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Start Your (Little) Engines: Activist Investor Wins Exxon Board Seats

Against a backdrop of numerous recent key climate announcements, May 26, 2021, marked a bad day for Big Oil. Engine No. 1, an activist investor with a keen Environmental, Social and Governance focus, won at least 2 of 12 seats on ExxonMobil's board in a proxy fight. Royal Dutch Shell was ordered by a Dutch court to significantly increase its greenhouse gas emissions-reduction targets. And Chevron's shareholders, disregarding management's recommendations, voted to cut greenhouse gas emissions resulting from the end use of Chevron's products, known as Scope 3 emissions.

Engine No. 1, which owns less than 1% of ExxonMobil's stock, put forward four dissident directors in an effort to force ExxonMobil to better manage climate risk. Backed by some of ExxonMobil's largest institutional shareholders (including several large pension funds), Engine No. 1 won at least two seats on ExxonMobil's board and has a third candidate still in the running for one of the remaining two board seats. While the votes are still being counted at the time of writing, Engine No. 1's success will no doubt energize other activists. Its achievement also sends a strong signal to issuers in the broader extractive sector, which have been under mounting pressure to adapt emissions targets and improve their climate-related disclosures: namely, that climate change imposes financial risk, and boards must have the requisite skills to independently oversee a climate strategy in the transition away from fossil fuels to a net zero economy.

On the same day, a lower Dutch court found Shell partially responsible for global warming and ordered the company to significantly cut its greenhouse gas emissions at its Dutch operations. Despite Shell's recently announced strategy for reaching net zero emissions, which was supported by shareholders, the court relied on European human rights laws to order Shell to further reduce its emissions by 45% of 2019 levels by 2030. In support of its ruling, the court drew a connection between severe climate change and human rights, particularly the right to life, and held that companies have an obligation to respect those rights by adopting and implementing sufficiently stringent emissions-reduction targets. Shell has said that it will appeal the decision. If the decision is upheld, it will force Shell to significantly speed up its transition efforts.

Also on May 26, Chevron shareholders, ignoring management objections, voted in favour of a proposal to establish emissions-reduction targets that take into account Scope 3 emissions. Scope 3 emissions typically far outstrip the direct (Scope 1) and indirect (Scope 2) emissions that result from a company's operations, but have proven far more difficult for the extractive sector to quantify and address in their climate strategies.

The events of May 26 have left little room for doubt that things are moving quickly on the climate front. To keep pace during the transition to net zero, management and boards should consider the following:

- **Business as usual is off the table.** The unprecedented success of Engine No. 1's campaign to bring change (or at least transparency into climate change risk management and the possibility of change) to ExxonMobil, along with the recent success of similar climate campaigns in the courts, serves as a stark wake-up call to any players in the energy or extractive sectors that have been reluctant to develop and implement a robust climate strategy to transition to a net zero economy.
 - Companies should be working to enhance their reporting of climate-related issues in mainstream financial filings, consistent with the Recommendations of the Task Force on Climate-related Financial Disclosures.
 - Companies should keep climate strategy and risk management front and centre, and focus on developing a clear and compelling plan to reduce emissions.
 - Companies should maintain an active dialogue with investors and other stakeholders on climate change and other Environmental, Social and Governance issues.

- Good may not be good enough. The Dutch court ruling against Shell has underscored the fact that societal expectations regarding an appropriate rate of emissions reductions have outpaced those of industry players and that climate litigation may become a more frequently used tool to ensure that those expectations are aligned. This risk is underscored by a May 27, 2021, decision of Australia's Federal Court, which held that the Minister of the Environment has a duty of care that requires consideration of the harm to Australian children caused by the greenhouse gas emissions resulting from the production and use of coal when authorizing the expansion of a coal mine.
- Scope 3 emissions cannot be ignored. Although Chevron is not alone in incorporating Scope 3 emissions into its transition strategy notably, in 2020, BP announced plans to reduce Scope 3 emissions, and Suncor recently also committed to do so many of the key players in the extractive sector are still in the early stages of establishing Scope 3 baselines. Increased investor pressure on the sector, including in the form of climate-related shareholder proposals, is expected to motivate issuers to set clear Scope 3 targets and to implement robust action plans to reduce emissions across the full value chain.

For additional discussion on major trends and developments in climate-related issues, including some background on past shareholder proposals and climate-related agitation for change at ExxonMobil, Chevron, BP and other companies in the extractive sector, please refer to <u>Governance Insights 2020</u>; <u>Governance Insights 2019</u>; and <u>Governance Insights 2018</u>.

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