School of Law
UNIVERSITY OF GEORGIA
Prepare. Connect. Lead.

Georgia Law Review

Volume 58 | Number 1 Article 5

11-17-2023

What Do We Know About Shareholders' Potential to Solve Environmental and Social Problems?

Bryce C. Tingle
University of Calgary Faculty of Law, btingle@ucalgary.ca

Follow this and additional works at: https://digitalcommons.law.uga.edu/glr

Part of the Law Commons

Recommended Citation

Tingle, Bryce C. (2023) "What Do We Know About Shareholders' Potential to Solve Environmental and Social Problems?," *Georgia Law Review*: Vol. 58: No. 1, Article 5.
Available at: https://digitalcommons.law.uga.edu/glr/vol58/iss1/5

This Article is brought to you for free and open access by Digital Commons @ University of Georgia School of Law. It has been accepted for inclusion in Georgia Law Review by an authorized editor of Digital Commons @ University of Georgia School of Law. Please share how you have benefited from this access For more information, please contact tstriepe@uga.edu.

What Do We Know About Shareholders' Potential to Solve Environmental and Social Problems?

Cover Page Footnote

Bryce C. Tingle, KC is the N. Murray Edwards Chair of Business Law at the Faculty of Law in the University of Calgary

This article is available in Georgia Law Review: https://digitalcommons.law.uga.edu/glr/vol58/iss1/5

WHAT DO WE KNOW ABOUT SHAREHOLDERS' POTENTIAL TO SOLVE ENVIRONMENTAL AND SOCIAL PROBLEMS?

Bryce C. Tingle, KC[*]

Securities regulators around the world are attempting to assist socially conscious shareholders in driving changes in the way corporate America operates. At a time when legislative solutions to some of our most pressing social and environmental problems seem far away, many market actors have come to hope that shareholders can succeed in regulating and reforming corporate practices.

This paper summarizes the empirical evidence regarding the behavior of shareholders with explicit ESG mandates, the difficulties outsiders experience in evaluating ESG performance, and the outcomes generated by the limited tools available to shareholders under corporate law. It concludes there is little evidence that material improvements in environmental and social outcomes will be produced through shareholder power. The energy and resources of reformers would be better deployed somewhere other than corporate governance.

[*] Bryce C. Tingle, KC is the N. Murray Edwards Chair of Business Law at the Faculty of Law in the University of Calgary.

Published by Digital Commons @ University of Georgia School of Law, 2023

Georgia Law Review, Vol. 58, No. 1 [2023], Art. 5

TABLE OF CONTENTS

I. INTRODUCTION 171
A. WHY DOES UNDERSTANDING ESG INVESTOR BEHAVIOR MATTER? 175

II. THE QUESTION OF SHAREHOLDER INCENTIVES 182
A. THE INCENTIVES TO MAXIMIZE PORTFOLIO RETURNS 182
B. THE INCENTIVES TO AVOID INVESTING IN FIRM-SPECIFIC GOVERNANCE 191
C. THE ARGUMENT FOR SYSTEMATIC STEWARDSHIP 197
D. DO ESG FUNDS APPEAR TO BEHAVE AS THEORY PREDICTS? 202
E. THE CONNECTION BETWEEN ESG INVESTING AND FUND RETURNS 208

III. SHAREHOLDERS LACK ESG INFORMATION 214
A. WHAT DO ESG RATING FAILURES TELL US ABOUT ESG INVESTORS? 219
B. WHAT DO THE FAILURES OF ESG RATINGS TELL US ABOUT CORPORATE ESG? 221

IV. SHAREHOLDER GOVERNANCE TOOLS ARE POORLY SUITED TO ESG INTERVENTIONS. 230
A. NEGATIVE SCREENING OR DIVESTMENT 230
B. POSITIVE SCREENING 234
C. SHAREHOLDER ENGAGEMENT 239

V. CONCLUSION 246

I. INTRODUCTION

The biggest trend in Anglo-American capital markets is the growth of investment funds focused on what is variously termed, "sustainable," "socially responsible," or "ESG" investing.[1] More than one-third of total U.S. investment assets are now supposedly allocated according to "environmental, social and governance" (ESG) principles.[2] This is a relatively new phenomenon. As recently as 2014, Morningstar reported only 1% of new money went towards funds deploying ESG investment strategies.[3] Now, even investment managers that do not run specialized ESG funds work hard to burnish their image as champions of social and environmental causes. Famously, Blackrock's Larry Fink, who leads the largest asset manager in the world has used his annual letter to the world's CEOs to brand Blackrock as a vehicle for social change.[4] In his 2021 letter, he focused on the role of shareholders and indicated that Blackrock's management believes that "the climate transition presents a historic investment opportunity."[5] Estimates show that

---

[1] *See* Marcel Kahan & Edward B. Rock, *Index Funds and Corporate Governance: Let Shareholders Be Shareholders*, 100 B.U. L. REV. 1771, 1798–99 (2020) (describing the increasing attention on environmental, social, and governance (ESG) concerns).

[2] US SIF FOUND., 2020 REPORT ON US SUSTAINABLE AND IMPACT INVESTING TRENDS 1 (2020), https://www.ussif.org/files/Trends/2020_Trends_Highlights_OnePager.pdf [https://perma.cc/6DWH-GLTK]; *see also* Sara Bernow, Bryce Klempner & Clarisse Magnin, *From 'Why' to 'Why Not': Sustainable Investing as the New Normal*, MCKINSEY & CO. (2017) https://www.mckinsey.com/~/media/mckinsey/industries/private%20equity%20and%20principal%20investors/our%20insights/from%20why%20to%20why%20not%20sustainable%20investing%20as%20the%20new%20normal/from-why-to-why-not-sustainable-investing-as-the-new-normal.pdf?shouldIndex=false [https://perma.cc/L79N-PJGA] (estimating that ESG investing accounts for one-quarter of the $88 trillion of assets under management globally).

[3] Greg Iacurci, *Money Invested in ESG Funds More than Doubles in a Year*, CNBC (Feb. 11, 2021, 12:44 PM), https://www.cnbc.com/2021/02/11/sustainable-investment-funds-more-than-doubled-in-2020-.html [https://perma.cc/D3JX-MYLD].

[4] *See* Stephen M. Bainbridge, *Making Sense of the Business Roundtable's Reversal on Corporate Purpose*, 46 J. CORP. L. 285, 313 (2021) ("Blackrock CEO, Laurence D. Fink, arguably has been the most vocal proponent of ESG commitments . . . .").

[5] Larry Fink, *Larry Fink's 2021 Letter to CEOs*, BLACKROCK (2021) https://www.blackrock.com/us/individual/2021-larry-fink-ceo-letter [https://perma.cc/E5PE-YBZE].

ESG data drives somewhere between $30 trillion and $40.5 trillion of investment capital globally.[6]

Paralleling the growth in ESG funds, various third parties have created an array of reporting standards and rating schemes to assist institutional investors in allocating capital according to ESG criteria.[7] There are signs regulators intend to lend a hand by mandating disclosure of non-financial social and environmental

---

[6] *See, e.g.*, Alexander Fish, Dong Hyun Kim & Shankar Venkatraman, The ESG Sacrifice 5 (Nov. 17, 2019) (unpublished manuscript), https://papers.ssrn.com/sol3/papers.cfm?abstract_id=3488475 ("Sustainable investment has surged worldwide by more than a third since 2016, reaching assets of more than $30 trillion at the start of last year."); Dana Brakman Reiser & Anne Tucker, *Buyer Beware: Variation and Opacity in ESG and ESG Index Funds*, 41 CARDOZO L. REV. 1921, 1924 (2020) ("Global ESG assets under management reached $30 trillion in 2019."); Sophie Baker, *Global ESG-Data Driven Assets Hit $40.5 Trillion*, PENSIONS & INVS. (July 2, 2020, 1:25 PM), https://www.pionline.com/esg/global-esg-data-driven-assets-hit-405-trillion ("The value of global assets applying environmental, social and governance data to drive investment decisions has almost doubled over four years, and more than tripled over eight years, to $40.5 trillion in 2020.").

[7] These include indices like the FTSE4Good and Dow Jones Sustainability Index, ESG rating services such as Sustainalytics and RobecoSAM, and a shift of proxy advisors such as Institutional Shareholder Services and Glass-Lewis into this area. For further discussion of these indices, see Mona Naqvi & Manjit Jus, *The Benchmark that Changed the World: Celebrating 20 Years of the Dow Jones Sustainability Indices*, S&P GLOBAL: S&P DOW JONES INDICES (Sept. 1, 2019), https://www.spglobal.com/_media/documents/education-the-benchmark-that-changed-the-world-1-.pdf [https://perma.cc/P4N3-CHGG]; Florian Berg, Julian F. Kölbel & Roberto Rigobon, Aggregate Confusion: The Divergence of ESG Ratings 6–7 (Apr. 15, 2022), (unpublished manuscript), https://papers.ssrn.com/sol3/papers.cfm?abstract_id=3438533; Elena Escrig-Olmedo, María Ángeles Fernández-Izquierdo, Idoya Ferrero-Ferrero & Juana María Rivera-Lirio, *Rating the Raters: Evaluating How ESG Rating Agencies Integrate Sustainability Principles*, 11 SUSTAINABILITY 915 (2019); John G. Matsusaka & Chong Shu, A Theory of Proxy Advice when Investors Have Social Goals, (Apr. 6, 2021) (unpublished manuscript) https://papers.ssrn.com/sol3/papers.cfm?abstract_id=3547880 (finding recent changes drive proxy advisory firms to "tilt their advice away from policies that maximize issuer value towards policies that give more weight to social issues"); *Policy Supports Investors Choosing to Integrate Climate Performance & Disclosure into their Proxy Voting*, INSTITUTIONAL S'HOLDER SERVS. (Mar. 9, 2020), https://www.issgovernance.com/iss-launches-climate-voting-policy/ [https://perma.cc/7BRN-A2P5] (announcing the "launch of a new thematic specialty Climate Voting Policy, providing investors with a solution to integrate climate-related factors into their voting decisions"); *cf.* Patrick Bolton, Tao Li, Enrichetta Ravina & Howard Rosenthal, *Investor Ideology*, 137 J. FIN. ECON. 320 (2020) (finding the advice of proxy advisors is now to the left of most investors).

Tingle: Shareholders' Potential

information, among other possible interventions.[8] Academics have flooded the usual forums with proposals for how shareholder power might improve various social and environmental outcomes.[9] As one

---

[8] *See* Commissioner Allison Herren Lee, *Public Input Welcome on Climate Change Disclosures*, (Mar. 15, 2021), https://www.sec.gov/news/public-statement/lee-climate-change-disclosures [https://perma.cc/YRX7-X9WG] ("I am asking the staff [of the SEC] to evaluate our disclosure rules with an eye toward facilitating the disclosure of consistent, comparable, and reliable information on climate change."); *see also* News Release, U.S. Dep't of Labor, New Guidance on Economically Targeted Investments in Retirement Plans from U.S. Labor Department, No. 15-2045-NAT (Oct. 22, 2015), https://www.dol.gov/newsroom/releases/ebsa/ebsa20151022 [https://perma.cc/UWW6-Y37L] (noting that previous regulations "unduly discouraged fiduciaries from considering ETIs and environmental, social and governance ('ESG') factors under appropriate circumstances.").

European regulators have already moved forward on various initiatives. *See, e.g.*, Council Directive 2014/95, 2014 O.J. (L 330) 1, 1–4 (EC) (amending Council Directive 2013/34, 2013 O.J. (L 182) (EC) regarding disclosure of non-financial and diversity information by certain large undertakings and groups, defined as companies with significant operations in the EU or listed on an EU exchange with 500 or more employees); FIN. CONDUCT AUTH., PROPOSALS TO ENHANCE CLIMATE-RELATED DISCLOSURES BY LISTED ISSUERS AND CLARIFICATION OF EXISTING DISCLOSURE OBLIGATIONS, 2020, CP20/3, § 1.24 (UK), https://www.fca.org.uk/publication/consultation/cp20-3.pdf [https://perma.cc/YFB2-LLBS] (proposing a rule to require all listed issuers to state whether they comply with TCFD-aligned disclosures and explain any non-compliance); Council Regulation 2019/2088, 2019 O.J. (L 317) 1, 2–6 (EU) (regulating sustainability-related disclosures in the financial services sector). Canada has similarly begun to make regulatory changes in this area. *See* FIN. SVCS. COMM'N OF ONTARIO, ENVIRONMENTAL, SOCIAL AND GOVERNANCE (ESG) FACTORS 1–4 (2015), https://www.fsrao.ca/media/8311/download [https://perma.cc/L37C-5TKV] (requiring pension funds to discuss whether and in what ways they incorporate ESG in their investment decisions).

[9] *See* Lynn M. LoPucki, *Repurposing the Corporation Through Shareholder Markets*, 55 U.C. DAVIS L. REV. 1445, 1512 ("The ESG information system will measure the externalization of a variety of social costs. . . . Potential Stakeholders could shun the externalizers, or government could reimpose the externalized costs on the externalizers. Either course could reduce or eliminate future externalizations."); Lisa M. Fairfax, *Social Activism Through Shareholder Activism*, 76 WASH. & LEE L. REV. 1129, 1137 (2019) (discussing "the ability of corporations to engage in social activism . . . and the ability of shareholders to play a pivotal role in such engagement"); Aaron A. Dhir, *Realigning the Corporate Building Blocks: Shareholder Proposals as a Vehicle for Achieving Corporate Social and Human Rights Accountability*, 43 AM. BUS. L.J. 365, 374 (2006) (discussing the shareholder proposal mechanism); Virginia Harper Ho, *Nonfinancial Risk Disclosure and the Costs of Private Ordering*, 55 AM. BUS. L.J. 407, 437–38 (2018) (advocating for mandatory ESG disclosure); Ann M. Lipton, *ESG Investing, or, If You Can't Beat 'Em, Join 'Em*, *in* RSCH. HANDBOOK ON CORP. PURPOSE & PERSONHOOD 130 (Elizabeth Pollman & Robert B. Thompson eds., 2021), https://ssrn.com/abstract=3715935 (discussing possible reforms needed to facilitate shareholder engagement); Leo E. Strine, Jr., *Stewardship 2021: The*

observer notes, "climate change and sustainability disclosure has especially gripped the imagination of legal scholars."[10]

This paper is about whether shareholders are likely to drive the hoped-for changes in firm behavior. It does not cast doubt on the sincerity of most investment fund managers to play a role in solving the serious social and environmental problems of our day. Nor does it challenge the central assumption of reformers that competitive markets allow the average company the flexibility to make material voluntary ESG investments. (I have argued elsewhere, however, that this flexibility does not exist for most firms.)[11] Rather, this paper argues that shareholders lack the information, incentives, and tools they need to play the role imagined for them. It takes seriously the observation of the Nobel-prize-winning economist, Robert Shiller, that "[t]here's so much disagreement about investing, and it's because nobody really knows."[12]

Centrality of Institutional Investor Regulation to Restoring Fair and Sustainable American Economy, 24 U. PA. J. BUS. L. 1, 2 (2021) (arguing for reform of the institutional investor and stock market community for a better and more sustainable economy); Cynthia A. Williams & Jill E. Fisch, *Petition to SEC for Rulemaking on Environmental, Social, and Governance (ESG) Disclosure*, HARV. L. SCH. F. ON CORP. GOVERNANCE (Oct. 9, 2018), https://corpgov.law.harvard.edu/2018/10/09/petition-to-sec-for-rulemaking-on-environmental-social-and-governance-esg-disclosure [https://perma.cc/BXJ6-KCBZ] (arguing that mandatory ESG disclosures would reveal information material to the investing public).

[10] Brandon D. Stewart, *Shining Some Sunlight on Mandatory Corporate Climate-Related Disclosure*, 17 MCGILL J. SUST. DEV. L. 34, 70 (2021).

[11] *See* Bryce C. Tingle, *Is Governance a Likely Solution to Social Problems?* (forthcoming) [hereinafter Tingle, *Is Governance a Likely Solution*] (reviewing the empirical evidence that most American companies are embedded in competitive markets and that competitive markets constrain investments—like ESG—that have a lower net present value than the alternatives); *see also* Bryce C. Tingle, *Corporations on the Couch: Is Therapeutic Disclosure a Kind of Madness?*, 55 U.B.C. L. REV. 745, 770 (2022) [hereinafter Tingle, *Corporations on the Couch*] (arguing that voluntary ESG investments are difficult for the average firm due to constraints imposed on them by competitive markets and managerial self-interest).

[12] Matthew Craft, *How Companies Prey on Your Weaknesses: A Robert Shiller Q&A*, AP NEWS (Oct. 30, 2015, 11:35 AM), https://apnews.com/article/6eb4ba5780e04bf3bb47f3aa143e3e21 [https://perma.cc/CNG3-T2MV].

A. WHY DOES UNDERSTANDING ESG INVESTOR BEHAVIOR MATTER?

The term "ESG" is now the dominant term for describing socially and environmentally motivated investment behavior.[13] The sustainable investor "universe has been identified as specialising in the 'E' [environmental] and 'S' [social] sectors more than the 'G' [governance]."[14] Indeed, as Professor John Coffee observes:

> Conceptually, [lawyers] 'rebranded' SRI [socially responsible] investing and converted it into ESG investing by asserting that consideration of the 'governance factors' associated with public corporations would enable the fiduciary to identify superior investments and enhance risk-adjusted return. . . . This in turn enabled law firms to opine to their clients that ESG investing was fully compatible with the trustee's fiduciary obligations.[15]

In a series of papers, I have shown that there is little evidence that "governance" of the sort that shows up in institutional

---

[13] *See* Iain MacNeil & Irene-marié Esser, *From a Financial to an Entity Model of ESG*, 23 EUR. BUS. ORG. L. REV. 9, 10 (2022) (discussing the historical evolution towards ESG); Miriam von Wallis & Christian Klein, *Ethical Requirement and Financial Interest: A Literature Review on Socially Responsible Investing*, 8 BUS. RSCH. 61, 63 (2015) (discussing the evolving terminology).

[14] Daniel Cash, *Can Regulatory Intervention Save the Sustainability Rating Industry?*, 42 BUS. L. REV. 13, 20 (2021); *see also* María J. Muñoz-Torres, María Ángeles Fernández-Izquierdo, Juana M. Rivera-Lirio & Elena Escrig-Olmedo, *Can Environmental, Social, and Governance Rating Agencies Favor Business Models that Promote a More Sustainable Development?*, 26 CORP. SOC. RESP. & ENV'T MGMT. 439, 447 (2018) (finding that ESG rating agencies more heavily utilize social and environmental criteria rather than governance criteria to determine businesses' sustainability ratings).

[15] John C. Coffee, Jr., *The Future of Disclosure: ESG, Common Ownership, and Systematic Risk* 2 COLUM. BUS. L. REV. 602, 632 (2021); *see also* Max M. Schanzenbach & Robert H. Sitkoff, *Reconciling Fiduciary Duty and Social Conscience: The Law and Economics of ESG Investing by a Trustee*, 72 STAN. L. REV. 381, 388 (2020) ("[P]roponents of SRI rebranded the concept as ESG by adding corporate governance factors . . . and they asserted that ESG investing could improve risk-adjusted returns, thereby providing a direct benefit to investors."); Susan N. Gary, *Best Interests in the Long Term: Fiduciary Duties and ESG Integration*, 90 U. COLO. L. REV. 731, 732 (2019) (arguing that "a prudent investor should consider ESG information" when determining where to invest).

investment decisions actually does improve corporate outcomes.[16] But the widely believed myth that it matters explains why one criterion (governance), historically focused on improving risk-adjusted shareholder returns, was incorporated into a conceptual unit that also contained social and environmental criteria primarily focused on outcomes for non-shareholder constituencies.[17]

Notwithstanding the presence of "governance" as a putative element of ESG, this paper will follow the general practice of using the term "ESG" to denote a focus mainly on environmental and social outcomes intended to benefit non-shareholder constituencies (at least in the short-to-medium term). However, shareholders are still important to most schemes of ESG corporate governance reforms, as they are expected to be the parties that makes use of the new governance tools to drive companies towards better environmental and social performance.[18]

---

[16] *See* Bryce C. Tingle, *What is Corporate Governance? Can We Measure It? Can Investment Fiduciaries Rely on It?*, 43 QUEEN'S L.J. 223, 223 (2018) ("This article examines the existing empirical research and concludes that there appears to be no relationship between corporate governance scores or ranking schemes and future corporate performance."); Bryce C. Tingle, *Framed! The Failure of Traditional Agency Cost Explanations for Executive Pay Practices*, 54 ALTA. L. REV. 899, 899 (2017) (arguing that abiding by corporate governance "best practices" have led to "failures in executive compensation"); Bryce C. Tingle, *How Good Are Our "Best Practices" When It Comes to Executive Compensation? A Review of Forty Years of Skyrocketing Pay, Regulation, and the Forces of Good Governance*, 80 SASK. L. REV. 387, 389 (2017) [hereinafter Tingle, *How Good Are Our Best Practices?*] (critiquing the high-rate growth of executive pay as the result of "poor and overly narrow executive compensation best practices"); Bryce C. Tingle, *What Do We Really Know About Corporate Governance? A Review of the Empirical Research Since 2000*, 59 CAN. BUS. L.J. 292, 292 (2017) [hereinafter Tingle, *What Do We Really Know?*] (analyzing years of research to find that firms' best practices do not "contribute in a measurable way to firm performance").

