 2022), https://www.sec.gov/news/press-release/2022-92 [https://perma.cc/W9ZE-HDVA]. The SEC also filed an enforcement action against a fund manager for making misleading ESG disclosure. *See* Press Release, U.S. Sec. & Exch. Comm'n, SEC Charges BNY Mellon Investment Adviser for Misstatements and Omissions Concerning ESG Considerations (May 23, 2022), https://www.sec.gov/news/press-release/2022-86 [https://perma.cc/7URK-QLBH]; Isaac Mamaysky, *The SEC Sets Its Sights on ESG*, HARV. L. SCH. F. ON CORP. GOVERNANCE (Mar. 27, 2023), https://corpgov.law.harvard.edu/2023/03/27/the-sec-sets-its-sights-on-esg/ [https://perma.cc/SY9C-EGFW].

186. Specifically, the rules propose categorizing of ESG funds into three groups, each subject to distinct disclosure obligations. The three categories are Integration funds, ESF-focused funds, and Impact funds. *See* Sara Dewey, *The SEC's Proposed ESG Rules Aim to Provide Better Information to Investors*, HARV. L. SCH.: ENV'T & ENERGY L. PROGRAM (July 7, 2022), https://eelp.law.harvard.edu/the-secs-proposed-esg-rules-aim-to-provide-better-information-to-investors/ [https://perma.cc/Q492-DRKJ].

187. For an overview, see Danny Busch, *EU Sustainable Finance Disclosure Regulation*, 18 CAP. MKTS. L.J. 303 (2023).

Optimists believe that requiring more disclosure from ESG funds would improve their climate stewardship.[188] To be sure, transparency about the goals of ESG funds and their strategies for achieving these goals would allow investors to make informed choices about sustainable investment products. Yet, requiring more disclosure from ESG funds will not overcome the shortcomings that we have identified in this Article. More transparency would not create incentives for universal owners to engage in firm-specific stewardship. Nor would it eliminate the distorted incentives arising from these funds' commitment to promote sustainability without sacrificing returns.

Specifically, in the case of transition strategies, recall that our analysis does not rule out the possibility that fund managers may pressure companies to become greener. Rather, our concern is that fund managers' distorted incentives would pressure companies to become greener by adopting climate policies, such as investment in green energy, that are suboptimal for both investors and the planet. Because these policies presumably have some positive effect on emissions at the company level, universal owners could truthfully report that their stewardship has reduced emissions at the fund portfolio level. At the same time, these policies could be inefficient for shareholders and undermine the transition to a net zero economy.[189]

B. *ESG and Its Limits*

Our analysis has focused on climate stewardship, but it offers several lessons to other areas in which the universal owners are expected to be the driving force of stakeholder protection.

First, even powerful universal owners will not effectively push public companies to address systemic risks that require firm-specific solutions. Universal owners' business model and regulatory constraints prevent them from leading firm-specific changes. Capital markets have come to rely on activist funds to initiate changes of this type. However, these profit-driven activists will not undertake costly campaigns to address systemic risks or other worthy social goals that do not directly increase the value of their target company shares.

Second, there is an inevitable tension between the notion that ESG would cause companies to embrace policies requiring them to sacrifice profits and fund managers' promise to pursue sustainability without compromising financial returns. This tension might distort fund managers' investment choices and stewardship practices. In the climate context,

188. *See* Alessio M. Pacces, *Will the EU Taxonomy Regulation Foster Sustainable Corporate Governance?*, 13 SUSTAINABILITY 12316 (2021); Gaia Balp & Giovanni Strampelli, *Institutional Investor ESG Engagement: The European Experience*, 23 EUR. BUS. ORG. L. REV. 869, 878–82 (2022) (describing EU sustainable investment regulation as a driver of institutional investors' engagement on ESG issues).

189. We explained above why requiring public companies to disclose their emissions will not overcome universal owners' competence and incentive problems. *See supra* Section III.B.

this tension might result in large-scale misallocations of capital into renewable energy solutions. Similar distortions could emerge in other areas in which firms could claim to satisfy their ESG commitments by adopting different strategies with varying degrees of effectiveness.

To be sure, some ESG goals may not require management to choose from different business strategies. Accordingly, even universal owners without firm-specific expertise can effectively push companies to pursue these goals. Consider, for example, diversity on public company boards.[190] Universal owners can effectively push companies in their portfolio to improve board diversity by taking advantage of their capacity to adopt systemic measures that apply uniformly across companies. However, when systemic risks demand tailored, firm-specific solutions, even universal owners with a genuine commitment to sustainability cannot effectively address these risks in the face of managers' agency costs.