[17] *See* Bradford Cornell & Aswath Damodaran, *Valuing ESG: Doing Good or Sounding Good?*, 1 J. IMPACT & ESG INVESTING 76, 78 (2020) ("[G]ood corporate governance should be [sic] not be part of the ESG sales pitch, because it represents a mindset diametrically opposed to the stakeholder value mindset that underlies ESG.").

[18] *See* Thomas Lee Hazen, *Corporate and Securities Law Impact on Social Responsibility and Corporate Purpose*, 62 B.C. L. REV. 852, 893–95 (2021) (noting the presence of "shareholder proposals relating to sustainability, climate change, and ESG" which continue to showcase shareholder activism surrounding ESG); *see also Climate-Related Disclosures/ESG Investing*, SEC (Sept. 11, 2023) https://www.sec.gov/securities-topics/climate-esg [https://perma.cc/P4JE-DA4R] (highlighting the SEC's work "to ensure that investors receive the complete, consistent, and comparable climate-related information they need in public filings to make their investment decisions").

There have been academic efforts to characterize consumers and employees as potentially powerful sources of corporate change, but neither group is likely to prove sufficiently effective to justify, for example, the widespread imposition of mandatory ESG disclosure.[19] In the case of employees, they have been unable to halt the decline in labor's share of national income over the past several decades, so it is hard to believe that, outside a few high-tech industries where specialized human capital is vital, employees will be able to fundamentally alter corporate behavior in other areas.[20] Even when European corporate law places employee representatives on the board of directors, the best evidence is that they are unable to use this uniquely powerful corporate governance channel to produce better wages or job security.[21] In the case of consumers, boycotts

---

[19] *See e.g.*, LoPucki, *supra* note 9 (arguing that ESG disclosure will drive changes in business behavior through firms' competitive activities in labor and product markets); Ann M. Lipton, *Not Everything Is About Investors: The Case for Mandatory Stakeholder Disclosure*, 37 YALE J. ON REGUL. 499 (2020) (discussing the utility of ESG disclosure to non-investor constituencies).

[20] *See* INT'L LAB. ORG. & OECD, THE LABOUR SHARE IN G20 ECONOMIES 2 (2015), https://www.oecd.org/g20/topics/employment-and-social-policy/The-Labour-Share-in-G20-Economies.pdf [https://perma.cc/3MDS-JW2E] (describing the decline in labor income share and effects on other economic indicators); *see also* James Manyika et al., *A New Look at The Declining Labor Share of Income in The United States* 2 (McKinsey Glob. Inst., discussion paper, 2019), https://www.mckinsey.com/~/media/mckinsey/featured%20insights/employment%20and%20growth/a%20new%20look%20at%20the%20declining%20labor%20share%20of%20income%20in%20the%20united%20states/mgi-a-new-look-at-the-declining-labor-share-of-income-in-the-united-states.pdf [https://perma.cc/9A8E-8CD8] (discussing the decline in labor's share of national income and the potentially related effects).

[21] *See* Christine Blandhol, Magne Mogstad, Peter Nilsson & Ola L. Vestad, *Do Employees Benefit from Worker Representation on Corporate Boards?* 1 (Nat'l Bureau of Econ. Rsch., Working Paper No. 28269, 2021) (finding that workers have higher pay and less earnings risk in firms with worker representation on the board but that this is likely due to firms being larger and unionized); *see also* Gary Gorton & Frank A. Schmid, *Capital, Labor, and the Firm: A Study of German Codetermination*, 2 J. EUR. ECON. ASS'N 863, 864, 889–90 (2004) (finding that increasing the workers' share of seats on the supervisory board from one third to one half had no significant effect on wages); Simon Jäger, Benjamin Schoefer & Jörg Heining, *Labor in the Boardroom*, 136 Q.J. ECONOMICS 669, 671–72 (2021) (finding a reform that abolished the rights to worker representation for new firms left wages unaffected); Simon Jäger, Shakked Noy & Benjamin Schoefer, *What Does Codetermination Do?* 75 INDUS. & LAB. RELS. REV. 857, 865–66 (2022) (finding no impact of board-level employee representation on overall turnover).

Georgia Law Review, Vol. 58, No. 1 [2023], Art. 5

require considerable effort; they are rare; their success is not assured; and many businesses are not consumer-facing.[22]

In contrast, shareholders are given a privileged position in firm governance as a matter of corporate and securities law.[23] They are focused on corporate governance outcomes already, and they are sufficiently concentrated that they are likely easier to mobilize than thousands of preoccupied ordinary consumers.[24] Additionally, institutional investors are sophisticated enough to, in theory, read, process, and come to accurate conclusions about the complex disclosure provided on social and environmental issues.[25] Finally,

---

[22] *See* Philippe Delacote, *On the Sources of Consumer Boycotts Ineffectiveness*, 18 J. ENV'T & DEV. 306, 307 (2009) (concluding that the effectiveness of a consumer boycott is hurt by the need for collective action and that a high opportunity cost of participation reduces participation from consumers who would have the most impact); *see also* Jean-Robert Tyran & Dirk Engelmann, *To Buy or Not to Buy? An Experimental Study of Consumer Boycotts in Retail Markets*, 72 ECONOMICA 1, 12 (2005) (finding boycotts ineffective for lowering prices due to the small-agent and free rider problems).

[23] *See* Simone M. Sepe, *Board and Shareholder Power, Revisited*, 101 MINN. L. REV. 1377, 1391 (2017) (discussing the shift in market regulation and practices which allowed for shareholder empowerment since the early 2000s); *see also* Dorothy S. Lund & Elizabeth Pollman, *The Corporate Governance Machine*, 121 COLUM. L. REV 2563, 2575–78 (2021) (discussing the way shareholders' interests are currently privileged above those of any other corporate constituency).

[24] *See* Kathleen Rehbein, Sandra Waddock & Samuel B. Graves, *Understanding Shareholder Activism: Which Corporations are Targeted?*, 43 BUS. & SOC. 239, 240 (2004) ("Ownership of shares gives activists access to annual meetings as well as the right to submit resolutions."); Bernard S. Black, *Agents Watching Agents: The Promise of Institutional Investor Voice*, 39 UCLA L. REV. 811, 822 (1992) ("[A]pathy becomes much less rational as shareholdings grow . . . ."); *see generally* Pedro Matos, *ESG and Responsible Institutional Investing Around the World: A Critical Review,* CFA INST. RSCH. FOUND. (2020), https://www.cfainstitute.org/-/media/documents/book/rf-lit-review/2020/rflr-esg-and-responsible-institutional-investing.pdf [https://perma.cc/8J73-2PLH] (discussing the rise of institutional investors and the reasons to believe they might be able to engage with ESG issues).

[25] *See* Virginia H. Ho, *Modernizing ESG Disclosure*, 2022 U. ILL. L. REV. 277, 292–95 (discussing the complexity of ESG disclosure); *see also* Kai H.E. Leikefett, Holly J. Gregory & Leonard Wood, *Shareholder Activism and ESG: What Comes Next, and How to Prepare*, HARV. L. SCH. F. ON CORP. GOVERNANCE (May 29, 2021), https://corpgov.law.harvard.edu/2021/05/29/shareholder-activism-and-esg-what-comes-next-and-how-to-prepare/ [https://perma.cc/3YKK-B4VX] ("Companies should review their ESG-related disclosure practices and take steps to ensure that investors . . . do not deem them laggards. Companies deemed ESG laggards create low-hanging fruit for activists looking for opportunities to work ESG themes into their campaigns to change corporate policy and control.").

Tingle: Shareholders' Potential

shareholders have the power to pressure companies to do what those companies are refusing to do: improve their social and environmental performance.[26] For these reasons, most advocates of ESG disclosure assume shareholders will be its primary consumers.[27]

This paper is not about the merits of the social and environmental outcomes hoped for by reformers and ESG investment funds. It is self-evidently valuable to reduce discrimination, inequality, prejudice, pollution, and other social harms. Rather, it is about the narrow, but important, question of whether investors are up to the job assigned by these ESG reforms. If investors are unable to drive meaningful ESG change, then all the time and energy social reformers are putting into ESG disclosure is wasted. Professors Kahan and Rock already argue that corporate governance is primarily useful as a way for politicians and other powerful parties to seem to be doing something without actually impacting the real interests of those who benefit from the current political and social order.[28]

The failure of ESG funds to actually improve corporate outcomes will inevitably breed cynicism as well. If we believe that the shareholders' position in firm governance is sufficient to accomplish certain important goals, then any failures will be attributed to bad faith, corruption, or dishonesty. This Article will argue that shareholders do not have the power or incentives reformers assume. If this is correct, and failure is inevitable, it is crazy in our current

---

[26] *See* Brayden G. King, *A Political Mediation Model of Corporate Response to Social Movement Activism*, 53 ADMIN. SCI. Q. 395, 403–04 (2008) (noting that corporations tend to "be highly sensitive to shareholders' concerns while giving less credence to the demands made by secondary stakeholders, like movement activists" especially those "publicly traded corporations for which the shareholder is normatively the most important stakeholder group").

[27] *See, e.g.*, Andy Green, *Making Capital Markets Work for Workers, Investors, and the Public: ESG Disclosure and Corporate Long-Termism*, 69 CASE W. RES. L. REV. 909, 924 (2019) (discussing shareholders as the primary risk bearers of insufficient ESG disclosure).

[28] *See* Marcel Kahan & Edward Rock, *Symbolic Corporate Governance Politics*, 94 B.U. L. REV. 1997, 2042 (2014) (noting the "persistent gap between rhetoric and reality" on the impact of corporate governance).

Published by Digital Commons @ University of Georgia School of Law, 2023

political and social circumstances to embark on a project that will only generate more distrust of our institutions.[29]

All this ESG disclosure and activity is expensive. It costs investors a considerable amount to invest in ESG funds, which have higher fees[30] and seem to generate lower returns.[31] Just acquiring ESG data this year is expected to cost investors USD $1 billion.[32]

---

[29] *See generally Edelman Trust Barometer 2020*, EDELMAN (2020), https://www.edelman.com/sites/g/files/aatuss191/files/2020-01/2020%20Edelman%20Trust%20Barometer%20Global%20Report_LIVE.pdf [https://perma.cc/X4NV-BYB8] (finding low and declining levels of social trust globally, particularly with respect to various institutions including business).

[30] *See* Michael Wursthorn, *Tidal Wave of ESG Funds Brings Profit to Wall Street*, WALL ST. J. (Mar. 16, 2021, 5:30 AM), https://www.wsj.com/articles/tidal-wave-of-esg-funds-brings-profit-to-wall-street-11615887004 ("The environmental, social, and governance funds' average fee was 0.2% at the end of last year, while standard ETFs that invest in U.S. large-cap stocks have a 0.14% fee on average . . . ."); DANIEL R. FISCHEL, FOSSIL FUEL DIVESTMENT: A COSTLY AND INEFFECTIVE INVESTMENT STRATEGY 16–17 (2015), http://divestmentfacts.com/pdf/Fischel_Report.pdf [https://perma.cc/ZPL5-E6BN] (finding the average ESG mutual fund charged fees three times higher than the average of the ten largest mutual funds); Arno Riedl & Paul Smeets, *Why Do Investors Hold Socially Responsible Mutual Funds?*, 72 J. FINANCE 2505, 2533 (2017) (finding that "most socially responsible investors expect . . . to pay higher fees" to ESG funds).

[31] *See* Brad M. Barber, Adair Morse & Ayako Yasuda, *Impact Investing* 5 (Nat'l Bureau of Econ. Rsch., Working Paper No. 26582, 2019), https://www.nber.org/system/files/working_papers/w26582/w26582.pdf [https://perma.cc/D6SB-JQS5] (finding that investors are willing to accept a 2.5%–3.7% reduction in IRRs from venture capital funds that focus on environmental and social outcomes, as well as financial outcomes); Patrick R. Martin & Donald V. Moser, *Managers' Green Investment Disclosures and Investors' Reaction*, 61 J. ACCT. & ECON. 239, 239 (2016) ("[I]nvestors and managers tradeoff wealth for societal benefits . . . ."); Alessio M. Pacces, *Sustainable Corporate Governance: The Role of the Law* 5 (Eur. Corp. Governance Inst., Working Paper No. 550/2020, 2020), https://ssrn.com/abstract=3697962 ("[I]nvestors give up substantial returns to pursue sustainability."); Luc Renneboog, Jenke Ter Horst & Chendi Zhang, *Is Ethical Money Financially Smart? Nonfinancial Attributes and Money Flows of Socially Responsible Investment Funds*, 20 J. FIN. INTERMEDIATION 562, 587 (2011) (showing ESG fund flows are less sensitive to past negative fund performance); Aneesh Raghunandan & Shiva Rajgopal, *Do ESG Funds Make Stakeholder-Friendly Investments?*, 22 REV. ACCT. STUD. 822, 824 (2022) (finding ESG funds obtain lower stock returns but charge higher management fees); Riedl & Smeets, *supra* note 30, at 2533 (detailing a survey of investors finding "socially responsible investors expect SRI funds to earn lower returns than conventional funds").

[32] Emily Chasan, *Spending on ESG Data Seen Rising to $1 Billion Amid Asset Growth*, BLOOMBERG (Mar. 9, 2020, 5:17 PM), https://www.bloomberg.com/news/articles/2020-03-09/spending-on-esg-data-seen-rising-to-1-billion-amid-asset-growth ("Investors will likely

On the issuer side, there are dozens of different rating agencies producing more than 600 ESG ratings,[33] and companies frequently report against more than one of the many competing standards.[34] If shareholders can't make use of this information to drive meaningful change, all this work is a dead loss. The money would be better spent almost anywhere.

Finally, to the extent that the push for ESG investing is causing corporations to divert resources to projects that only appear to advance social and environmental goals, these resources would be better spent in other ways. Almost by definition, "greenwashing" or "wokewashing" is a waste of money, as well as a breeding ground for cynicism and dishonesty.[35]

Anyone seriously concerned about social and environmental problems must care about whether the expensive, distracting tools being promoted to solve these problems actually work. This Article

---

spend $1 billion on data tracking environmental, social and governance factors by 2021 . . . .").

[33] Fish, Kim & Venkatraman, *supra* note 6, at 5 ("There are more than 600 ESG . . . ratings being produced globally . . . ."); *see also,* Feifei Li & Ari Polychronopoulos, *What a Difference an ESG Ratings Provider Makes!*, RSCH. AFFILIATES (Jan. 2020) https://www.researchaffiliates.com/publications/articles/what-a-difference-an-esg-ratings-provider-makes [https://perma.cc/9Z9W-BN8N] ("At the time of this writing, we have identified 70 different firms that provide some sort of ESG ratings data."); Cornell & Damodaran, *supra* note 17, at 77 (discussing inconsistent ESG measurement criterion and the resulting divergent ratings); *infra* text accompanying notes 169–190.

[34] *See* Amir Amel-Zadeh & George Serafeim, *Why and How Investors Use ESG Information: Evidence from a Global Survey*, 74 FIN. ANALYSTS J. 87, 87 (2018) ("Whereas fewer than 20 companies disclosed ESG data in the early 1990s, the number of companies issuing sustainability or integrated reports had increased to nearly 9,000 by 2016."); U.S. CHAMBER OF COM. FOUND., CORPORATE SUSTAINABILITY REPORTING: PAST, PRESENT, FUTURE 29 (2018), https://www.uschamberfoundation.org/sites/default/files/Corporate%20Sustainability%20Reporting%20Past%20Present%20Future.pdf [https://perma.cc/A77X-3ETK] (noting that some public companies report they are asked to complete up to 250 different surveys on ESG matters).

[35] *See Special Report: Institutional Investors, U.S. Report, Edelman Trust Barometer, 2021*, EDELMAN 9, https://www.edelman.com/sites/g/files/aatuss191/files/2021-11/2021%20Investor%20Trust%20Report_FINAL.pdf [https://perma.cc/6LMA-RYA8] (reporting nearly three out of four institutional investors do not trust companies to achieve their stated ESG commitments); *see also* Thomas P. Lyon & A. Wren Montgomery*, The Means and End of Greenwash*, 28 ORG. & ENV'T 223, 229 (2015) (discussing consumer skepticism resulting from deceptive greenwashing practices).

Georgia Law Review, Vol. 58, No. 1 [2023], Art. 5

is about the most prominent of these tools in corporate governance: institutional shareholder power.

II. THE QUESTION OF SHAREHOLDER INCENTIVES

Policy debates in corporate law often depend on very crude models of human behavior.[36] It is not this Article's intention to argue that investment fund managers are dishonest or hypocritical in expressing a desire to facilitate corporate progress on ESG issues. Rather, this Part argues that a variety of structural features in the industry have the combined effect of reducing the amount of time and attention investment funds can spend on ESG issues not immediately connected to generating financial returns. This Part can thus be seen as providing a background for the rest of the Article's arguments that it is (i) very hard for shareholders to know about the social and environmental impacts of their portfolio companies; (ii) very hard for them to find out about the viable alternatives available to individual companies; and (iii) very hard to productively intervene in corporate strategy using the tools they are given by the legal system.

A. THE INCENTIVES TO MAXIMIZE PORTFOLIO RETURNS

The most obvious feature of investment funds is that their managers have strong economic incentives to maximize risk-adjusted returns.[37] In the market for investment advice, money

---

[36] *See* Tingle, *How Good Are Our Best Practices?*, *supra* note 16, at 403–05 (discussing how models of human behavior shape corporate compensation structures).

[37] For the most exhaustive treatment of these incentives, see ROGER M. BARKER & IRIS H.Y. CHIU, CORPORATE GOVERNANCE AND INVESTMENT MANAGEMENT (2017). *See also* Martin Lipton & Steven A. Rosenblum, *A New System of Corporate Governance: The Quinquennial Election of Directors*, 58 U. CHI. L. REV. 187, 196 (1991) ("Institutional stockholders have little incentive or inclination to behave like traditional owners in the classical economic model—that is, to work actively towards the long-term operating success of the corporation. They tend to focus instead on the current market price of the corporation's stock."); Jack B. Jacobs, *"Patient Capital": Can Delaware Corporate Law Help Revive It?*, 68 WASH. & LEE L. REV. 1645, 1650 (2011) (noting that "institutional investors are managed by persons or firms whose compensation depends on generating short-term returns from the portfolio company shares under fund management"); Lynne L. Dallas, *Short-Termism, the Financial Crisis, and Corporate Governance*, 37 J. CORP. L. 265, 272 (2012) (finding that cultural and economic incentives lead asset managers to prioritize short-term financial gain over long-term benefit);

tends to flow to managers who generate the best returns.[38] This is true for index funds,[39] as well as actively managed funds,[40] and it is true even for managers of captive money such as public pension funds.[41] For example, after the Alberta Investment Management Corporation (AIMCo) reported a $2.1 billion loss in the spring of 2020, the consequences were swift.[42] First, it became a very public political headache for the government[43]: the CEO was forced to resign along with at least five other senior officers;[44] proposals were made to significantly shake up the board of directors by adding representatives of the various pension schemes with money managed by AIMCo;[45] and finally, one of those plans representing

---

Andrei Shleifer & Robert W. Vishny, *Equilibrium Short Horizons of Investors and Firms*, 80 AM. ECON. ASS'N PAPERS AND PROCS. 148, 148 (1990) (summarizing "the often lamented pursuit by investors of short-term capital gains").

[38] *See* Patrick J. Collins, "*Without More": Trust Manager Selection and Retention*, 125 BANKING L.J. 391, 395–96 (2008) (discussing the quantitative criteria in selecting investment managers).

[39] *See* Usha Rodrigues, *Corporate Governance in an Age of Separation of Ownership from Ownership*, 95 MINN. L. REV. 1822, 1832 (2011) (stating that "there is little incentive for an index fund manager to engage in activism of any kind").

[40] *See* Roberta Romano, *Less is More: Making Institutional Investor Activism a Valuable Mechanism of Corporate Governance*, 18 YALE J. REG. 174, 179 (2001) ("The fact that . . . private pension and mutual funds do not engage in activism has been explained by the competitive nature of the industry. . . .").

[41] *See* BARKER & CHIU, *supra* note 37, at 18 (noting that "[p]ension fund management from both developed countries and emerging economies accounts for the lion's share of assets under management").

[42] *See* Lisa Johnson, *University Teacher Pension Plan Pulls Out Billions in Assets from AIMCo Management*, EDMONTON J. (May 10, 2021) https://edmontonjournal.com/news/politics/university-teachers-pension-plan-pulls-out-billions-in-assets-from-aimco-management [https://perma.cc/X2RG-YQTF] (describing the $2.7 billion AIMCo loss).

[43] *See id.* (documenting that "[m]embers of the Opposition . . . delivered boxes of complaints, collected from Albertans concerned about their pensions, to the office of the Premier of Alberta").

[44] *See* Janet French, *CEO Leaving AIMCo in Wake of $2.1-Billion Investment Loss*, CBC NEWS (Nov. 18, 2020, 4:48 PM), https://www.cbc.ca/news/canada/edmonton/ceo-leaving-aimco-in-wake-of-2-1-billion-investment-loss-1.5807217 [https://perma.cc/7K3Q-SVLA] (documenting the departure of the CEO of AIMCo, two other senior leaders, and three executives).

[45] *See* Michelle Bellefontaine, *Alberta Finance Resists Pension Plan Representation on AIMCo Board*, CBC NEWS (Feb. 26, 2021, 7:02 PM), https://www.cbc.ca/news/canada/edmonton/alberta-finance-resists-pension-plan-

Georgia Law Review, Vol. 58, No. 1 [2023], Art. 5

university professors withdrew its $2.7 billion investment and gave it to other managers.[46]

There are virtually no funds, of any type, in which managers' compensation is not closely related to their performance in generating returns.[47] This goes beyond the portion of managers' pay packages that are explicitly linked to their performance; it includes the portion of their pay that derives from the total assets under management.[48] Indeed, the primary economic incentive for managers is to increase the size of their assets under management, as that has the most impact on their own remuneration.[49] This means that relative fund performance is what matters. Funds are not managed to exceed some internal hurdle, they are managed to exceed the market alternatives: the returns generated by other

representation-on-aimco-board-1.5930295 [https://perma.cc/2U5V-TLV2] (documenting proposals and referendums for reform of AIMCo after the scandal).

[46] Johnson, *supra* note 43.

[47] *See* Allison L. Evans, *Portfolio Manager Ownership and Mutual Fund Performance*, 37 FIN. MGMT. 513, 515 (2008) (noting that 90% of disclosed compensation is tied to fund performance).

[48] *See id.* (noting that "compensation is based primarily on net assets under management").

[49] *See* Jonathan B. Berk & Richard C. Green, *Mutual Fund Flows and Performance in Rational Markets*, 112 J. POL. ECON. 1269, 1271 (2004) (finding that fund managers are incentivized to increase the size of their funds until diseconomies of scale risk an outflow of investor funds); *see also* M.K. Berkowitz & Y. Kotowitz, *Incentives and Efficiency in the Market for Management Services: A Study of Canadian Mutual Funds*, 26 CAN. J. ECONOMICS 850 (1993) (discussing the prevalence of asset-based compensation in Canadian funds relative to performance-based compensation); Chengdong Yin, *The Optimal Size of Hedge Funds: Conflict Between Investors and Fund Managers*, 71 J. FINANCE 1857 (2016) (finding that the primary driver of manager compensation is fund size, not performance); Bing Liang & Christopher Schwarz, Is Pay for Performance Effective? Evidence From the Hedge Fund Industry 27 (Mar. 2011) (unpublished manuscript), http://ssrn.com/abstract=1333230 (finding that increasing assets under management is the primary motivation of hedge fund managers); Ronald J. Gilson & Curtis J. Milhaupt, *Shifting Influences on Corporate Governance: Capital Market Completeness and Policy Channeling*, 12 HARV. BUS. L. REV. 1, 42 (2022) (explaining that, "[b]ecause the mutual fund advisor's compensation is typically set as a percentage of [assets under management]," advisors are incentivized to increase those assets); Ronald J. Gilson & Jeffery N. Gordon, *The Agency Costs of Agency Capitalism: Activist Investors and the Revaluation of Governance Rights*, 113 COLUM. L. REV. 863 (2013) (discussing how the business model of investment intermediaries focuses on increasing assets under management through relative performance).

managers, or at least some relevant index benchmark.[50] This in turn produces a market for investment advice that rewards and punishes managers largely on the relative performance of their investments.

Even in the case of a fund in which the investors are captive and cannot move their money, and where the fund management company itself cannot be changed, the individuals in that management company will be in some sort of competition amongst themselves. Who wants to be the lowest ranked employee or to tell the trapped beneficiaries that their investment portfolio has underperformed?[51] In addition, these managers will be aware that they are operating in a broader industry that is not characterized by institutional barriers to competition, and that their ability to land attractive jobs in the future will be significantly impacted by their current performance.

We know this description of the incentives operating on fund managers is correct because we have run a natural experiment over the past thirty years or so, during which we have significantly increased shareholder power over corporations.[52] Over that time, "[t]he hope of reducing agency costs through institutional activism has led to regulatory and structural changes to increase shareholder power."[53] The result is that over the past few decades we have been "persistently moving towards shareholder empowerment."[54] What

---

[50] *See* Jill E. Fisch, *Securities Intermediaries and the Separation of Ownership from Control*, 33 SEATTLE U. L. REV. 877, 881 (2010) (discussing the motivations of fund managers to "match the returns of their benchmark rather than to engage in more costly activism"); Andrea Devenow & Ivo Welch, *Rational Herding in Financial Economics*, 40 EUR. ECON. REV. 603, 603 (1996) (summarizing contemporary papers on rational herding in financial markets and determining that "herding could potentially be universal").

[51] *See* Jeffrey N. Gordon, *Systematic Stewardship* 14 (Eur. Corp. Governance Inst., Working Paper No. 566/2021, 2022) ("If the asset manager is advisor to a pension fund or endowment, relative performance is similarly used in retention and compensation decisions.").

[52] *See* Martin Gelter, *The Pension System and the Rise of Shareholder Primacy*, 43 SETON HALL L. REV. 909, 911 (2013) ("[C]hanges in the pension system helped to transform corporate governance into a system dominated by the shareholder interest . . . ."); Bryce C. Tingle, *Two Stories About Shareholders*, 58 OSGOODE HALL L.J. 57, 71–76 (2021) (describing and evaluating the impact of two competing economic models of shareholder behavior).

[53] Fisch, *supra* note 50, at 884 .

[54] PAVLOS E. MASOUROS, CORPORATE LAW AND ECONOMIC STAGNATION: HOW SHAREHOLDER VALUE AND SHORT-TERMISM CONTRIBUTE TO THE DECLINE OF THE WESTERN ECONOMIES 301 (2013); *see also* Simon Deakin, Prabirjit Sarkar & Mathias Siems, *Is There a Relationship Between Shareholder Protection and Stock Market Development?*, 3 J.L. FIN. &

Georgia Law Review, Vol. 58, No. 1 [2023], Art. 5

has resulted? Corporate retained earnings in America have declined from an average of 50%–60% percent in 1962, to 3% in 2002.[55] Over this time period, U.S. shareholders "have withdrawn more money from [public] companies than they have invested" to the point that "[t]here is little question that public equity largely has disappeared as a significant form of permanent capital."[56] Where corporations gain relatively more independence from institutional shareholder influence, the evidence is that non-shareholder constituencies benefit, as these corporations pay more tax (as a result of deploying less aggressive tax avoidance strategies);[57] they get better deals from lenders (as the risk of expropriation by shareholders declines);[58] they are more likely to have stronger relationships with important customers, suppliers, or strategic partners;[59] they engage

ACCT. 115, 123 (2018) ("[W]ithout exception, all countries have increased the level of shareholder protection.").

[55] Lawrence E. Mitchell, *Whose Capital; What Gains?,* ISSUES IN GOVERNANCE STUD., no. 49, (Brookings Inst., Washington, D.C.), July 2012, at 2, https://www.brookings.edu/wp-content/uploads/2016/06/Whose-Capital-What-Gains.pdf [https://perma.cc/U4SB-LLL5].

[56] *Id.* at 2–3; *see also* Justin Fox & Jay W. Lorsch, *What Good Are Shareholders?*, HARV. BUS. REV., July–Aug. 2012, at 49, 51 https://hbr.org/2012/07/what-good-are-shareholders [https://perma.cc/KV4K-FDZW] ("Factor in dividend payments, and we find a multi-trillion-dollar transfer of cash *from* U.S. corporations *to* their shareholders over the past 10 years.").

[57] *See* Douglas Cummings, Bryce C. Tingle, & Feng Zhan, *For Whom (and for When) Is the Firm Governed? The Effect of Changes in Corporate Fiduciary Duties on Tax Strategies and Earnings Management*, 27 EUR. J. FIN. MGMT. 775, 779 (2021) (finding that "changes to the fiduciary duty improve measurable outcomes for non-shareholder constituencies"); Inder K. Khurana & William J. Moser, *Institutional Shareholders' Investment Horizons and Tax Avoidance*, 35 J. AM. TAX'N ASS'N 111, 113–14 (2013) (finding that firms owned by long-term institutional shareholders demonstrate less tax avoidance than other firms without the same liberty to plan for the future); C.S. Agnes Cheng, Henry He Huang, Yinghua Li & Jason Stanfield, *The Effect of Hedge Fund Activism on Corporate Tax Avoidance*, 87 ACCT. REV. 1493, 1522 (2012) (finding firms under short-term activist hedge fund shareholder pressure "experience significant increases in tax avoidance").

[58] *See* Tingle, *supra* note 52, at 96 ("[T]he increase in value comes expressly from the assurance that these investments cannot be expropriated by the shareholders through a takeover."); Huasheng Gao, Kai Li & Yujing Ma, *Stakeholder Orientation and the Cost of Debt: Evidence from State-Level Adoption of Constituency Statutes*, 56 J. FIN. & QUANTITATIVE ANALYSIS 1908, 1937 (2021) (finding a "causal effect of stakeholder orientation on firms' cost of debt financing").

[59] *See* William C. Johnson, Jonathan M. Karpoff & Sangho Yi, *The Bonding Hypothesis of Takeover Defenses: Evidence from IPO Firms*, 117 J. FIN. ECON. 307, 309 (2015) ("IPO firm valuation is positively related to the use of takeover defenses, but only when the IPO firm has a large customer, dependent supplier, or strategic partner.").

Tingle: Shareholders' Potential

in less risky behavior (which means they make lower profits but are more likely to survive a crisis);[60] they spend more on corporate social responsibility;[61] and they invest more in longer term projects.[62]

---

[60] *See* Nadia Saghi-Zedek & Amine Tarazi, *Excess Control Rights, Financial Crisis and Bank Profitability and Risk*, 55 J. BANKING & FIN. 361, 375 (2015) ("[T]he presence of excess control rights negatively affects bank profitability and positively impacts risk."); Reint Gropp & Matthias Köhler, *Bank Owners or Bank Managers: Who is Keen on Risk? Evidence from the Financial Crisis* 3 (ZEW, Discussion Paper No. 10-013, 2020), https://ftp.zew.de/pub/zew-docs/dp/dp10013.pdf [https://perma.cc/3EJ3-FM6T] (finding that, in relation to banks, that "shareholders prefer more risk relative to managers" and "owner controlled banks are significantly more likely to receive government assistance during the crisis"); Alan Digam, *The Future of Shareholder Democracy in the Shadow of the Financial Crisis*, 36 SEATTLE U. L. REV. 639, 643–58 (2013) (finding that the more power institutional shareholders had over banks, the more likely the banks would have outsized profits before the 2008 financial crisis and the more likely they would have larger losses after the crisis began).

[61] *See* Ing-Haw Cheng, Harrison Hong & Kelly Shue, *Do Managers Do Good With Other People's Money?* 26 (Nat'l Bureau of Econ. Rsch., Working Paper No. 19432, 2013) (finding that "improvements in managerial incentives and governance lead to a reduction in firm goodness").

[62] *See* Caroline Heqing Zhu, *The Preventive Effect of Hedge Fund Activism: Investment, CEO Compensation and Payout Policies*, 17 INT'L J. MANAGERIAL FIN. 401, 413 (2020) (finding that, "[i]n proactive response to an increase in the likelihood of hedge fund intervention, firms cut CEO pay, limit capital investment and R&D expenses and raise shareholder distributions and CEO turnover"); John C. Coffee Jr. & Darius Palia, *The Wolf at the Door: The Impact of Hedge Fund Activism on Corporate Governance*, 41 J. CORP. L. 545, 589 (2016) ("[T]he conclusion seems inescapable that activist interventions (or at least many of them) are associated with a decline in R&D and long-term investment."); Ian D. Gow, Sa-Pyung Sean Shin & Suraj Srinivasan, *Activist Directors: Determinants and Consequences* 4 (Harvard Bus. Sch., Working Paper No. 14-120, 2014), https://dash.harvard.edu/handle/1/13479133 [https://perma.cc/VC3Q-LN7Y] ("[A]ctivist directors play[] a significant role in curbing expenditures on . . . research and development (R&D) . . . ."); Alon Brav, Wei Jiang, Song Ma & Xuan Tian, Shareholder Power and Corporate Innovation: Evidence from Hedge Fund Activism 30 (May 21, 2015) (unpublished manuscript), https://www.activistinsight.com/research/Shareholder%20Power%20and%20Corporate%20Innovation%20Evidence%20from%20Hedge%20Fund%20Activism_150915114423.pdf [https://perma.cc/N4DA-E2S6] (finding that hedge fund activist-targeted firms experience a decline in R&D expenditures, but an innovative output increase); K.J. Martijn Cremers & Simone M. Sepe, Board Declassification Activism: Why Run Away from the Evidence? (June 2017) (unpublished manuscript), www.ssrn.com/abstract=2991854 (finding a negative effect of Shareholder Rights Project board declassification on the firm value, which largely impacted firms with high R&D spend); K.J. Martijn Cremers & Simone M. Sepe, Board Declassification Activism: The Financial Value of the Shareholder Rights Project, (June 2017) (unpublished manuscript), www.ssrn.com/abstract=2962162 (analyzing the value implications of classified boards); Joern H. Block, *R&D Investments in Family and Founder Firms: An Agency Perspective*, 27 J. BUS. VENTURING 248, 249 (2012) (finding managers are usually primarily

The most notable shareholder interventions (by activist investors) are generally about financial engineering moves designed to increase short-term payouts to shareholders, often by transferring wealth from stakeholders like employees and debt holders.[63] As shareholders gain increasing power, the compensation

---

interested in projects with short-term payoffs over uncertain projects with long term payoffs); MASOUROS, *supra* note 54 (detailing the way the growth in shareholder power has led to increasingly short-term corporate behavior); Caroline Flammer & Aleksandra Kacperczyk, *The Impact of Stakeholder Orientation on Innovation: Evidence from a Natural Experiment*, 62 MGMT. SCI. 1982, 1982 (2016) (finding that enactment of constituency statutes in firms leads to significant increases in the number of patents and the citations per patent).

[63] *See* YVAN ALLAIRE & FRANÇOIS DAUPHIN, "ACTIVIST" HEDGE FUNDS: CREATORS OF LASTING WEALTH? WHAT DO THE EMPIRICAL STUDIES REALLY SAY? 16 (2014) www.igopp.org/wp-content/uploads/2014/07/IGOPP_Article_Template2014_Activism_EN_v6.pdf [https://perma.cc/RRN2-D3RN] (finding that "there is no 'creation' of value, but rather a 'transfer' of value to shareholders from employees and bondholders" (citation omitted)); Robin Greenwood & Michael Schor, *Investor Activism and Takeovers*, 92 J. FIN. ECON. 362, 363 (2009) (finding no improvement in the operating performance of targets of shareholder activists, but that the returns are entirely due to targets being acquired); William W. Bratton, *Hedge Funds and Governance Targets: Long-Term Results* 1 (Univ. of Pa. L. Sch. Inst. For L. and Econ., Research Paper No. 10-17, 2010), http://ssrn.com/abstract=1677517 (finding an increase in debt among funds pushing for short-term gains); Alon Brav, Wei Jiang & Hyunseob Kim, *The Real Effects of Hedge Fund Activism: Productivity, Asset Allocation, and Labor Outcomes*, 28 REV. FIN. STUD. 2723, 2749 (2015) (finding that employees of hedge fund activism-targeted firms faced stagnation of wages and reduction of hours despite an increase in productivity); Yvan Allaire & François Dauphin, *The Game of 'Activist' Hedge Funds: Cui Bono?*, 13 INT'L J. DISCLOSURE & GOVERNANCE 279, 288, 303 (2016) (finding the goal of hedge fund managers is often to sell-off a targeted company rather than long term improvement, and that activist holding had no impact on performance after three years); Matthew R. Denes, Jonathan M. Karpoff & Victoria B. McWilliams, *Thirty Years of Shareholder Activism: A Survey of Empirical Research*, 44 J. CORP. FIN. 405, 413 (2017) (documenting that "target firms tend to decrease their capital expenditures, increase their payouts, and increase their incidence of asset divestitures, restructurings, or employee layoffs" and "[loan] spreads increase when the activism is related to an acquisition or financial restructuring"); K.J. Martijn Cremers, Erasmo Giambona, Simone M. Sepe & Ye Wang, Hedge Fund Activism and Long-Term Firm Value 27 (Jan. 2016) (unpublished manuscript), https://ccl.yale.edu/sites/default/files/files/leo16_Sepe.pdf [https://perma.cc/NN2M-53W3] ("[H]edge fund intervention may . . . undermin[e] the ability of corporate managers to pursue value-increasing long-term investments and complicat[e] (or mak[e] more costly) the cooperation of other stakeholders towards such long-term value creation."); Leo E. Strine, Jr., *Who Bleeds When the Wolves Bite?: A Flesh-and-Blood Perspective on Hedge Fund Activism and Our Strange Corporate Governance System*, 126 YALE L.J. 1870, 1929, 1945 (2017) (concluding that gains from activism often involve shifts of wealth from workers and creditors); Coffee & Palia, *supra* note 62, at 549 ("[T]he rise of activist funds to power implies that creditors, employees, and other corporate constituencies will be compelled to make

arrangements of companies have been altered so that executive pay closely tracks fluctuations in shareholder welfare.[64] Several recent papers even argue that the growth of institutional shareholder power has had a direct effect on increasing inequality by holding down employee wages.[65]

In short, most of the available evidence seems to suggest that shareholders generally pursue increasing their portfolios' returns.[66] This cannot be controversial. It amounts to saying no more than asset managers act in their own interests, which, to a significant degree, are also (quite properly) the interests of those whose money is being invested. Professors Gilson and Milhaupt observe that "[i]t was the reconcentration of equity in institutional investors that . . . gave rise to a shift toward capital market completeness, and so to

---

wealth transfers to shareholders."); Tingle, *supra* note 52, at 88–89 ("Nearly all research to date suggests that the principal effects of an activist intervention are a reduction in capital assets and R&D spending; a decline or stagnation in employment levels and wages; a reduction in the amount of cash held by the corporation; and an increase in leverage. The cash freed up from these changes is returned to shareholders . . . .").

[64] *See* Marianne Bertrand & Sendhil Mullainathan, *Are CEOs Rewarded For Luck? The Ones Without Principals Are*, 116 Q.J. ECONOMICS 901, 901 (2001) ("Shareholders . . . optimally design the [CEO's] pay package in order to increase the CEO's incentive to maximize firm value."); Kevin J. Murphy, *Politics, Economics, and Executive Compensation*, 63 U. CIN. L. REV. 713, 739 (1995) (arguing performance-based pay leads to higher compensation, such pay being a premium charged by executives for accepting more risk); John E. Core & Wayne R. Guay, *Is CEO Pay Too High and Are Incentives Too Low? A Wealth-Based Contracting Framework*, 24 ACAD. MGMT. PERSPS. 5, 9 (2010) (finding a strong relation between performance and executive compensation, with results indicating that poor financial performance by the firm leads to decreased pay for CEOs).

[65] *See, e.g.*, Anna Stansbury & Lawrence H. Summers, *The Declining Worker Power Hypothesis: An Explanation for the Recent Evolution of the American Economy* 2 (Nat'l Bureau of Econ. Rsch., Working Paper 27193, 2020) ("[T]he increase in shareholder power and shareholder activism has led to pressure on companies to cut labor costs, resulting in wage reductions within firms and the 'fissuring' of the workplace as companies increasingly outsource and subcontract labor."); Zohar Goshen & Doron Levit, *Common Ownership and the Decline of the American Worker*, COLUM. L. SCH.: BLUE SKY BLOG (June 1, 2021) https://clsbluesky.law.columbia.edu/2021/06/01/common-ownership-and-the-decline-of-the-american-worker/ [https://perma.cc/VU5W-366Q] (arguing the rise of large institutional investors "has been a significant cause of wage stagnation and income inequality").

[66] Tingle, *supra* note 52, at 88–89 (discussing how various types of active shareholder engagement with companies do not appear connected to reducing managerial slack or malfeasance, but instead appear primarily motivated by a desire to increase shareholder financial returns, often by expropriating value from other corporate constituencies).