The government is better positioned than universal owners to effectively address climate risks and other systematic risks that require firm-specific solutions. The government can adopt measures that would force polluters to internalize the cost of their emissions, thereby allowing markets to price climate risks and facilitating firm-specific activism by hedge funds. Government agencies also possess the scale and expertise needed to coordinate funding and subsidies for sustainable energy R&D, finance the orderly phase-out of polluting energy sources, and implement accommodating regulatory policies for each emerging technology. Importantly, economists suggest that the most straightforward way for the government to enact effective policy and coordination is by adopting a carbon tax. Universal owners are unable to achieve anything similar.

Moreover, firm-specific expertise is not required for investors to push for government regulation. Universal owners could use their influence over management to prevent companies from lobbying against climate legislation. After all, many believe that corporate lobbying is one of the principal reasons for the government's failure to act on climate.[191] Universal owners could insist that companies take measures to ensure that their lobbying activities align with their climate policies. Interestingly, the number of climate-related lobbying proposals submitted by shareholders increased in 2023.[192] These proposals require companies to disclose whether their lobbying activities (either directly or through

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190. *See* Todd A. Gormley, Visha K. Gupta, David A. Matsa, Sandra C. Mortal & Lukai Yang, *The Big Three and Board Gender Diversity: The Effectiveness of Shareholder Voice*, 149 J. FIN. ECON. 323 (2023) (finding that campaigns by index funds led firms to diversify their boards).

191. *See, e.g.*, Michael P. Vandenbergh, *Private Environmental Governance*, 99 CORNELL L. REV. 129 (2013).

192. *See* Ronald O. Mueller, Elizabeth A. Ising & Thomas J. Kim, *Shareholder Proposal Developments During the 2023 Proxy Season*, HARV. L. SCH. F. ON CORP. GOVERNANCE (Aug. 3, 2023), https://corpgov.law.harvard.edu/2023/08/03/shareholder-proposal-developments-during-the-2023-proxy-season/ [https://perma.cc/BEA4-F92T] ("There were 150 climate change related proposals submitted in 2023, up from 130 proposals submitted in 2022 and 83 proposals submitted in 2021.")

membership in trade associations) are consistent with their pledges to reduce emissions. Yet, it seems that large asset managers are not eager to support these shareholder proposals, as they are deemed to be too prescriptive.[193]

CONCLUSION

Climate change has become an undeniable global crisis, posing a serious challenge to our planet's survival and prompting businesses to reevaluate their strategies for sustainable growth. The emergence of universal owners has sparked optimism that they could spearhead market-wide initiatives to reduce carbon emissions. Several reasons have been proposed as to why universal owners might assume this role. First, universal owners must respond to the demands of their investors who are concerned about climate change. Second, since universal owners hold the entire market, they may want to avoid the negative externalities that one corporation could have on another within their portfolio. One version of the latter justification, known as portfolio primacy, suggests that universal owners might sacrifice the value of a polluting corporation to increase the value of the other corporations in their portfolio. However, the portfolio primacy justification has been criticized by scholars for its illegality and impracticability. The other version suggests that universal owners care about climate change as a systematic risk and can engage in systematic stewardship to mitigate this risk.

This article explains why systematic stewardship may not achieve the desired outcome of reducing carbon emissions. Universal owners lack the necessary incentives and competence to effectively reduce carbon emissions. They have distorted incentives, as they market ESG-funds with conflicting promises: "You can do good as you do well." This untenable promise that ESG-fund returns will not be lower than non-ESG fund returns prevents universal owners from effectively compelling corporations to reduce emissions.

Moreover, although climate change is a systematic risk, addressing it requires firm-specific knowledge and engagement, as well as economy-wide coordination, which, regrettably, universal owners cannot provide. Worse yet, no other actors can provide the required firm-specific engagement. For-profit hedge fund activists won't launch campaigns without expecting short-term profits, while ideology-driven hedge fund activists and designated ESG directors likely lack resources and face legal and regulatory constraints. Additionally, investor coalitions cannot effectively engage in firm-specific activities and will likely resort to one-size-fits-all measures.

193. *See id.* (noting that support for climate-related lobbying proposals fell from 2021 to 2022 given asset managers' reluctance to support shareholder proposals deemed to be overly prescriptive).

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