Georgia Law Review, Vol. 58, No. 1 [2023], Art. 5

even more attention to shareholder value maximization in the first place."[67]

It should be noted that this investor behavior is not a uniquely American phenomenon—the result of, say, Delaware's shareholder-primacy regime. The growth in shareholder power over the past thirty years occurred throughout the developed world and the results were essentially the same.[68] The European Commission's recent report on sustainable corporate governance found:

> Evidence collected over the 1992–2018 period shows that there is a trend for publicly listed companies within the EU to focus on short-term benefits of shareholders rather than on the long-term interests of the company. Data indicate an upward trend in shareholder pay-outs, which increased fourfold, from less than 1% of revenues in 1992 to almost 4% in 2018. Moreover, the ratio of CAPEX and R&D investments to revenues has been declining since the beginning of the 21st century.[69]

It is impossible, of course, to conclusively demonstrate a causal connection between these trends in corporate behavior and the rise of shareholder influence.[70] However it is clear that: (i) the trends are closely matched; (ii) we would expect a causal relationship based on a simple assessment of the interests of institutional asset managers; and (iii) at the very least, the rise of shareholder power did not prevent a worsening of corporate outcomes for non-shareholder constituencies. In fact, as we shall see, the evidence is weak that

---

[67] Gilson & Milhaupt, *supra* note 49, at 39; *see also* Gelter, *supra* note 52, at 910–11 (highlighting the shift from managerial capitalism to investor capitalism).

[68] *See* MASOUROS, *supra* note 54, at 35 (explaining that the "shift in the institutional logistics of corporate governance towards shareholder value" has been observed in "the major Western economies" since the early 1970s).

[69] ERNST & YOUNG FOR EUR. COMM'N DIRECTORATE GEN. FOR JUST. & CONSUMERS, STUDY ON DIRECTORS' DUTIES AND SUSTAINABLE CORPORATE GOVERNANCE, at vi (2020) (emphasis omitted), https://op.europa.eu/en/publication-detail/-/publication/e47928a2-d20b-11ea-adf7-01aa75ed71a1/language-en [https://perma.cc/X2WA-KZPZ].

[70] *See* Bryce C. Tingle, *Institutional Shareholders, Short-Termism and the Odds of a Coincidence*, 63 CAN. BUS. L.J. 389, 395 (2020) (book review) (explaining that establishing causation between shareholder influence and trends in corporate behavior "is probably impossible").

shareholders—even those who are branded as ESG funds—meaningfully pursue social and environmental objectives unrelated to marketing or fund financial performance.[71]

Finally, even self-declared ESG funds do not provide any public guidance on how the funds' social and environmental value creation is to be measured, nor do the funds allocate a meaningful amount of their managers' pay to their environmental and social achievements.[72] Generally, managers running ESG funds are paid in more or less the same ways as their peers in other funds: based on financial performance.[73]

B. THE INCENTIVES TO AVOID INVESTING IN FIRM-SPECIFIC GOVERNANCE

The argument that shareholders do not have the resources or incentives to invest time in firm-specific corporate governance has been made in many places by many scholars.[74] The widespread hope

[71] *See infra* discussion accompanying notes 120–145.

[72] *See* Paul Brest, Ronald J. Gilson & Mark A. Wolfson, *How Investors Can (and Can't) Create Social Value* 5 (Eur. Corp. Governance Inst., Working Paper No. 394/2018, 2018), https://papers.ssrn.com/sol3/papers.cfm?abstract_id=3150347 (explaining that ESG funds "label their activities in a loose fashion that reflects either their aspirations or their market strategies rather than measurable results").

[73] *See id.* at 26 (documenting that "asset managers running impact investing funds [are] paid based (almost) exclusively [based] on financial value").

[74] *See* Gilson & Gordon, *supra* note 49, at 895 (noting the "mismatch between skills and incentives with respect to active company management" resulting in "governance rights [being] chronically undervalued"); Gordon, *supra* note 51, at 14 (explaining that firm-specific corporate governance is associated with a "positive cost" and "is not a winning proposition from a relative performance perspective" for shareholders); Bryce C. Tingle, *The Agency Cost Case for Regulating Proxy Advisory Firms*, 49 U.B.C. L. REV. 725, 738 (2016) [hereinafter Tingle, *The Agency Cost*] (arguing that fund managers have "very little incentive . . . to become involved in the corporate governance of portfolio companies"); Tingle, *supra* note 52, at 64–65 (contending that, in one way of interpreting current norms, "[s]hareholders lack the information necessary to make informed decisions about the firm[,] . . . may be unable to make nuanced judgments about the business with the information available to them . . . [and] their interests nevertheless conflict with those of the organization"); Bryce C. Tingle, *Expressive Voting and Irrational Outcomes in Corporate Elections*, 67 MCGILL L.J. 71, 113 (2021) [hereinafter Tingle, *Expressive Voting*] (concluding that shareholders prefer to invest time in expressive or symbolic matters instead of firm-specific governance); Lucian Bebchuk & Scott Hirst, *Index Funds and the Future of Corporate Governance: Theory, Evidence, and*

Georgia Law Review, Vol. 58, No. 1 [2023], Art. 5

in the 1990s that institutional shareholders would improve corporate governance gradually "faltered because it turned out that sustained monitoring was inconsistent with the [asset managers'] business model . . . both in the economic incentives and the legal exposure."[75]

Investment professionals' success is, as we have seen, measured in terms of their portfolios' relative performance.[76] Superior performance over competing funds or various benchmark indices will generally result in higher assets under management and, as compensation for managers is ordinarily a percentage of assets under management, will lead to significantly higher pay. Even if we assume ESG considerations are connected to better financial outcomes, this dynamic means that fund managers do not have any incentives to engage in firm-specific initiatives, as the benefits of such interventions will largely be captured by other shareholders and reflected in the relevant benchmark indices. In other words, firm-specific governance does not improve a portfolio's *relative* performance.

The barriers to governance activity are worse than this suggests, since the outcomes of ESG interventions are usually uncertain and often occur only over the very long term.[77] They are expensive (possibly involving proxy fights and takeovers), and they carry considerable legal risks.[78] If a fund manager spots an ESG failure

---

Policy, 119 COLUM. L. REV. 2029, 2134–35 (2019) (discussing the barriers to effective governance activity from index funds).

[75] Gordon, *supra* note 51, at 14; *see also* Randall S. Thomas, *The Evolving Role of Institutional Investors in Corporate Governance and Corporate Litigation*, 61 VAND. L. REV. 299, 300 (2008) (discussing the inverse relationship between increased agency monitoring and shareholders' economic interests).

[76] *See supra* discussion accompanying notes 47–50.

[77] *See* Paul Cox, Stephen Brammer & Andrew Millington, *An Empirical Examination of Institutional Investor Preferences for Corporate Social Performance*, 52 J. BUS. ETHICS 27, 29 (2004) ("There is a broad consensus in the conceptual literature that many of the financial gains from improved social performance accrue in the long run . . . ."); *see also* People v. Exxon Mobil Corp., No. 452044/2018, 2019 WL 6795771, at *19 (N.Y. Sup. Ct. Dec. 10, 2019) ("No reasonable investor . . . would make investment decisions based on speculative assumptions of costs that may be incurred 20+ or 30+ years in the future with respect to unidentified future projects.").

[78] *See* Bernard S. Black, *Shareholder Passivity Reexamined*, 89 MICH. L. REV. 520, 523 (1990) ("[I]nstitutional shareholders are hobbled by a complex web of legal rules that make it difficult, expensive, and legally risky to own large percentage stakes or undertake joint

with an obvious potential impact, it will always be more lucrative for the fund manager to sell her position in the company before the market realizes the risk. The alternative is for the fund manager to expend considerable time and effort trying to fix the problem, which will alert other investors to the issue.[79] The share price of the company will decline to reflect the ESG risk, driving down its value in the fund manager's portfolio.[80] At the same time, her interventions may be unsuccessful, so she will be exposed to the consequences of the ESG failure. Even if she succeeds and the stock price improves, this improvement may only return the stock price to its level when the market was ignorant of the ESG risk discovered by the fund manager. If it improves beyond this point, it still may not help the manager or her fund, as funds are evaluated on their quarterly or annual performance, and the returns to ESG investments likely arise over the longer term. (It is implausible corporate leaders routinely miss the chance for a short-term gain). In any event, the growth in corporate value won't benefit the fund manager, as it will be reflected in the relative returns of rival funds and benchmarks.[81]

These arguments assume that a portfolio manager is likely to even spot a specific risk in the dozens or hundreds of companies in which she invests. Most money managers have no operational or managerial experience, have little technical training or experience, possess no insight into organizations or particular markets, and usually don't know about the available alternatives.[82] They invest

efforts."); *see also* Leonard S. Machtinger, *Proxy Fight Expenditures of Insurgent Shareholders*, 19 CASE W. RSRV. L. REV. 212, 228 (1968) ("A shareholder considering whether or not to commence or actively participate in a proxy fight must realize that such contests are quite expensive.").

[79] *See* John C. Coffee, Jr., *Liquidity Versus Control: The Institutional Investor as Corporate Monitor*, 91 COLUM L. REV. 1277, 1328 (1991) (finding that "money managers are rationally apathetic because the expected gains from most . . . governance issues are small, deferred, and received by investors, while the costs are potentially large, immediate, and borne by money managers").

[80] *See id.* at 1324 (noting that manager governance interventions "result in an interim period of disruption, uncertainty, and decreased profitability").

[81] *See id.* at 1325 (arguing that manager focus on short-term profits over corporate governance results from "head-to-head competition for investor funds").

[82] *See* Alon Brav, Wei Jiang, Frank Partnoy & Randall Thomas, *Hedge Fund Activism, Corporate Governance, and Firm Performance*, 63 J. FINANCE 1729, 1755 (2008) (noting that "many of the hedge funds . . . are not experts in the specific business of their target firms").

Georgia Law Review, Vol. 58, No. 1 [2023], Art. 5

in many large and complex companies with few independent sources of information about their activities.[83] Studies show that when shareholders do gain board seats, the new board members are much more likely to have finance backgrounds rather than technical or operational experience,[84] and even when the activists are motivated principally by a desire to improve financial returns, the targeted companies underperform their peers unless they are sold.[85]

Some categories of funds, such as the rapidly growing index fund and ETF segment, compete primarily on their very low fees, which leave them with very few resources for ESG activities.[86] Even in the segment of the market occupied by ESG-branded funds, "vastly more" money flows to lower-priced products.[87] Competition over the past few years has driven fee levels down for ESG funds, even though this means fewer resources available for investigating and intervening in corporate activities.[88]

---

[83] *See* Steven L. Schwarcz, *Rethinking the Disclosure Paradigm in a World of Complexity*, 2004 U. ILL. L. REV. 1, 5 (finding that some complex transactions in corporations cause disclosure to be detailed and sophisticated beyond the level of even most institutional investors); Barbara Black, *Behavioral Economics and Investor Protection: Reasonable Investors, Efficient Markets*, 44 LOY. U. CHI. L.J. 1493, 1506 (2013) (calling complex and lengthy disclosure a "[w]aste of investors' time").

[84] *See* ANDREW BOREK, ZACHARY FRIESNER & PATRICK MCGURN, INSTITUTIONAL S'HOLDER SERVS., THE IMPACT OF SHAREHOLDER ACTIVISM ON BOARD REFRESHMENT TRENDS AT S&P 1500 FIRMS, at 28 (2017) (finding that "financial services professionals" and "corporate executives" were the most likely candidates for board positions).

[85] *See* Ed deHaan, David Larcker & Charles McClure, *Long-Term Economic Consequences of Hedge Fund Activist Interventions* 12 (Eur. Corp. Governance Inst., Working Paper No. 577/2018, 2018), https://www.ecgi.global/sites/default/files/working_papers/documents/finaldehaanlarckermcclure.pdf [https://perma.cc/P522-QU3L] ("The biggest improvements in productivity are concentrated among plants that were sold after the activist intervention."); Bratton, *supra* note 63, at 2 (finding financial underperformance "particularly notable" where hedge funds entered the board room); ELAINE BUCKBERG & JONATHAN MACEY, NAT'L ECON. RSCH. ASSOCS., REPORT ON EFFECTS OF PROPOSED SEC RULE 14A-11 ON EFFICIENCY, COMPETITIVENESS AND CAPITAL FORMATION 9 (2009) (noting that there are "[s]everal . . . studies [that] establish that when dissident directors win board seats, those firms underperform peers by 19 to 40% over the two years following the proxy contest").

[86] *See* Bebchuk & Hirst, *supra* note 74, at 2057 (noting that the small margins and an inability to profitably increase fees disincentivize index funds from investing in ESG activities).

[87] *See* Wursthorn, *supra* note 30, ("Lower priced U.S. total market sustainable ETFs saw vastly more inflows than funds priced above 0.15% last year . . . .").

[88] *See id.* (comparing the fees for ESG funds with ETF funds).

Tingle: Shareholders' Potential

There is considerable evidence supporting this picture of institutional asset managers possessing few resources or incentives to invest in firm-specific governance[89]: (i) it took government initiatives to encourage funds to make use of their franchise in the first place;[90] (ii) many funds almost immediately delegated their governance powers to proxy advisors;[91] (iii) fund managers

---

[89] *See* Ronald J. Gilson & Jeffrey N. Gordon, *Agency Capitalism: Further Implications of Equity Intermediation* 14 (Eur. Corp. Governance Inst., Working Paper No. 239/2014, 2014), https://scholarship.law.columbia.edu/cgi/viewcontent.cgi?article=2836&context=faculty_scholarship [https://perma.cc/82VQ-J7ZK] ("Firm-specific performance activism is costly; for a diversified shareholder, the benefit-cost calculus will rarely be positive."); Stephen Choi, Jill E. Fisch & Marcel Kahan, *Director Elections and the Role of Proxy Advisors*, 82 S. CAL. L. REV. 649, 653 (2009) (discussing asset managers' delegation of governance powers to proxy advisors); John C. Coffee, Jr., *Liquidity Versus Control: The Institutional Investor as Corporate Monitor*, 91 COLUM. L. REV. 1277, 1328 (1991) (finding that money managers are not incentivized to take an interest in corporate governance issues).

[90] *See* 17 C.F.R. § 275.206(4)–(6) (2003) (prohibiting funds from voting on client securities without meeting requirements for, among other things, disclosure to clients and written fiduciary policies); *see also* Choi, Fisch & Kahan, *supra* note 89, at 653–54 (documenting that 2003 SEC regulations affecting mutual fund voting policies "increased the demand for proxy advisory services"). The 2003 change followed a similar reform in 1988, when the U.S. Department of Labor announced that ERISA pension fund fiduciaries had a duty to make informed decisions about how they voted the shares in their portfolios. *See* STEPHEN M. BAINBRIDGE, CORPORATE GOVERNANCE AFTER THE FINANCIAL CRISIS 31–32 (2012) (documenting the introduction of SEC Rule 19c-4 in 1988 and its intended effects on proxy solicitations); U.S. Dep't of Lab., Pension & Welfare Benefits Admin., Opinion Letter Re: Avon Products, Inc. Employees' Retirement Plan (Feb. 23, 1988) (stating that pension fund advisors' fiduciary duties respecting the management of employee benefit plans include how proxies should be voted); Dep't of Lab., Interpretive Bulletin Relating to Written Statements of Investment Policy, Including Proxy Voting Policy or Guidelines, 29 C.F.R. § 2509.94-2 (2007) (interpreting "sections 402, 403 and 404 of [ERISA] as those sections apply to voting of proxies on securities held in employee benefit plan investment portfolios and the maintenance of and compliance with statements of investment policy, including proxy voting policy" and "provid[ing] guidance on the appropriateness under ERISA of active monitoring of corporate management by plan fiduciaries"); SEC Staff Legal Bulletin No. 20, 109 S.E.C. Docket 1296 (June 30, 2014) (offering "guidance about investment advisers' responsibilities in voting client proxies and retaining proxy advisory firms" and "guidance on the availability and requirements of two exemptions to the federal proxy rules that are often relied upon by proxy advisory firms").

[91] *See* David F. Larcker, Allan L. McCall & Gaizka Ormazabal, *Outsourcing Shareholder Voting to Proxy Advisory Firms*, 58 J.L. & ECON. 173, 202 (2015) (finding that a substantial portion of institutional investors rely on proxy advisory firms for research and determining voting on their behalf); Dorothy S. Lund, *The Case Against Passive Shareholder Voting*, 43 J. CORP. L. 493, 515–16 (2018) (finding Vanguard, BlackRrock, and State Street are all understaffed and often outsource voting decisions to ISS and Glass Lewis).

Georgia Law Review, Vol. 58, No. 1 [2023], Art. 5

subscribe to proxy advisors' recommendations even when there is abundant evidence that the assumptions behind those recommendations are problematic and that errors commonly occur in advisors' work;[92] (iv) fund management companies employ relatively few people concerned with governance and voting decisions;[93] (v) their voting patterns suggest they don't spend time understanding their portfolio companies' governance issues;[94] (vi) many of their voting decisions actually appear deliberately designed to be ineffective;[95] and (vii) their most dramatic interventions (shareholder proposals and proxy campaigns) provide little evidence that they are driven by governance considerations or that they produce better corporate outcomes.[96]

---

[92] *See* Tingle, *The Agency Cost*, *supra* note 74, at 753 ("This leads us to an overarching concern about proxy firms' approach to corporate governance: there is considerable evidence that good governance does not primarily consist in the adoption of specific governance best practices."); Bryce C. Tingle, *Bad Company! The Assumption Behind Proxy Advisors' Voting Recommendations*, 37 DALHOUSIE L.J. 709, 709 (2014) [hereinafter Tingle, *Bad Company!*] (examining "the assumptions that underlie [proxy] advisors' voting recommendations, and the influence these assumptions have on corporate decision-making").

[93] *See* Lund, *supra* note 91, at 515–16 (finding Vanguard employed fifteen people devoted to voting and engagement for approximately 13,000 companies, BlackRock employed twenty for 14,000 companies, and State Street employed fewer than ten for 9,000 companies).

[94] *See* Tingle, *What Do We Really Know?*, *supra* note 16, at 329 ("Institutional investors have few incentives to spend time on corporate governance matters . . . .").

[95] *See* Tingle, *Expressive Voting*, *supra* note 74, at 75 ("[Shareholder] voting decisions are driven by empirically questionable and often deliberately ineffective corporate governance practices.").

[96] *See* Tingle, *supra* note 52, at 106 ("Shareholder power is exercised in favour of strategies that show little engagement with the actual business realities experienced by their targets and, in the wake of their interventions, companies tend to underperform, especially over the long-term."); Kahan & Rock, *supra* note 28, at 2041 (discussing the ways shareholder governance initiatives are designed to be ineffective); Jay Cai, Jacqueline L. Garner & Ralph A. Walkling, *A Paper Tiger? An Empirical Analysis of Majority Voting*, 21 J. CORP. FIN. 119, 122 (2013) (arguing that majority shareholder voting produces "insignificant abnormal returns and negligible changes to firm performance, director elections, and director turnover"); Michael P. Smith, *Shareholder Activism by Institutional Investors: Evidence from CalPERS*, 51 J. FINANCE 227, 251 (1996) (finding that "[c]hanges in operating performance [following intervention] do not reflect statistically significant improvement"); Willard T. Carleton, James M. Nelson & Michael S. Weisbach, *The Influence of Institutions on Corporate Governance Through Private Negotiations: Evidence from TIAA-CREF*, 53 J. FINANCE 1335, 1351 (1998) (finding negative outcomes resulting from TIAA-CREF's activism); TRACIE WOIDTKE, MANHATTAN INST., PUBLIC PENSION FUND ACTIVISM AND FIRM VALUE 3 (2015) (finding that "pension funds' shareholder activism influences companies but that such

Tingle: Shareholders' Potential

C. THE ARGUMENT FOR SYSTEMIC STEWARDSHIP

In light of the evidence that institutional shareholders hardly ever engage in firm-specific governance, advocates for ESG mandates sometimes claim that the growth in investment fund concentration, as well as the growth of passive index funds, has changed the calculus.[97] Many of the largest funds do not have the option of selling shares in a company with significant ESG risk. They are required to "own" the market (either as a function of scale or internal mandate), so they have an incentive to engage with portfolio companies that are underperforming according to ESG measures.[98]

Professor Jeffrey Gordon provides one of the most sophisticated versions of this argument.[99] According to the capital asset pricing model, which underlies much of modern finance, a properly diversified portfolio eliminates idiosyncratic (that is, firm-specific) risk, but the portfolio remains exposed to risks that affect the

---

influence is not generally associated with positive valuation effects; when influence is associated with social-issue activism, valuation effects tend to be negative"); Vinod Venkiteshwaran, Subramanian R. Iyer & Ramesh P. Rao, *Is Carl Icahn Good for Long-Term Shareholders? A Case Study in Shareholder Activism*, 22 J. APPLIED CORP. FIN. 45, 55 (2010) (finding that Carl Icahn's targets that are not immediately acquired suffer very negative (-60%) returns).

[97] *See* Byung Hyun Ahn, Jill E. Fisch, Panos N. Patatoukas & Steven Davidoff Solomon, *Synthetic Governance*, 2 COLUM. BUS. L. REV. 476, 480 (2021) ("[I]ndex technology similarly enables investors to select into or out of preferred governance mechanisms, more closely tying the capital markets with the market for corporate governance."); Coffee, *supra* note 89, at 1352 (arguing that "because institutions hold for the long-term, such [indexed] investors are more likely to reap the benefits of improved corporate governance" which "should reduce the costs of active monitoring to an acceptable level"); Gordon, *supra* note 51, at 34 (noting that "reconcentration of share ownership in the hands of institutional investors . . . . means that they are at least persuadable by activist shareholders as to the existence of target management's strategic or operational shortfalls").

[98] *See* Simon C.Y. Wong, *How Institutional Investors Should Step Up as Owners*, MCKINSEY & CO. (Sept. 1, 2020), https://www.mckinsey.com/capabilities/risk-and-resilience/our-insights/how-institutional-investors-should-step-up-as-owners [https://perma.cc/3HJ9-289Q] ("Since they are betting on long-term gains in the broad equity market and have very little room to shift their holdings, passive [index] funds should have good reason to engage actively with companies in their index.").

[99] *See* Gordon, *supra* note 51, at 629 (arguing for "systematic stewardship" for which "[t]he canonical candidate is the broad-based index fund").

Georgia Law Review, Vol. 58, No. 1 [2023], Art. 5

market as a whole.[100] He suggests that climate change risk is just such an example of market-wide risk: "The disruptions associated with various realizations of climate change risk will ramify across the entire economy and thus across a diversified stock portfolio; climate change risk is systematic."[101]

He references the past thirty or so years of shareholder engagement with corporate governance as an example of this sort of logic. Funds subscribed to certain governance "best practices" which they then applied across their portfolio companies "even though firm-specific analysis would surely produce governance heterogeneity."[102] He admits that these best practices were only "sometimes" supported by empirical evidence and so were instead a function of unexamined assumptions about "managerial accountability to shareholders."[103] But tellingly, Gordon doesn't dwell on whether these governance practices actually improved portfolio performance, implying that it is the intentions of investment fund managers to reduce systemic risk that matters.[104]

There are considerable difficulties with this argument when applied to the environmental and social aspects of ESG investing. The biggest problem is that a systemic problem doesn't necessarily call for a systemic solution. The analogy with corporate governance is useful: a systemic problem (managerial agency costs) produced systemic solutions (independent directors, the use of equity incentives, etc.) which turned out to have, on average, no effect whatsoever on the problem at hand and might have created new ones.[105] It is likely that the only effective solutions to systemically

---

[100] *Id.* at 629.

[101] *Id.* While it is not part of my argument, it is worth noting that climate change risk may not be systemic in its economic effects in the ways Professor Gordon's argument requires. *See, e.g.*, *21st Century Economy: Protecting the Financial System from Risks Associated with Climate Change*: *Hearing Before the S. Comm. on Banking, Housing, and Urban Affairs,* 117th Cong. (2021) (statement of John H. Cochrane, Senior Fellow, Hoover Inst., Stanford Univ.) https://www.banking.senate.gov/imo/media/ doc/Cochrane%20Testimony%203-18-21.pdf [https://perma.cc/3BDS-PCEF] (arguing that global warming, while real, does not actually pose a systemic financial risk because of the time horizons involved).

[102] Gordon, *supra* note 51, at 630.

[103] *Id.*

[104] *See id.* ("[S]uch investors *believe* the adoption of these positions will increase the value of the firm on average." (emphasis added)).

[105] *See* Tingle, *What Do We Really Know?*, *supra* note 16, at 331 ("[I]t is up to academics and members of the corporate governance industry to promulgate the message that the

problematic managerial self-interest are a series of idiosyncratic, firm-specific measures. That is what a lot of empirical evidence suggests anyways.[106]

There are good reasons to believe that there are also no practical solutions to social and environmental problems that are easily generalizable to heterogeneous companies. There are only a few current strategies available to ESG funds,[107] and later in this Article, we will see that there is little evidence that investors are able to either use them consistently, or that—when used—these strategies produce better social and environmental outcomes.[108]

A simple illustration of the problem is provided by a recent study that found that "the majority of . . . recent green patenting is not driven by highly rated ESG firms, firms that are commonly favored by ESG funds, but instead by firms that are explicitly excluded from ESG funds['] investment universe."[109] In fact, the best green patents come from notoriously bad actors: "[T]he incremental green patent is significantly more likely to come from energy firms than any other

---

current king of the corporate governance regime doesn't have a stitch of clothing to its name."); Tingle, *The Agency Cost*, *supra* note 74, at 735 ("[I]f the available evidence suggests agency costs are leading to informational failures in the proxy advice market, it is likely that these failures characterize the market, demonstrating a market failure of the type that securities regulation is designed to remedy."); Tingle, *How Good are Our Best Practices?*, *supra* note 16, at 388–89 ("During this period of unprecedented attention to corporate governance, controlling agency costs, maximizing returns to shareholders, and setting managerial incentives properly, executive compensation exploded. . . . These practices have been promoted and adopted with little regard to their actual impact and the relevant empirical evidence.").

[106] *See* Tingle, *What Do We Really Know?*, *supra* note 16, (providing evidence that governance practices have different effects on different types of companies); Bryce C. Tingle, *The Most Important Theory in Corporate Law is Useless: Agency Cost Theory Explains Anything and Predicts Nothing*, 21 BERKELEY BUS. L.J. (forthcoming) (manuscript at 48) ("Governance structures can be understood as the result of firm-specific value-maximizing contracts between corporate constituencies . . . . [T]he preponderance of evidence suggests that attempts to enact the normative agency cost agenda by imposing generalized best practices will likely be value destroying.").

[107] *See* Amir Amel-Zadeh & George Serafeim, *Why and How Investors Use ESG Information: Evidence from a Global Survey*, 74 FIN. ANALYSTS J. 87, 94 (2018) (listing the eight common strategies available for ESG funds).

[108] *See infra* discussion accompanying notes 121–138.

[109] Lauren Cohen, Umit G. Gurun & Quoc H. Nguyen, *The ESG-Innovation Disconnect: Evidence from Green Patenting* 5 (Nat'l Bureau of Econ. Rsch., Working Paper No. 27990, 2020).

Georgia Law Review, Vol. 58, No. 1 [2023], Art. 5

type of firm . . . . In addition, the green patents of [these] firms are significantly higher quality, in terms of being more highly cited."[110] These low ESG energy companies also are "significantly more likely to produce 'blockbuster' green patents than other firms."[111]

Any shareholder investment and engagement protocol that depends on evaluating the R&D initiatives of various companies, regardless of their ESG credentials, requires precisely the careful attention and engagement with the idiosyncratic activities of specific companies that both Professor Gordon and I think is unlikely.

A second problem for Professor Gordon's argument is that arresting climate change is only one of many corporate welfare outcomes desired by society. Employees want well-paying, stable employment. Lenders (as we have seen, the real contributors of capital to public firms) desire to be repaid. Governments need tax revenue. Consumers need products and services. Future generations surely have an interest in innovation and economic growth.[112] Even if we assume systemic solutions to climate change are available to shareholders, society has an interest in the impact of these solutions on other constituencies and the other things society wants from corporations.

Most corporate constituents do not "own" the market. They are retail shareholders with investments in only a few particular firms. Or they are employees, customers, suppliers, business partners, or communities in economically vital relationships with a single, specific firm. Why should they support the right of institutional shareholders to manage their systemic risk by imposing one-size-fits-all environmental costs on that firm? The vast majority of the people involved in a corporation have an interest in decision-making that respects the specific circumstances of that firm, and that is designed to facilitate its unique flourishing.

---

[110] *Id.*

[111] *Id.*

[112] *See* TYLER COWEN, STUBBORN ATTACHMENTS: A VISION FOR A SOCIETY OF FREE, PROSPEROUS, AND RESPONSIBLE INDIVIDUALS 125–26 (2018) ("Our working standard for evaluating choices should be to increase sustainable economic growth, because those choices overcome aggregation problems and are decisively good. That provides us with a broad quantitative proxy for the long-run development of human civilization . . . .").

These issues must be considered if government regulation is being enlisted to assist institutional shareholders in imposing solutions that, at best, will reduce undiversifiable portfolio risk. Does anyone seriously believe institutional shareholders, left to their own devices, will be better at calibrating the disparate consequences of their environmental and social activities than they ever managed in the much simpler field of corporate governance?[113] As we have seen, a significant element in the rise of ESG investing is a generalized concern (especially in Europe) that the past few decades' governance initiatives giving shareholders more power, had the unsurprising effect of advancing shareholder interests, to the detriment of other groups.[114]

The third problem with systemic risk arguments is that they fail to connect the (assumed) long-term risk reduction benefits of social and environmental engagement to the (actual) short-term benefit to investment fund managers of maximizing relative portfolio returns. As one group of scholars correctly observed: "There is a broad consensus in the conceptual literature that many of the financial gains from improved social performance accrue in the long run . . . ."[115] Even if ESG initiatives reduce systemic risk, the incentives for conscientiously pursuing ESG goals are still much lower than the incentives we have already discussed to improve the short-term relative financial performance of the fund.[116]

The fourth problem with the systemic risk argument is that it doesn't appear to reflect what actually happens when investors incorporate ESG information into their decision-making. A recent survey found, for example, that "ESG investors tend to prefer analysis on individual companies over industry level analysis."[117]

---

[113] *See supra* notes 102–106 and accompanying discussion.

[114] *See supra* note 70 and accompanying discussion.

[115] Paul Cox, Stephen Brammer & Andrew Millington, *An Empirical Examination of Institutional Investor Preferences for Corporate Social Performance*, 52 J. BUS. ETHICS 27, 29 (2004); *see also* Elisabeth Albertini, *Does Environmental Management Improve Financial Performance? A Meta-Analytical Review*, 26 ORG. & ENV'T 431, 437 (2013) (contrasting the short-term return of financial profitability with the "very long term [return] for the environmental issue").

[116] *See supra* notes 47–50 and associated discussion.

[117] Emiel van Duuren, Auke Plantinga & Bert Scholtens, *ESG Integration and the Investment Management Process: Fundamental Investing Reinvented*, 138 J. BUS. ETHICS 525, 531 (2016).

Georgia Law Review, Vol. 58, No. 1 [2023], Art. 5

This is precisely what we would expect if reducing risk in the long term was less important than outperforming competitors in the short-to-medium term. The researchers summarize the attitude of institutional investors: "ESG integration is much like traditional active management based on fundamental investing, in the sense that it is characterized by a strong need for company specific information."[118]

The final problem is that, as we will see, there have been multiple long-term studies looking at the impact of the usual measures of ESG on firm risk; they generally find no evidence for the claimed connection.[119]

D. DO ESG FUNDS APPEAR TO BEHAVE AS THEORY PREDICTS?

Thus far I have argued that the incentives operating on nearly all institutional fund managers are to maximize the returns to the portfolio regardless of its ESG character, generate returns superior to those of competitors or market benchmarks, and minimize the time spent on individual firm ESG analysis and interventions. How well do these predictions correspond to what we see?

A recent survey of institutional fund managers found that "the use of ESG information is driven primarily by financial rather than ethical motives."[120] The low value placed on ESG by institutional investors is visible in the tiny fraction of resources they employ for ESG specialists. Professors Bebchuk and Hirst point out that Blackrock employs only forty-five "stewardship personnel" to oversee ESG matters for an estimated 11,246 portfolio companies.[121] Vanguard and State Street employ less than half as many ESG

---

[118] *Id.* at 529.

[119] *See infra* discussion accompanying notes 190–191.

[120] Amel-Zadeh & Serafeim, *supra* note 107, at 92; *see also* Tim Quinson, *Why the Biggest U.S. ESG Fund Has No Direct Renewable Holdings*, BLOOMBERG NEWS (Mar. 3, 2021, 6:15 AM), https://www.bloomberg.com/news/articles/2021-03-03/biggest-esg-fund-has-no-direct-renewable-holdings-green-insight-kltcg25d (emphasizing a quote from the manager of the largest ESG fund in America stating: "we hesitate to overplay the ESG hand . . . . We have a responsible large-cap investment approach. We use the 'E' [environmental] to help us discover what we want to avoid, and also to help us find stocks that we want to own").

[121] Bebchuk & Hirst, *supra* note 74, at 2077.

specialists for even larger portfolios.[122] Bebchuk and Hirst calculate that the average stewardship budget is "less than one-fifth of 1%—only 0.2%—of the estimated fees that each of the [three largest index funds] charge for managing equity assets."[123] This should not come as a surprise; over the period that good corporate governance dominated investment fund marketing, those funds were investing few resources into corporate governance, including the ways the funds made voting decisions.[124]

Researchers find that the managers of many types of investment funds tend to use third-party ESG ratings rather than actually reading companies' ESG disclosures, which "suggests that the managers are constrained in their resources."[125] Strangely, however, these same respondents did not believe ESG investing necessitated additional resources.[126] The only thing that explains these apparently divergent observations is that fund managers have a general reluctance to spend resources on ESG.

Another way of examining investor incentives is by looking at whether managers are prepared to sacrifice portfolio returns for ESG benefits. There are many theoretical arguments that fund managers should be prepared to do so, given their clients' stated concern for environmental and social outcomes.[127] However, the only empirical study conducted under real market conditions finds that, "the greenium, or the premium that green assets trade to

---

[122] *See id.* (showing that Vanguard has twenty-one employees for 13,225 portfolio companies and that State Street has twelve for 12,191 estimated companies).

[123] *Id.*

[124] *See* Tingle, *Expressive Voting*, *supra* note 74 (discussing the evidence that institutional investors pay little attention to their voting decisions, which often diverge from their investing decisions); Tingle, *The Agency Cost, supra* note 74, at 738–40 (discussing the limited internal resources applied to shareholders' corporate governance activities and those shareholders' consequent dependence on proxy advisory firms).

[125] van Duuren, Plantinga & Scholtens, *supra* note 117, at 529.

[126] *See id.* at 528 ("The results from the survey suggest that the respondents do not share the idea that ESG investing should incur substantially higher cost.").

[127] *See, e.g.*, Oliver Hart & Luigi Zingales, *Companies Should Maximize Shareholder Welfare Not Market Value*, 2 J.L. FIN. & ACCT. 247, 271 (2017) (arguing that "shareholder welfare maximization should replace market value maximization as the proper objective of companies"); Henry L. Friedman & Mirko S. Heinle, *Taste, Information, and Asset Prices: Implications for the Valuation of CSR*, 21 REV. ACCT. STUD. 740, 759 (2016) ("[M]anagers who are interested in maximizing stock price have an incentive to invest in projects that yield a positive [corporate social responsibility] outcome even if they are not cash flow maximizing.").

otherwise identical non-green securities, is precisely equal to zero."[128] This is in line with a recent survey by the State Treasurer's Office of California that elicited a unanimous response by managers that "their firms would not accept a lower yield for a green bond."[129]

It should come as no surprise, therefore, that empirical studies repeatedly find that ESG-branded investment funds do not, on average, hold more environmentally and socially responsible companies than conventional funds.[130] Some researchers find ESG funds hold portfolio companies with *worse* track records for compliance with labor and environmental laws, relative to non-ESG funds.[131] In fact, ESG funds' investments on average "exhibit worse

---

[128] David F. Larcker & Edward M. Watts, *Where's the Greenium?*, 69 J. ACCT. & ECON. 1, 2 (2020). The authors note there are previous studies that use laboratory experiments or use ex post returns to attempt to calculate estimates of ex ante expected returns and risk, but no studies (before their own) had looked at actual market transactions when risk and return are known ex ante. *Id.* at 4; *see also* Matt Levine, *Twenty Percent of a Picture of a Dog*, BLOOMBERG (Sept. 9, 2021, 1:00 PM), https://www.bloomberg.com/opinion/articles/2021-09-09/twenty-percent-of-a-picture-of-a-dog (noting that, due to valuation challenges, "ESG loans don't have much in the way of financial stakes at all").

[129] JOHN CHIANG, CAL. STATE TREASURER, GROWING THE U.S. GREEN BOND MARKET, VOLUME 1: THE BARRIERS AND CHALLENGES 14 (2017); *see also*, Rodrigo Zeidan, *Why Don't Asset Managers Accelerate ESG Investing? A Sentiment Analysis Based on 13,000 Messages from Finance Professionals,* 31 BUS. STRATEGY & ENV'T 3028, 3029 (2022) (finding that in private communications finance professionals mostly express "a negative view of ESG investing" that includes "a consensus . . . that ESG indicators are not risk factors").

[130] *See* Sabastian Utz & Maximillian Wimmer, *Are They Any Good at All? A Financial and Ethical Analysis of Socially Responsible Mutual Funds*, 15 J. ASSET MGMT. 72, 81 (2014) (finding that socially responsible funds from the United States do not hold considerably more ethical assets than conventional mutual funds); Hao Liang, Lin Sun & Melvyn Teo, *Responsible Hedge Funds*, 26 REV. FINANCE 1585, 1631 (2022) ("Investors do not on average discriminate between low- and high-ESG signatories."); Aneesh Raghunandan & Shiva Rajgopal, Do Socially Responsible Firms Walk the Talk? 30 (Dec. 10, 2022) (unpublished manuscript), https://papers.ssrn.com/sol3/papers.cfm?abstract_id=3609056 ("[T]he correlation between self-proclaimed high-ESG companies and their records is underwhelming. These results raise several questions about whether the declaration of high-minded ideals by firms is cheap talk."); Soohun Kim & Aaron Yoon, *Analyzing Active Fund Managers' Commitment to ESG: Evidence from the United Nations Principles for Responsible Investment*, 69 MGMT. SCI. 741, 757 (2023) ("We find no evidence that [United Nations Principles for Responsible Investment] signatories are superior performers on ESG issues, and early joiners do not exhibit a higher fund-level ESG score than late joiners."); Quinson, *supra* note 120 (stating that the largest ESG fund in America "has no direct investments in renewable energy companies").

[131] *See* Raghunandan & Rajgopal, *supra* note 31, at 824 ("ESG funds' portfolio firms, on average, exhibit worse performance with respect to carbon emissions, in terms of both raw

performance with respect to carbon emissions, in terms of both raw emissions output and emissions intensity."[132] A recent survey among investment managers who claim to actively integrate ESG factors into their investment process showed many of them did not buy or sell a single share in a given year due to ESG-related information.[133] Indeed, another study found a company's addition or deletion from an ESG index (and thus the ESG funds following the index) was almost completely unrelated to its actual history of environmental and labor violations.[134]

The way ESG managers build their portfolios seems to support the argument of this Article that their primary motivation is to generate superior relative financial returns. They find themselves owning companies that do poorly on ESG measures because those companies have appealing short-term return profiles. This means their ESG rhetoric is, in practice at least, likely little more than a fund marketing strategy.[135] Tellingly, new ESG funds start by owning high social responsibility companies for the first two years, but once the funds are established, there is a steep decline in the environmental and social quality of portfolio companies in

---

emissions output and emissions intensity"); Rajna Gibson Brandon et al., *Do Responsible Investors Invest Responsibly?*, 26 REV. FINANCE 1389, 1424 (2022) (finding a "substantial disconnect between what institutional investors claim to do in terms of ESG and what they really do"); Kim & Yoon, *supra* note 130, at 742 (finding active managers that sign the PRI experience an increase in environmental controversies among the companies in their portfolios).

[132] Raghunandan & Rajgopal, *supra* note 31, at 824. *See also* Patrick Bolton & Marcin Kacperczyk, *Do Investors Care About Carbon Risk?*, 142 J. FIN. ECON. 517, 539 (2021) (finding that, with respect to carbon intensity and the rate of carbon emission growth, "these variables have no significant impact on institutional investor portfolios").

[133] *See* van Duuren, Plantinga & Scholtens, *supra* note 117, at 529 ("What is perhaps surprising is that during the entire year a large minority of ESG investors did not do any buy or sell as a result of ESG specific information. For these three categories together, 51% of the managers did not sell a single stock due to a positive ESG signal and 39% did not buy a single stock due to a negative signal.").

[134] *See* Raghunandan & Rajgopal, *supra* note 130, at 17 (finding that "(i) [PRI] signatory firms are more likely to commit violations of labor and environmental laws, and (ii) that these firms did not demonstrate any improvement in this regard subsequent to signing the Statement despite the explicit commitments therein").

[135] *See* Kim & Yoon, *supra* note 130, at 642 ("[A]sset managers . . . use PRI status largely as a marketing tool to attract capital, especially because, ignoring reputational concerns, the cost of joining the PRI represents a very small fraction of the signatories' AUM . . . .").

Georgia Law Review, Vol. 58, No. 1 [2023], Art. 5

subsequent years.[136] This is not a function of changes in the companies, but of managers' altering their investment behavior, presumably once the fund's "brand" has been established.[137]

If we look at the way shareholders vote their shares, we find a similar picture of disengagement with environmental and social concerns. In 2019, investor support for shareholder proposals on ESG matters reached a new record, but it was on average only 29% of the votes cast at the meeting.[138] Active investment managers who sign the UN's Principles of Responsible Investment actually "decrease their support of pro-governance proposals compared to the pre-signing period."[139]

Voting is the easiest and cheapest form of shareholder engagement and so it is notable, for example, that America's largest and oldest ESG fund "has voted *against* almost all environmental resolutions over the past 14 years. The same is true of other socially conscious resolutions, including board diversity."[140] Amusingly, a different fund, "the State Street Gender Diversity exchange traded fund[,] has voted against or abstained on resolutions asking for reports on gender pay equity, sexual harassment and employment diversity . . . ."[141] Because index funds cannot sell bad actors, it has been hoped that they would instead use their voting power to advance ESG causes, but the biggest three index fund groups are actually less likely to support ESG proposals than other

---

[136] *See* Maximilian Wimmer, *ESG-Persistence in Socially Responsible Mutual Funds*, 3 J. MGMT. & SUSTAINABILITY 9, 12–13 (2013) (finding that high ESG scores of socially responsible mutual funds tend to be short-lived, declining after three or four years).

[137] *See id.* at 13 ("I . . . conclude that the observed convergence of ESG-scores two to three years [later] . . . must be attributed to changes in the funds' portfolios.").

[138] *See* Cydney Posner, *How Do the Largest Fund Families Vote on Shareholder Proposals Related to ESG?*, JD SUPRA (Mar. 2, 2020), https://www.jdsupra.com/legalnews/blog-how-do-the-largest-fund-families-90960/ [https://perma.cc/3NNP-4WBK] ("In 2019, investor support for shareholder proposals related to environmental, social and governance matters reached a record average high of 29% . . . .").

[139] Kim & Yoon, *supra* note 130, at 742 (emphasis omitted).

[140] Gita R. Rao, *A Surprise About Some ESG Funds — They Actually Vote Against Environmental and Socially Conscious Resolutions*, MKT. WATCH (Dec. 18, 2020, 10:40 AM), https://www.marketwatch.com/story/a-surprise-about-some-esg-funds-they-actually-vote-against-environmental-and-socially-conscious-resolutions-11608306020 [https://perma.cc/VW8H-3HEL].

[141] *Id.*

institutional investors.[142] This is another blow to the theory that systemic risk will lead to systemic engagement.[143]

The real evidence that the existing incentive structure for institutional investors militates against engagement with ESG is the growing movement to impose new regulations on these investors. It is significant, however, that even these new regulatory interventions do not appear to be enough. The preferred regulatory intervention, mandatory disclosure by fund managers, was first introduced by France in 2015, and the initial results have been underwhelming.[144] "Green" investments have grown from 0.5% to 1.41%, and only two investors bothered to start setting green investment targets.[145] For its part, the SEC has found it necessary to bring enforcement actions against funds that were failing to live up to their ESG advertising and to bring in new rules requiring ESG funds to do what they say.[146]

---

[142] *See* Posner, *supra* note 138 (documenting the failure of the three largest index funds to support ESG proposals); *see also* Caleb N. Griffin, *Environmental and Social Voting at the Big Three*, COLUM. L. SCH.: BLUE SKY BLOG (June 16, 2020), https://clsbluesky.law.columbia.edu/2020/06/16/environmental-and-social-voting-at-the-big-three/ [https://perma.cc/P3B7-WFQL] (noting that, although the big three index funds have consistently voted against ESG initiatives, "[n]one of the Big Three appears to have broken any explicit promises with its voting behavior").

[143] *See* discussion *supra* section II.C.

[144] Brandon D. Stewart, *Business as Usual?: The Limited Influence of Climate Change Disclosure and Fiduciary Duties on the Low-Carbon Investment Practices of Canada's Big 10 Public Pension Funds*, 33 J. ENV'T L. & PRAC. 93, 108 (2020) (observing "only a "gradual move" towards green investments after three years of reporting.")

[145] *Id.*

[146] *See, e.g.*, Press Release, SEC, Deutsche Bank Subsidiary DWS to Pay $25 Million for Anti-Money Laundering Violations and Misstatements Regarding ESG Investments (Sept. 25, 2023), https://www.sec.gov/news/press-release/2023-194 [https://perma.cc/K99B-4R3E] (reporting a settlement against a Deutsche Bank Subsidiary for failure to follow their ESG guarantees); Press Release, SEC, SEC Charges Goldman Sachs Asset Management for Failing to Follow its Policies and Procedures Involving ESG Investments (Nov. 22, 2022), https://www.sec.gov/news/press-release/2022-209 [https://perma.cc/5S2W-UHUW] (describing a $4 million penalty for "policies and procedures failures involving the ESG research" at Goldman Sachs Asset Management); Press Release, SEC, 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/6ETF-WL75] (settling claims of "misstatements and omissions about Environmental, Social, and Governance (ESG) considerations" for $1.5 million). *See also* Press Release, SEC, SEC Proposes to Enhance Disclosures by Certain Investment Advisers and Investment Companies About ESG Investment Practices (May 25, 2022),

E. THE CONNECTION BETWEEN ESG INVESTING AND FUND RETURNS

It is very hard to make sense of these facts if ESG investing is, in fact, connected to higher risk-adjusted returns. This connection is essential to the argument that investment fiduciaries are permitted to invest in ways that support the interests of non-shareholder constituencies.[147] It is also key to many of the arguments that shareholders are a viable source of support for social and environmental initiatives.[148] But it amounts to saying that institutional fund managers, the most sophisticated parties in our financial markets, have not, until recently, understood key factors to generating investment returns.[149] Why haven't they been ESG before now? Why do they seem reluctant to be ESG now, even if their brand is ESG? Why do regulators feel they need to get involved?

Even if we assume that for a long period investors didn't understand the importance of stakeholders or social license in the

---

https://www.sec.gov/news/press-release/2022-92 [https://perma.cc/T6U9-DLN8] (outlining proposed amendments to rules for ESG factors).

[147] *See* Max M. Schanzenbach & Robert H. Sitkoff, Special Report, *ESG Investing: Theory, Evidence, and Fiduciary Principles*, 33 J. FIN. PLAN. 42, 47 (2020) (documenting that American law only permits ESG investment decisions connected to maximizing risk-adjusted returns); Susan N. Gary, *Best Interests in the Long Term: Fiduciary Duties and ESG Integration*, 90 U. COLO. L. REV. 731, 735 (2019) (finding that only "[a]s long as a strategy does not involve sacrificing financial returns . . . the duty of loyalty is not compromised by a direction to invest using a strategy that incorporates ESG criteria"); RESTATEMENT (THIRD) OF TRUSTS § 78(1) (AM. L. INST. 2007) (stating that a trustee must "administer the trust solely in the interest of the beneficiaries"); Schanzenbach & Sitkoff, *supra* note 15, at 452–53 ("ESG factors better assess long-term risk implies that a fiduciary with a short time horizon should favor firms with low ESG scores, as the payoff investment in a high-ESG-score firm will take too long to realize."); Coffee, *supra* note 15, at 28 ("By adding governance to the mix . . . one not only did good (ethically), but one also did better (financially). This in turn enabled law firms to opine to their clients that ESG investing was fully compatible with the trustee's fiduciary obligations.").

[148] *See, e.g.*, Fink, *supra* note 5 ("Our investment conviction is that sustainability and climate integrated portfolios can provide better risk-adjusted returns to investors.").

[149] *See* Brest, Gilson & Wolfson, *supra* note 72, at 23 (observing that the common argument that current stock prices do not reflect the impact of future regulation or the risk of stranded assets as "implausible").

performance of portfolio companies, many of them do now.[150] In theory, it takes a relatively small group of investors to spot a way companies are systematically being over-valued (or under-valued) to sell (or buy) the shares of those companies until the pricing error is corrected.[151] In other words, the opportunity for ESG investing to generate abnormal returns lasts just as long as it takes for market prices to adjust to new understandings about the importance of ESG. There is, in fact, evidence that returns to some types of ESG investing existed through the 1990s before disappearing early this century.[152]

This problem does not go away if risk reduction is the rationale for ESG investing.[153] If, for example, a particular company has a history of bad ESG practices, perhaps this means it has a higher risk of negative outcomes. In theory, this company should trade at a discount to its peers because of this risk.[154] This does not mean, however, that an investor who buys the company will do worse with

---

[150] There were 27,500 newspaper articles about ESG investing from 1982–2009. Gunther Capelle-Blancard & Stephanie Monjon, *Trends in the Literature on Socially Responsible Investment: Looking for the Keys Under the Lamppost*, 21 BUS. ETHICS 239, 241 (2012).

[151] *See* Eugene F. Fama & Kenneth R. French, *Disagreement, Tastes, and Asset Prices*, 83 J. FIN. ECON. 667, 673 (2007) ("[W]hen all misinformed investors hold the market portfolio, complete rationality of prices requires just one active informed investor, who may have infinitesimal wealth, but whose rational beliefs nevertheless drive asset prices."); Henri Servaes & Ane Tamayo, *The Role of Social Capital in Corporations*, 33 OXFORD REV. ECON. POL'Y 201, 215 (2017) ("[I]f prices do not fully reflect the fundamentals of a company and if this information is readily available, there is sufficient arbitrage capital available to correct any mispricing.").

[152] *See* Arian Borgers, Jeroen Derwall, Kees Koedijk & Jenke ter Horst, *Stakeholder Relations and Stock Returns: On Errors in Investors' Expectations and Learning*, 22 J. EMPIRICAL FIN. 159, 175 (2013) (finding returns decline sharply to ESG investing after 2004); Jeroen Derwall, Kees Koedjik & Jenke Ter Horst, *A Tale of Values-Driven and Profit-Seeking Social Investors*, 35 J. BANKING & FIN. 2137, 2137 (2011) (finding the profits to ESG investing diminish in the long run); Gerhard Halbritter & Gregor Dorfleitner, *The Wages of Social Responsibility—Where Are They? A Critical Review of ESG Investing*, 26 REV. FIN. ECON. 25, 31 (2015) ("We find a significant decline in the explanatory power of ESG scores over the last decade.").

[153] *See supra* discussion accompanying notes 99–104.

[154] *See e.g.* Derwall, Keodjik & Ter Horst, *supra* note 152, at 2138 (arguing socially irresponsible companies can have lower valuations "because values-driven investors shun and thus push their prices below those of responsible stocks, all else being equal").

Georgia Law Review, Vol. 58, No. 1 [2023], Art. 5

that investment than if the investor bought one of its peers.[155] Because the investor acquired its shares at a discount, the investor's risk-adjusted returns should be identical to those it would have received by buying undiscounted stock in one of the better-behaved peer companies. Indeed, there is a chance that, as the company's bad behavior makes it riskier, the investor may receive a premium.[156]

As we would expect, researchers have found that bad environmental performers trade at prices that more or less reflect the economic losses imposed by regulators.[157] The market appears to price the cost of bad ESG performance accurately. As well, one of the rare studies looking explicitly at risk found that, as theory would predict, "the risk/return trade-off is such that no clear utility gain or loss can be realized by investing in firms characterized by different levels of social and environmental performance."[158]

Notwithstanding these theoretical points, the literature on the performance of ESG investments is vast. From 2000 to 2009, three-quarters of all academic papers on ESG investing dealt with the

---

[155] *See* Derwall, Keodjik & Ter Horst, *supra* note 152, at 2145 ("Stocks that investors avoid by using these types of [ESG] screens earn anomalously positive returns . . . .").

[156] For example, researchers have found premiums associated with owning so-called "sin" stocks (alcohol, gaming, and tobacco). *See* Harrison Hong & Marcin Kacperczyk, *The Price of Sin: The Effects of Social Norms on Markets*, 93 J. FIN. ECON. 15, 17 (2009) ("[S]in stocks . . . have higher expected returns than comparables."); Lasse Heje Pedersen, Shaun Fitzgibbons & Lukasz Pomorski, *Responsible Investing: The ESG-Efficient Frontier*, 142 J. FIN. ECON. 572, 5993 (2021) (finding a sin premium and that "proxies for . . . ESG are weaker predictors of future profits").

[157] *See* Jonathan M. Karpoff, John R. Lott, Jr. & Eric W. Wehrly, *The Reputational Penalties for Environmental Violations: Empirical Evidence*, 48 J.L. & ECON. 653, 671 (2005) (explaining that companies that break environmental laws primarily suffer legal, not reputational, harms). *But see* Simon Glossner, The Price of Ignoring ESG Risks 3 (Apr. 8, 2018) (unpublished manuscript), https://editorialexpress.com/cgi-bin/conference/download.cgi?db_name=XXVIfinanceforum&paper_id=57 [https://perma.cc/8BM6-3PGB] (finding the market fails to fully incorporate the consequences of bad behavior).

[158] Ioannis Oikonomou, Chris Brooks & Stephen Pavelin, *The Impact of Corporate Social Performance on Financial Risk and Utility: A Longitudinal Analysis*, 41 FIN. MGMT. 483, 512 (2012). *But see* Emirhan Ilhan, Zacharias Sautner & Grigory Vilkov, *Carbon Tail Risk*, 34 REV. FIN. STUD. 1540, 1543 (2021) (finding carbon emissions may increase risk as reflected in out-of-the-money put option prices).

financial performance issue.[159] There are many meta-studies attempting to summarize literally hundreds of empirical studies.[160] Unfortunately, it is impossible to draw any definite conclusions from all this work. As a literature review observed after reviewing many of the meta-studies, "to date the relationship between social responsibility and returns has not been conclusive."[161] One of the

---

[159] *See* Capelle-Blancard & Monjon, *supra* note 150, at 245 (finding that the term "performance" was used in nearly three quarters of all academic journal articles on socially responsible investment from 2000–2009).

[160] These studies include: Donna J. Wood & Raymond E. Jones, *Stakeholder Mismatching: A Theoretical Problem in Empirical Research on Corporate Social Performance*, 3 INT'L J. ORG. ANALYSIS 229 (1995); Moses L. Pava & Joshua Krausz, *The Association Between Corporate Social-Responsibility and Financial Performance: The Paradox of Social Cost*, 15 J. BUS. ETHICS 321 (1996); Joshua D. Margolis & James P. Walsh, *Misery Loves Companies: Rethinking Social Initiatives by Business*, 48 ADMIN. SCI. Q. 268 (2003); Marc Orlitzky, Frank L. Schmidt & Sara L. Rynes, *Corporate Social and Financial Performance: A Meta-Analysis*, 24 ORG. STUD. 403 (2003); Andreas G.F. Hoepner & David G. McMillan, Research on 'Responsible Investment': An Influential Literature Analysis Comprising a Rating, Characterisation, Categorisation and Investigation (Aug. 2009) (unpublished manuscript), https://ssrn.com/abstract=1454793; Albertini, *supra* note 115; Christophe Revelli & Jean-Laurent Viviani, *Financial Performance of Socially Responsible Investing (SRI): What Have We Learned? A Meta-Analysis*, 24 BUS. ETHICS: EUR. REV. 158 (2015); Jan Endrikat, Edeltraud Guenther & Holger Hoppe, *Making Sense of Conflicting Empirical Findings: A Meta-Analytic Review of the Relationship Between Corporate Environmental and Financial Performance*, 32 EUR. MGMT. J. 735 (2014); Timo Busch & Gunnar Friede, *The Robustness of the Corporate Social and Financial Performance Relation: A Second-Order Meta-Analysis*, 25 CORP. SOC. RESP. & ENV'T MGMT. 583 (2018).

[161] von Wallis & Klein, *supra* note 13, at 80; *see also* Capelle-Blancard & Monjon, *supra* note 150, at 247 (stating that studies "almost unanimously show that the financial performance of the SRI funds is not significantly different relative to their conventional peers or relative to a benchmark index. [T]his empirical result is widely expected"); Halbritter & Dorfleitner, *supra* note 152, at 25 (reviewing the literature and finding that "[m]ost studies . . . do not indicate significant performance differences" between ESG and conventional funds); Joscha Nollet, George Filis & Evangelos Mitrokostas, *Corporate Social Responsibility and Financial Performance: A Non-Linear and Disaggregated Approach*, 52 ECON. MODELLING 400, 400 (2016) ("Recent literature appears to be rather inconclusive with respect to the question of whether corporate social responsibility performance (CSP) can be translated in positive corporate financial performance (CFP)."); Pedersen, Fitzgibbons & Pomorski, supra note 156, at 593 (finding the positive financial returns to ES performance are solely due to "governance," not environmental or social activities); Oikonomou, Brooks & Pavelin, *supra* note 158, at 483 ("[T]here is no consensus in the relevant literature, either at the firm or portfolio level of analysis, with results often in sharp conflict."); Stephen J. Fowler & C. Hope, *A Critical Review of Sustainable Business Indices and Their Impact*, 76 J. BUS. ETHICS 243, 244 (2007) ("[T]here is no consensus in the academic or practitioner communities on the relative performance of SRI mutual funds."). Investment results outside of America

Georgia Law Review, Vol. 58, No. 1 [2023], Art. 5

problems is that most of the studies use third party ESG ratings as a proxy for environmental and social performance[162] and, as I will argue in the following section, there is considerable evidence that these ratings schemes are invalid.[163]

There are some studies, however, that use real world measures of environmental and social performance, rather than depending on third-party ESG ratings. In general, these studies fail to find that environmental and social considerations produce superior investment returns. For example, a recent paper found that "stocks of companies with high levels and growth rates of emissions have higher returns than those . . . with low levels and growth rates of emissions."[164] (Another study merely found no connection between greenhouse gas emissions and stock and bond returns.)[165] Scholars looking at market reactions to ESG news stories found there was a very small reaction to negative events and no market reaction to positive ESG events.[166] A similar study found that corporate

---

seem broadly similar. *See* Benjamin R. Auer & Frank Schuhmacher, *Do Socially (Ir)responsible Investments Pay? New Evidence from International ESG Data*, 59 Q. REV. ECON. & FIN. 51, 61 (2016) (finding that Asian ESG funds do not beat the broad market and European ESG funds underperform); Florencio Lopez-de-Silanes, Joseph A. McCahery & Paul C. Pudschedl, *ESG Performance and Disclosure: A Cross-Country Analysis*, 2020 SING. J. LEGAL STUD. 217, 217 (2020) (finding "ESG scores have little or no impact on risk-adjusted financial performance.").

[162] *See* Lies Bouten, Charles H. Cho, Giovanna Michelon & Robin W. Roberts, CSR Performance Proxies in Large-Sample Studies: 'Umbrella Advocates', Construct Clarity, and the 'Validity Police' 33 (2018) (unpublished manuscript), https://papers.ssrn.com/sol3/papers.cfm?abstract_id=3107182 (finding the results of various papers are a function of the choice of ESG ratings provider); Katja Rost & Thomas Ehrmann, *Reporting Biases in Empirical Management Research: The Example of Win-Win Corporate Social Responsibility*, 56 BUS. & SOC'Y 840, 871 (2015) (discovering evidence of reporting and selection bias in ESG research on performance issues); Béchir Ben Lahouel, Brahim Gaies, Younes Ben Zaied & Abderrahmane Jahmane, *Accounting for Endogeneity and the Dynamics of Corporate Social – Corporate Financial Performance Relationship*, 230 J. CLEANER PROD. 352, 357 (2019) (discussing problems with the scientific validity of previous research on the connection between ESG and financial performance, particularly endogeneity issues).

[163] *See infra* Part IV.

[164] Bolton & Kacperczyk, *supra* note 132, at 16.

[165] *See* Wei Dai & Philipp Meyer-Brauns, Greenhouse Gas Emissions and Expected Returns 10 (Nov. 2022) (unpublished manuscript), https://ssrn.com/abstract=3714874 (finding no compelling evidence that a firm's emissions reliably predict future firm profitability or expected stock or bond returns).

[166] *See* Gunther Capelle-Blancard & Aurélien Petit, *Every Little Helps? ESG News and Stock Market Reaction*, 157 J. BUS. ETHICS 543, 558 (2019) (finding a 0.1% change in firm's

announcements of positive CSR initiatives are followed by a slight decline in share price.[167]

Similar results come from papers that concentrate on the ways different types of ESG funds assemble their portfolios. Dual-objective venture capital funds (also known as "impact" funds) are focused on investing in private companies that will generate positive environmental and social outcomes, as well as financial results; they appear to earn lower rates of return than traditional venture capital funds.[168] A study looking at portfolios that exclude companies on the basis of fourteen potentially controversial issues (such as adult entertainment, gambling, fur, weapons, etc.) found that "controversial investments generally yield positive abnormal returns, and that screening produces suboptimal financial performance."[169]

ESG ratings of the funds themselves are a fairly recent phenomenon. Morningstar only began offering its "five globes" rating scheme in 2016.[170] As we would expect, given the lack of a clear case for ESG investment returns elsewhere in the empirical

---

market value on a three-day window around the publication of negative ESG news while finding no significant change for positive ESG news); Nahoko Mitsuyama & Satoshi Shimizutani, *Stock Market Reaction to ESG-Oriented Management: An Event Study Analysis on a Disclosing Policy in Japan*, 35 ECON. BULL. 1098, 1108 (2015) (finding no market reaction to ESG branding announcements by Japanese firms).

[167] *See* Philipp Krüger, *Corporate Goodness and Shareholder Wealth*, 115 J. FIN. ECON. 304, 328 (2015) (finding investors react slightly negatively when positive news about a firm's CSR policies is revealed).

[168] *See* Barber, Morse & Yasuda, *supra* note 31, at 33 (documenting impact funds earn 4.7% less IRRs than peer venture capital funds).

[169] Pieter Jan Trinks & Bert Scholtens, *The Opportunity Cost of Negative Screening in Socially Responsible Investing*, 140 J. BUS. ETHICS 193, 194 (2017); *see also* Doron Avramov, Si Cheng, Abraham Lioui & Andrea Tarelli, Investment and Asset Pricing with ESG Disagreement 3 (Nov. 21, 2020), https://ssrn.com/abstract=3711218 (finding "brown stocks outperform green stocks by 0.59% per month in raw return and 0.40% per month in CAPM-adjusted return"); Hong & Kaperczyk, *supra* note 156, at 35 (finding a premium on sin stocks); Pedersen, Fitzgibbons & Pomorski *supra* note 156, at 593 (finding a premium for carbon and sin stocks).

[170] *See* Clark Barr, Dayna Doman & Violet Redensek, *Morningstar Sustainability Rating Methodology*, MORNINGSTAR (Nov. 8, 2021), https://www.morningstar.com/content/dam/marketing/shared/research/methodology/744156_Morningstar_Sustainability_Rating_for_Funds_Methodology.pdf [https://perma.cc/DD8A-5MZN] (noting the release of the "five globes" rating scheme in 2016).

literature, highly-rated ESG funds do not appear to generate better financial performance than low-rated funds.[171] (I am ignoring a large literature that attempts to evaluate fund performance based on the funds' own self-description since, as discussed earlier, there is substantial evidence that this self-description doesn't reflect the actual investment behavior of many funds.)[172]

III. SHAREHOLDERS LACK ESG INFORMATION

As discussed in the previous section, one of the strongest incentives operating on institutional shareholders is to keep the costs associated with firm specific governance to a minimum. So, it is not surprising that Blackrock, which has the largest stewardship investment team in the asset-management industry, requires each individual on the team to be responsible "for as many as 500 companies, generating a workload so vast that it can be very difficult to probe too deeply."[173] Industry experts note that it is difficult to imagine a single individual meaningfully engaging with more than thirty or forty companies' ESG activities at any given time.[174] Even these much lower numbers would strike most people familiar with the actual governance of large corporations to be optimistic. For example, when we look at how investors engage with even simple corporate disclosure around plain-vanilla governance issues, studies of "comply-or-explain" governance regimes—like

---

[171] *See* Samuel M. Hartzmark & Abigail B. Sussman, *Do Investors Value Sustainability? A Natural Experiment Examining Ranking and Fund Flows*, 74 J. FINANCE 2789, 2792–93 (2019) ("[W]e do not find evidence of high returns for high sustainability funds.").

[172] *See supra* notes 131–136 and accompanying discussion; *see also* Reiser & Tucker, *supra* note 6, at 1999 (finding considerable variation in how seriously ESG funds live up to their ostensible focus).

[173] Alastair Marsh, *Blackrock's Vow for Greener Planet to Get First Real-World Test*, BLOOMBERG L. (Mar. 2, 2020, 6:00 AM), https://www.bloomberglaw.com/product/blaw/document/Q6KBWGT0G1KW?criteria_id=22d72e062a7fb66904091e6ef514ce7f&searchGuid=6beb7878-9bacbe42205658d8.

[174] *Id.* (referencing the comments of a chief executive officer of a shareholder engagement firm); *see also* Bebchuk & Hirst, *supra* note 74, at 2073 ("[M]ost investors are unlikely to have sufficient expertise or resources to evaluate the many stewardship decisions made by index fund managers."); Paul Rose, *Proxy Advisors and Market Power: A Review of Institutional Investor Robovoting* 15–18 (Ohio St. L. Stud. Rsch. Paper No. 631, 2021), https://papers.ssrn.com/sol3/papers.cfm?abstract_id=3851233 (discussing the evidence some institutional shareholders lack the resources to come to voting decisions on their own).

that of the UK—find that "market prices do not react to firm explanations, suggesting that investors may ignore or not understand their content."[175]

By far, the best evidence of investors' lack of engagement, however, is the dependence of institutional investors on proxy advisory firms and simple rating schemes.[176] The ESG ratings industry exists because "[m]ost . . . investors are unable to assess the sustainability of companies on their own, and therefore, rely heavily on the ESG scores provided by sustainability rating agencies."[177] The ESG ratings industry is comprised of more than 125 different firms.[178] While ESG data firms provide varying levels

---

[175] Stewart, *supra* note 10, at 12–13; *see also* Sridhar Arcot, Valentina Bruno & Antoine Faure-Grimaud, *Corporate Governance in the UK: Is the Comply or Explain Approach Working?*, 30 INT'L REV. L. & ECON. 193, 194 (2010) ("[T]he market as a whole seems to be ignoring the explanations provided."); Yan Luo & Steven E. Salterio, *Governance Quality in a "Comply or Explain" Governance Disclosure Regime*, 22 CORP. GOVERNANCE 460, 476 (2014) ("[C]redibility of disclosure and market disciplinary power . . . is critical to success of 'comply or explain' governance regimes."); Aaron Dhir & Sarah Kaplan, Editorial, *Women in the Boardroom: Has the Time for Quotas Arrived?*, GLOBE & MAIL (Oct. 6, 2017), https://digitalcommons.osgoode.yorku.ca/public_writing/157/ [https://perma.cc/LG6F-DW7L] (finding a lack of change after three years of the comply-or-explain, and discussing need for more prescriptive measures); *see generally* Troy A. Paredes, *Blinded by the Light: Information Overload and Its Consequences for Securities Regulation*, 81 WASH. U. L.Q. 417 (2003) (describing the practical limitations of disclosure regimes).

[176] Tingle, *The Agency Cost*, *supra* note 74, at 782 (claiming that the proxy advisory industry has "become de facto regulators of corporate governance"); Tingle, *Bad Company!*, *supra* note 92, at 747 ("There is no real alternative to third-party proxy advisors—not if we expect institutional shareholders to vote at all."); Tingle, *What Do We Really Know?*, *supra* note 17, at 323 (discussing that "best practices" followed in many commercial, academic, and regulatory governance rating schemes have no impact on corporate performance).

[177] Samuel Drempetic, Christian Klein & Bernhard Zwergel, *The Influence of Firm Size on the ESG Score: Corporate Sustainability Ratings Under Review*, 167 J. BUS. ETHICS 333, 334 (2019); *see also* van Duuren, Plantinga & Scholtens, *supra* note 117, at 529 ("[I]nvestors may be time-constrained and therefore may have a tendency to use processed data such as ESG ratings.").

[178] *See* Rakhi Kumar & Ali Weiner, *The ESG Data Challenge*, STATE ST. GLOB. ADVISORS (Mar. 2019), https://www.ssga.com/investment-topics/environmental-social-governance/2019/03/esg-data-challenge.pdf ("As of 2016, there were more than 125 ESG data providers . . . ."). *But see* Li & Polychronopoulos, *supra* note 33, at 3 (identifying seventy firms as of 2020); Sakis Kotsantonis, Chris Pinney & George Serafeim, *ESG Integration in Investment Management: Myths and Realities*, 28 J. APPLIED CORP. FIN. 10, 14 (2016) ("One survey has reported finding that more than 80 ESG rankings and ratings have been developed in the last decade alone.").

of detail about corporate initiatives, the most salient information for readers is generally the overall "score" for companies, which is usually either provided or which can be easily calculated.[179]

The most important fact about ESG ratings is that they are invalid. There is no room for doubt on this point in the relevant empirical literature. Over a dozen studies have compared corporate ESG ratings and found wide variation in the way the same company is rated by different ESG data providers.[180] The lack of correlation and consistency between rating firms suggests that the ESG data from these firms is not reliably telling us much about the ESG qualities of the subject corporations. Correlations among credit

---

[179] Hartzmark & Sussman, *supra* note 171, at 2832 (discussing investors' preference for Morningstar's globe ratings over more detailed information); Steen Thomsen, Value Creation and Corporate Governance 3 (Nov. 5, 2020) (unpublished manuscript), https://ssrn.com/abstract=3710467 ("[B]ecause of the complexities involved companies invariably fall back on subjective consideration of a number of indicators, such as ESG ratings.").

[180] *See, e.g.*, Li & Polychronopoulos, *supra* note 33, at 1 (constructing two portfolios, each on the basis of a different ESG data providers' rankings, and finding very low correlation of returns); Berg, Kölbel & Rigobon, *supra* note 7, at 23 (finding that "ESG rating methodologies differ from each other" due to variations in categorization and taxonomy); Halbritter & Dorfleitner, *supra* note 152, at 27 (looking at the data from three ratings firms and "find[ing] significant variations in distribution and risk characteristics"); Gregor Dorfleitner, Gerhard Halbritter & Mai Nguyen, *Measuring the Level and Risk of Corporate Responsibility—An Empirical Comparison of Different ESG Rating Approaches*, 16 J. ASSET MGMT. 450, 465 (2015) (finding "hardly any correlation" between ratings of firms or appraisals of their ESG risk); Kumar & Weiner, *supra* note 178, at 2 (finding that "ratings of companies are only consistent for about half of the coverage universe"); Arthur Hughes, Michael A. Urban & Dariusz Wójcik, *Alternative ESG Ratings: How Technological Innovation Is Reshaping Sustainable Investment*, 13 SUSTAINABILITY 1, 19–20 (2021) (finding low commensurability between different methodology for creating ESG ratings); Avramov et al., *supra* note 169, at 2 (finding "substantial variations across different rating providers" that are "quite persistent throughout the entire [eighteen-year] sample period," with an average rating correlation of less than half); Rajna Gibson Brandon, Philipp Krueger & Peter S. Schmidt, *ESG Rating Disagreement and Stock Returns* 26 (Eur. Corp. Governance Inst., Working Paper No. 651/2020, 2021), https://papers.ssrn.com/sol3/papers.cfm?abstract_id=3433728 (evaluating ESG ratings and finding that "disagreement varies across industries"); Bouten et al., *supra* note 162, at 35 ("Given the lack of commensurability across . . . ratings, the precision required for meaningful empirical testing . . . appears extremely difficult, if not impossible."); Dane Christensen, George Serafeim & Anywhere Sikochi, *Why is Corporate Virtue in the Eye of the Beholder? The Case of ESG Ratings* 20 (Harvard Bus. Sch. Working Paper, Paper No. 20-084, 2021), ("[R]ating agencies tend to have strikingly different views on a given firm's ESG performance.").

ratings agencies is 99% (meaning they rate the same company identically 99% of the time).[181] Correlations among ESG rating firms are usually below 50%.[182] This is not a problem that the industry is getting closer to solving. Disagreement among ESG data intermediaries over the performance of a given company has actually been increasing over time.[183]

Another way of measuring the validity of the ESG data provided to investors is by looking at how well it predicts future performance. Once again, the ESG ratings are poor guides to the things we care about in the real world. The companies at the centers of the largest corporate scandals of the past two decades have often been highly ranked on ESG measures: Enron, WorldCom, Adelphia, Healthcare, BP, and Shell.[184] Empirical studies find that ESG intermediaries' measurements of "environmental strengths" do a poor job of predicting future pollution and compliance violations.[185] High ESG ratings are unconnected with labor-related issues and enforcement

---

[181] *See* Berg, Kölbel & Rigobon, *supra* note 7, at 6–7 (contrasting correlations among ESG ratings and credit ratings).

[182] *See supra* note 180 (setting out the range of correlations in the academic literature).

[183] *See* Christensen, Serafeim & Sikochi, *supra* note 180, at 21 ("[D]espite improving ESG disclosures and ESG performance over time, ESG disagreement appears to be increasing over time.").

[184] *See* David J. Vogel, *Is There a Market for Virtue? The Business Case for Corporate Social Responsibility*, 47 CAL. MGMT. REV. 19, 36–37 (2005) (listing Enron, Worldcom, Aldephia, Healthcare, BP, and Shell as companies previously touted for their ESG initiatives); Tatiana Botelho & Alessandra Magrinni, Assessing Oil: A Review of Sustainability Ratings Evaluation of Oil Companies 2 (2011) (conference paper on file with the Corporate Responsibility Research Conference), https://crrconference.org/Previous_conferences/downloads/crrc2011botelhomagrinni.pdf [https://perma.cc/HK9K-GV3S] (finding BP led or ranked very highly in several sustainability indexes before Deepwater Horizon); Cheri Hasz, *The U.S. Oil and Gas Industry Should Be a Leader and Follow the EU's Lead on ESG Disclosure*, 29 TUL. J. INT'L & COMPAR. L. 135, 142–43 (2021) ("[P]rior to the Deepwater Horizon catastrophe in 2010, British Petroleum (BP) had achieved high scores on certain ESG standards.").

[185] *See* Aaron K. Chatterji, David I. Levine & Michael W. Toffel, *How Well Do Social Ratings Actually Measure Corporate Social Responsibility?*, 18 J. ECON. & MGMT. STRATEGY 125, 162 (2009) (noting shortfalls in ESG ratings' ability to predict future environmental performance); Raghunandan & Rajgopal, *supra* note 130, at 18 (finding a negative association between high ESG companies and environmental violations).

actions.[186] Instead, high ethical and social scores are actually connected with aggressive accounting policies and earnings management.[187] Companies with high ESG ratings pay their executives in the same ways and in the same amounts as other companies, but when COVID-19 hit, they were *less likely* to reduce CEO and director pay, even as they laid off employees.[188]

There is also a more limited body of research on the impact of ESG ratings on firm risk; this is particularly relevant to the "systemic stewardship" claim on behalf of ESG funds. A long-term (eighteen-year) study of highly rated ESG companies found "a negative but insignificant relationship between the various corporate social strengths and systematic financial risk."[189] This was true when the rated ESG components were considered individually and in aggregate.[190] A recent examination of ESG funds found their methods of portfolio selection actually exposed them to more investment risk, as it leads them to be overweight in small

[186] *See* Raghunandan & Rajgopal, *supra* note 130, at 18 (finding that BRT signatories had "higher rates of violations than their matched peers, with respect to all violations . . . as well as labor and environmental violations specifically").

[187] *See e.g.*, Vassiliki Grougiou, Stergios Leventis, Emmanouil Dedoulis & Stephen Owusu-Ansah, *Corporate Social Responsibility and Earnings Management in U.S. Banks*, 38 ACCT. F. 155, 156 (2014) (finding transparent earnings reporting is "a significant determinant" of ESG quality, but that the reverse is not true); Jennifer Martínez-Ferrero, Shantanu Banerjee & Isabel María García-Sánchez, *Corporate Social Responsibility as a Strategic Shield Against Costs of Earnings Management Practices*, 133 J. BUS. ETHICS 305, 309–10 (2016) (discussing links between ESG ratings and aggressive accounting policies and testing whether CSR strategies can improve corporation reputation); Diego Prior, Jordi Surroca & Josep A. Tribó, *Are Socially Responsible Managers Really Ethical? Exploring the Relationship Between Earnings Management and Corporate Social Responsibility*, 16 CORP. GOVERNANCE 160, 172 (2008) (finding a "positive impact of earnings management practices on CSR"); Rim Makni Gargouri, Ridha Shabou & Claude Francoeur, *The Relationship Between Corporate Social Performance and Earnings Management*, 27 CAN. J. ADMIN. SCIS. 320, 331 (2010) (finding that "CSP dimensions concerning the environment and employees are positively associated with EM").

[188] *See* Amit Batish et al., *Sharing the Pain: How Did Boards Adjust CEO Pay in Response to COVID-19?*, STAN. CLOSER LOOK SERIES 2 (Sept. 1, 2020), https://www.gsb.stanford.edu/sites/default/files/publication-pdf/cgri-closer-look-86-sharing-the-pain-how-did-boards-adjust-ceo-pay.pdf [https://perma.cc/YY2C-VFEM] ("We would expect CEOs and directors of companies that truly value ESG to be more (not less) likely to reduce their pay during times of economic stress, but this is not what we found.").

[189] Oikonomou, Brooks & Pavelin, *supra* note 158, at 505.

[190] *See id.* at 508 (finding that the "financial risk impact of CSP is not masked when the aggregate measures replace the individual components").

issuers, volatile tech companies, and firms that are abnormally susceptible to changes in inflation, interest rates, and (amazingly) oil prices.[191]

A. WHAT DO ESG RATING FAILURES TELL US ABOUT ESG INVESTORS?

The failures of these rating schemes to come to the same conclusions about the same companies is well-known outside the precincts of academia. It is widely reported in the financial press,[192] by regulators,[193] and even in communications from ESG asset managers themselves.[194] Commissioner Peirce of the Securities and Exchange Commission noted in a well-publicized speech that "the

---

[191] Derek Horstmeyer, *The Surprising Risks of Investing in ESG Funds*, WALL ST. J. (Sept. 16, 2021, 1:00 PM), https://www.wsj.com/articles/risks-of-esg-funds-11631539404 (analyzing risks associated with ESG investing).

[192] *See, e.g.*, James Mackintosh, *Is Tesla or Exxon More Sustainable? It Depends Whom You Ask*, WALL ST. J. (Sept. 17, 2018, 11:58 AM), https://www.wsj.com/articles/is-tesla-or-exxon-more-sustainable-it-depends-whom-you-ask-1537199931 (pointing out that "[i]nvestors picking a scoring system for ESG . . . issues facing companies can have any of [various] outcomes"); Robin Wigglesworth, *Rating Agencies Using Green Criteria Suffer from 'Inherent Biases'*, FIN. TIMES (July 20, 2018), https://www.ft.com/content/a5e02050-8ac6-11e8-bf9e-8771d5404543 ("Agencies that judge companies according to their [ESG] metrics suffer from wildly diverging standards and 'inherent biases,' according to a report by the American Council for Capital Formation."); Jon Sindreu & Sarah Kent, *Why It's So Hard to Be an 'Ethical' Investor*, WALL ST. J. (Sept. 1, 2018, 7:00 AM), https://www.wsj.com/articles/why-its-so-hard-to-be-an-ethical-investor-1535799601 ("A Journal analysis of four leading ESG ratings providers found that they come to completely different conclusions about what makes a company a 'sustainable' investment. General Motors Co., for example, is given an ESG score of about average by Sustainalytics, but rated at the very bottom by MSCI . . . ."); Kate Allen, *Lies, Damned Lies and ESG Rating Methodologies*, FIN. TIMES (Dec. 6, 2018), https://www.ft.com/content/2e49171b-a018-3c3b-b66b-81fd7a170ab5 (highlighting the findings of a report which noted "the lack of consistency between [ESG] scoring methods") .

[193] *See* Hester M. Peirce, Comm'r, SEC, Scarlet Letters: Remarks before the American Enterprise Institute (June 18, 2019), https://www.sec.gov/news/speech/speech-peirce-061819 [https://perma.cc/WZ6M-K66N] (describing how corporations are often marked with a "scarlet letter" based on their ESG ratings even though "there are many different scorecards and standards out there, each of which embodies the maker's judgments about any issues to classify as ESG [such that] [t]he analysis . . . may treat similarly situated companies differently and may even treat the same company differently over time for no clear reason").

[194] *See* Kumar & Weiner, *supra* note 178, at 2 ("ESG data providers generally develop their own sourcing, research, and scoring methodologies. As a result, the rating for a single company can vary widely across different providers.").

Georgia Law Review, Vol. 58, No. 1 [2023], Art. 5

different [ESG] ratings available can vary so widely, and provide such bizarre results that it is difficult to see how they can effectively guide investment decisions."[195] The failure of ESG ratings to predict positive ESG outcomes is also readily apparent to any moderately well-informed market observer. For example, BP's hypocritical (but successful) "beyond petroleum" burnishing of its ESG credentials in the decade before the Deepwater Horizon disaster was thoroughly reported.[196]

The fact that ESG ratings are still purchased and relied upon by institutional investors provides strong support for the argument that fund incentive structures militate against meaningful engagement with ESG issues. There are clear analogues with the much older proxy advisory industry that provides shareholders with corporate governance information: institutional investors use this data even though it is inaccurate, presumably because they don't have the resources or incentives to do the necessary firm-specific work themselves, and it is more important to appear to be engaged in corporate governance than to actually engage with it.[197] The centrality of deeply flawed ESG ratings to investment fund decisions is similarly strong evidence that ESG investors are more

---

[195] Peirce, *supra* note 193.

[196] *See, e.g.*, Mark S. Schwartz, *Beyond Petroleum or Bottom Line Profits Only? An Ethical Analysis of BP and the Gulf Oil Spill*, 125 BUS. SOC. REV. 71, 73 (2020) ("In 2001 [BP's new CEO] renamed the company BP from British Petroleum and began to use the tagline 'Beyond Petroleum'. . . . [B]y 2003, BP gave every appearance of having evolved into an environmentally friendly, sustainability-oriented firm."); Botelho & Magrinni, *supra* note184, at 2 (noting that at the time of the incident, BP "had a better reputation than its peers in terms of social responsibility," and "indexes that seek only the most environmentally friendly companies held millions of dollars in BP shares"); Hasz, *supra* note 184, at 142–43 ("[P]rior to the Deepwater Horizon catastrophe in 2010, [BP] had achieved high scores on certain ESG standards."); RUPERT DARWALL, REAL CLEAR FOUND., CAPITALISM, SOCIALISM AND ESG 17 (2021), https://www.realclearpolitics.com/docs/2021/rupert_darwall_capitalism_socialism_and_esg_may_2021.pdf [https://perma.cc/7FWX-8338] (noting that BP's share price increased by 71% after the company's rebrand).

[197] *See* Tingle, *What Do We Really Know?*, *supra* note 17, at 322–23 (summarizing the evidence that academic, media and commercial corporate governance rating schemes fail to predict desired corporate outcomes); Tingle, *The Agency Cost, supra* note 74, at 740–41 (discussing the evidence of errors at every stage of proxy advisors' workstreams and the apparent indifference of their institutional investor clientele).

concerned with keeping overhead low and achieving strong relative returns than effecting meaningful ESG reforms.

B. WHAT DO THE FAILURES OF ESG RATINGS TELL US ABOUT CORPORATE ESG?

The ESG data providers are neither stupid nor wicked. They sincerely want to provide useful information for institutional investors who, in turn, would like (within the constraints under which they operate) to improve corporate ESG outcomes. The failure of ESG ratings is probably not best understood as some kind of intellectual or moral failure of the ratings agencies; instead, the failure of ESG ratings tells us something about ESG itself: environmental and social impacts are difficult to understand and summarize.

There are intractable problems associated with investors obtaining, evaluating, and acting on ESG information:

> • Unlike most relevant financial aspects of a business, ESG involves elements that are either impossible to quantify or that are too complex to quantify.[198]
>
> • Many ESG factors are purely subjective, such as employee happiness and being a good member of the community. There is a large empirical literature that finds low validity in these sorts of management system measurements.[199] For example, unions and management disagree on how often they meet and whether work has become more intense.[200] Employees

---

[198] *See* Cash, *supra* note 14, at 22 ("[T]he non-financial reporting realm . . . considers elements that are impossible to quantify[] or are . . . too complex to quantify.").

[199] *See* Chatterji, Levine & Toffel, *supra* note 185, at 164 ("Our results are consistent with a large literature that finds low validity of management system measurements.").

[200] *See* Adrienne E. Eaton, *The Survival of Employee Participation Programs in Unionized Settings*, 47 INDUS. & LAB. RELS. REV. 371, 371 (1994) (highlighting differences in union representatives' and managers' responses regarding their perceptions of employee participation programs); Francis Green, *Why Has Work Become More Intense?*, 43 INDUS. RELS. 709, 724 (2004) (citing survey data showing that "[w]orkers' representatives report the stronger balance in favor of work intensification, with 61 percent saying work effort had gone

fail to agree on the human resource management practices at their firms.[201]

• Many ESG factors are incommensurate even across a single dimension. Taking worker welfare as an example, in 2000 Exxon Mobil was rated highly because of its strong retirement benefits programs, but had also been involved in major controversies about health and safety issues.[202] Does Exxon treat employees well or not?

• ESG factors are incommensurate across dimensions.[203] How does positive performance in one dimension, such as the environment, relate to negative performance in other dimensions, such as participation in a controversial business (like gambling), or treating the workforce poorly?[204] Bloomberg's ESG data covers 120 different indicators—how are these to be weighted and balanced?[205]

• ESG involves constituencies whose interests often, even usually, conflict over the usual timeframe for business decision-making: shareholders, workers, lenders, customers, communities, suppliers, and the

---

up a lot . . . . Among managers, 40 percent reported that work effort had gone up a lot, whereas another 37 percent reported that it had gone up a little").

[201] *See* Chatterji, Levine & Toffel, *supra* note 185, at 164 ("Often, employees do not even agree on the human resource management practices that prevail in their workplace.").

[202] Oikonomou, Brooks & Pavelin, *supra* note 158, at 490.

[203] *See* Brandon, Krueger & Schmidt, *supra* note 180, at 2 ("Our analysis of pairwise correlations between ESG ratings from different providers . . . highlights more subtle patterns in disagreement, which go against the common belief of generalized ESG rating disagreement . . . .").

[204] *See, e.g.*, Krüger, *supra* note 167, at 305 (discussing the different ways positive and negative ESG announcements are received by shareholders depending on the nature of those announcements, the history of the companies' failures in the relevant area, and the possibility of agency costs producing the ESG initiative)

[205] *See id.* (finding that "shareholders tend to react positively to CSR news whenever it is more likely to be the result of the firm . . . 'offsetting' previous corporate social irresponsibility"); *see also* Cornell & Damodaran, *supra* note 17, at 78 ("Bloomberg's ESG data covers 120 environmental, social, and governance indicators.").

environment.[206] How are these conflicts to be factored into evaluating a firm's performance?

• ESG requires nuanced value judgments.[207] Many ESG funds avoid companies active in the arms trade.[208] Should this include firms that make radar systems for the military? Or provide logistical support to the armed forces? Or who (like Walmart) only sell guns, rather than manufacturing them? Or who count gun manufacturers among their customers?[209] These types of questions ramify across an ESG portfolio and are

---

[206] *See* Jeffrey M. Lipshaw, *The False Dichotomy of Corporate Governance Platitudes*, 46 J. CORP. L. 345, 350 (2021) ("[S]hareholder absolutists and the stakeholder or social responsibility purists are engaging in a rhetorical battle largely removed from the reality that shareholder success is and always has been inseparable from corporate commitment to some or all of those constituencies"); Bainbridge, *supra* note 4, at 318 ("Neither the law nor the incentive structure for CEOs has changed. When faced with . . . zero-sum decisions, CEOs remain legally obliged—and can be expected—to prefer shareholder interests."); Thomsen, *supra* note 179, at 40 ("Companies exist to fill to serve [sic] a social need which they fill by providing society with goods and services. . . . [T]he purpose may be broadened to include fair treatment of stakeholders—like employees, suppliers or government organizations—who help serve the purpose."); Leo E. Strine, Jr., *Restoration: The Role Stakeholder Governance Must Play in Recreating a Fair and Sustainable American Economy: A Reply to Professor Rock*, 76 BUS. LAW. 397, 431 (2021) ("From just an investor perspective, many Americans are exposed to the risks of private companies as pensioners, and as constituents of organizations . . . . As importantly, Americans are workers at these companies, live in communities where they operate and often seek tax subsidies, consume products and services they deliver, and thus suffer in these capacities if these companies do not fairly treat their workers, their communities of operation, the environment, their consumers, and their creditors.").

[207] *See* Magali A. Delmas, Dror Etzion & Nicholas Nairn-Birch, *Triangulating Environmental Performance: What Do Corporate Social Responsibility Ratings Really Capture?*, 27 ACAD. MGMT. PERSPS. 255, 256 (2013) (explaining that ESG is "an essentially artificial construct that can be interpreted and evaluated in many ways").

[208] *See* Brook Sutherland, *Defense Stocks Search for Their Place in the ESG Universe*, BLOOMBERG NEWS (March 25, 2022, 2:54 PM), https://www.bloomberg.com/opinion/articles/2022-03-25/industrial-strength-defense-stocks-search-for-their-place-in-the-esg-universe-l16s9bcq#xj4y7vzkg [https://perma.cc/8PHT-XRLQ] ("There's long been a perception that investors who prioritize stocks with strong environmental, social and governance (ESG) credentials should and do shun companies that get a significant portion of their revenues from products designed to harm or kill human beings.").

[209] These sorts of questions are discussed by von Wallis & Klein. *See* von Wallis & Klein, *supra* note 13, at 68 (explaining that military contracting is considered a traditionally negative social investment); *see also* Berg, Kölbel & Rigobon, *supra* note 7, at 23 (noting that "matching indicators to consistent categories is a difficult exercise" for ESG).

much harder to solve than the simple question of whether a business's risk-adjusted returns merit an investment (and most active managers don't even manage to succeed at this consistently).[210]

- One value judgment that deserves specific attention is whether it is the absolute externalities produced by a company that matters, or its relative production of externalities. Is it carbon use adjusted for size that matters, or total carbon emissions?[211] (As it happens, large companies tend to receive better ESG scores than smaller companies, notwithstanding shareholder engagement with a large company is likely to produce greater total reductions in emissions).[212]

- Another value judgement that deserves specific attention is whether we focus on the ESG performance of the company in question, or include the ESG performance of its customers or suppliers? Companies (and their shareholders) often have little knowledge or power over firms in their supply or customer chains. The food production industry scores very well on emissions if we only look at the industry itself; if we look at emissions from third parties who supply the food production industry with materials, or who buy the food

[210] There is relatively little disagreement that active managers generally fail to beat the market. *See, e.g.*, Martin J. Gruber, *Another Puzzle: The Growth in Actively Managed Mutual Funds*, 51 J. FINANCE 783, 783 (1996) ("[T]he average actively managed fund has negative performance compared to a set of indices."); Javier Gil-Bazo & Pablo Ruiz-Verdú, *The Relation Between Price and Performance in the Mutual Fund Industry*, 64 J. FINANCE 2153, 2153 (2009) (noting that "on average such [actively managed equity] funds underperform index funds").

[211] *See* Chatterji, Levine & Toffel, *supra* note 185, at 165 (noting a prominent ESG rating provider does a poor job of identifying eco-inefficient companies).

[212] *See* Dorfleitner, Halbritter & Nguyen, *supra* note 180, at 460 (showing a table in which larger companies are assessed at higher ESG higher than smaller companies); Drempetic, Klein & Zwergel, *supra* note 177, at 519 ("The results indicate that the ESG score is distorted in favor of larger companies, because ESG scores are dependent on resources for providing ESG data and data availability of the ESG score."); Bolton & Kacperczyk, *supra* note 132, at 5 (discussing that "technological change [to lower emissions] will benefit firms where returns to scale are highest").

and waste from the industry, then it becomes one of the worst emitting industries in the economy.[213]

• Disclosure, generally, seems poorly suited to providing a basis for ESG decision-making.[214] ESG is so

---

[213] *See* Bolton & Kacperczyk, *supra* note 132, at 13 (listing "food products" as among the "most scope . . . emission intensive industries"); *see also* Escrig-Olmedo et al., supra note 7, at 13 (noting that, because "there is no evidence that ESG rating agencies integrate life-cycle thinking as an explicit principle in their sustainability assessment," they miss the true scale of emissions from industries).

[214] *See* Henry T.C. Hu, *Illiteracy and Intervention: Wholesale Derivatives, Retail Mutual Funds, and the Matter of Asset Class*, 84 GEO. L.J. 2319, 2376–77 (1996) (reviewing data showing most people don't read prospectuses or understand them sufficiently to make good decisions); *see also* Schwarcz, *supra* note 83, at 35 (discussing how some complex transactions cause disclosure to be complex beyond the understanding of even institutional investors); Tamar Frankel, *The Failure of Investor Protection by Disclosure*, 81 U. CIN. L. REV. 421, 435 (2012) ("As promises and institutional structures have become increasingly complex, so did disclosure . . . . Most humans have great difficulty in calculating complexity. They simplify complex materials in order to absorb and understand their meaning and make decisions."). Securities regulators in the United States have expressed concern about disclosure. *See* SEC, DISCLOSURE TO INVESTORS: A REAPPRAISAL OF FEDERAL ADMINISTRATIVE POLICIES UNDER THE '33 AND '34 ACTS: 'THE WHEAT REPORT' (1969) (concluding prospectuses are too long or complex and cannot be easily understood); SEC, REPORT OF THE TASK FORCE ON DISCLOSURE SIMPLIFICATION xii–7 (1996) (making a number of recommendations to simplify disclosure); Susanna Kim Ripken, *Paternalism and Securities Regulation*, 21 STAN. J.L. BUS. & FIN. 1, 46 (2015) (discussing how too much disclosure can lead investors to either ignore the data or selectively understand portions); Black, *supra* note 83, at 1506 (finding lengthy and complex disclosures would simply be a "waste of . . . time" for most unsophisticated investors); Jean-Noël Chauvey, Sophie Giordano-Spring, Charles H. Cho & Dennis M. Patten, *The Normativity and Legitimacy of CSR Disclosure: Evidence from France*, 130 J. BUS. ETHICS 789, 801 (2015) (finding that French regulations requiring greater disclosure "have not led to a proliferation of high-quality CSR reporting packages by French corporations"); Carlos Larrinaga, Francisco Carrasco, Carmen Correa, Fernando Llena & José M. Moneva, *Accountability and Accounting Regulation: The Case of the Spanish Environmental Disclosure Standard*, 11 EUR. ACCT. REV. 723, 737 (2002) (finding roughly 80% of companies in Spain did not provide any environmental disclosure, while those that did failed to report aspects that impact the firm negatively); Ravindranath Madhavan & John E. Prescott, *Market Value Impact of Joint Ventures: The Effect of Industry Information-Processing Load*, 38 ACAD. MGMT. J. 900, 912 (1995) ("A basic assumption of this study is that analysts understand the firms they monitor. However, . . . the value of a joint venture may be difficult to assess if it is designed to enhance or combine capabilities or routines whose synergistic effects are not easily understood by analysts."); Morris H. Stocks & Adrian Harrell, *The Impact of an Increase in Accounting Information Level on the Judgment Quality of Individuals and Groups*, 20 ACCT. ORGS. & SOC'Y 685, 697–98 (1995) ("[A]s the information level increased, the individual participants appear to have experienced moderate information processing difficulties, while the group participants appear to have experienced few

> complex that it takes considerable effort and time to understand disclosure. We know from a large empirical literature that decision-making quality *declines* as the amount of disclosure increases.[215] So it is not a surprise that more ESG disclosure is associated with larger disagreements between ESG rating firms.[216]

---

information processing difficulties."); Steven M. Davidoff & Claire A. Hill, *Limits of Disclosure*, 36 SEATTLE U. L. REV. 599, 599–603 (2013) (noting the problem in the 2008 financial crisis was not insufficient disclosure of risks, but an inability of investors to understand and price those risks); Paredes, *supra* note 175, at 440–43 (summarizing literature on information overload in the context of financial markets); Jacob Jacoby, *Is it Rational to Assume Consumer Rationality? Some Consumer Psychological Perspectives on Rational Choice Theory*, 6 ROGER WILLIAMS U. L. REV. 81, 133 (2000) (arguing that, at some point, "acquiring more information leads consumers to make poorer decisions"); Omri Ben-Shahar & Carl E. Schneider, *The Failure of Mandated Disclosure*, 159 U. PA. L. REV. 647, 743 (2011) ("A principal lesson of our review of why mandated disclosure fails is that length, complexity, and difficulty are the enemies of successful mandates."); *see generally*, OMRI BEN-SHAHAR & CARL E. SCHNEIDER, MORE THAN YOU WANTED TO KNOW: THE FAILURE OF MANDATED DISCLOSURE 183 (2014) (arguing that mandated disclosure is "not always useless," but it is "so indiscriminately used with such unrealistic expectations and such unhappy results that it should be presumptively barred. . . . [sparing] the world much pointless regulation and [possibly helping to] drive lawmakers—legislatures, administrative agencies, and courts—to search harder for solutions actually tailored to problems").

[215] *See, e.g.*, BEN-SHAHAR & SCHNEIDER, *supra* note 214, at 6 (arguing that empirical studies rarely show that disclosures lead to good decision-making); Paredes, *supra* note 175, at 440–41 ("Studies have shown that as a decision maker is given more information, decision quality initially increases; once the information level reaches a certain point, however, the decision maker's decision quality decreases if she is given additional information."); Susanna Kim Ripken, *The Dangers and Drawbacks of the Disclosure Antidote: Toward a More Substantive Approach to Securities Regulation*, 58 BAYLOR L. REV. 139, 146–47 (2006) (arguing that overly complex disclosure "floods the individual with too much nonessential data and overloads the person with information that inhibits optimal decision-making"); Stocks & Harrell, *supra* note 214, at 686 ("[A]s the information environment becomes more complex, the level of information processing by the processing unit increases up to some maximum processing level. After this point, additional environmental complexity results in a lower level of information processing."). Many researchers find the identical phenomenon, that it is the quantity not the substance of reporting that drives ESG ratings. *See, e.g.*, Raghunandan & Rajgopal, *supra* note 31, at 3 (suggesting "that ESG funds may be concerned about the existence of firms' disclosures rather than the content of the information being disclosed"); Florencio Lopez-de-Silanes, Joseph A. McCahery & Paul C. Pudschedl, *ESG Performance and Disclosure: A Cross-Country Analysis*, SING. J. LEGAL STUD. 217, 217 (2020) (suggesting that "firms with good ESG scores are simply disclosing more information").

[216] *See* Christensen, Serafeim & Sikochi, *supra* note 180, at 5 (noting that disagreement increases with the volume of disclosure on ESG matters).

Tingle: Shareholders' Potential

• ESG decisions must take into account the cost and viability of various alternative ESG-relevant strategies or investments, but securities disclosure is almost always about what the company is doing, not about hypothetical possibilities. (Disclosure about possible futures and predicted results carry a risk of lawsuits).[217]

• The most useful ESG information for shareholders would be details around ESG strategies, innovations, and the results of a firm's experiments to improve outcomes. Unfortunately, this is exactly the same kind of information that is also most helpful to a company's competitors in their own ESG efforts. To the extent regulators require this sort of disclosure of proprietary information, they create incentives for public companies to refrain from pioneering new innovations, as disclosure will enable their competitors to achieve the same outcomes more efficiently by avoiding the expense of research and experiments, as well as the losses produced by mistakes.[218] In the same way that executive pay disclosure probably helped increase executive pay, corporate ethics disclosure resulted in watering down ethical codes, and anti-corruption disclosure may have hurt the developing countries it

---

[217] *See, e.g.*, Virginia Milstead et al., *Do Hypothetical Risk Disclosures Give Rise to Securities Claims?*, REUTERS (May 17, 2023), https://www.reuters.com/legal/legalindustry/do-hypothetical-risk-disclosures-give-rise-securities-claims-2023-05-17/ (describing the risks companies face in disclosing hypothetical ESG challenges).

[218] *See* Sergio Gilotta, *Disclosure in Securities Markets and the Firm's Need for Confidentiality: Theoretical Frameworks and Regulatory Analysis*, 13 EUR. BUS. ORG. L. REV. 45, 88 (2012) ("Pursuing transparency unconditionally, however, is not feasible: as the analysis has shown, it would thwart innovation and this does not seem a price worth paying."); Luigi Zingales, *The Future of Securities Regulation*, 47 J. ACCT. RSCH. 391, 394 (2009) ("While a hypothetical social planner does not internalize the competitive position of each individual firm, he does internalize the incentive to invest in research and development (R&D). If mandatory disclosure discourages R&D investments, it is clearly not socially desirable."); Wolfgang Schön, *Corporate Disclosure in a Competitive Environment—The Quest for a European Framework on Mandatory Disclosure*, 6 J. CORP. L. STUD. 259, 294 (2006) ("[T]he 'public good' side of corporate information in the capital market can also be counterbalanced by the welfare-enhancing effect of innovation. Once an enterprise becomes aware that corporate disclosure of innovative activities might reduce the benefit it will derive from these activities it might be induced to stop it.").

Published by Digital Commons @ University of Georgia School of Law, 2023

was trying to help, public disclosure is well understood as reducing the returns to innovation.[219] At the very least, this means companies will work hard to avoid making public the kind of proprietary information shareholders would find most useful in appraising ESG activities.[220]

• Ultimately, ESG information has to come from the issuers themselves. The ambiguities, commensurability issues, missing hypotheticals, and value judgements contained in the disclosure will generally be resolved by companies in whatever ways make themselves look best. As this ESG disclosure may impact a firm's cost of capital, the attitude of its employees and customers, and the company's regulatory future, it is probably a duty of management (as well as being in their own interests) to put the company's best foot forward.[221]

[219] *See, e.g.*, Tingle, *Corporations on the Couch*, *supra* note 11, at 745–46 (noting the ways corporate disclosure intended to reduce inequality, improve diversity, prevent conflicts in the developing world, reduce corruption, produce more ethical behavior, and combat slave labor, have produced perverse results); Matthias Breuer, Christian Leuz & Steven Vanhaverbeke, *Reporting Regulation and Corporate Innovation* 39 (Nat'l Bureau of Econ. Rsch., Working Paper No. 26291, 2022), http://www.nber.org/papers/w26291 [] ("We find that mandated firms' reporting spurs innovation activity of other related firms (e.g., competitors, customers, or suppliers), especially larger ones."); Tomasz Obloj & Todd Zenger, *The Influence of Pay Transparency on (Gender) Inequity, Inequality and the Performance Basis of Pay*, 6 NATURE HUM. BEHAV. 646, 653 (2022) (discussing how pay transparency increases the equity and equality of pay but reduces the link between pay and individual performance).

[220] *See* Hans B. Christensen, Luzi Hail & Christian Leuz, *Mandatory CSR and Sustainability Reporting: Economic Analysis and Literature Review*, 26 REV. ACCT. STUD. 1176, 1233 (2021) (questioning "whether firms use boilerplate language as an avoidance strategy to hide (unfavorable) CSR performance or retain proprietary information") .

[221] *See* Martinez-Ferrero, Banerjee & García-Sánchez, *supra* note 187, at 306 (drawing analogies to earnings management to argue that managers "are more likely to carry out these discretionary [social responsibility] practices, possibly in order to help them secure their jobs and increase compensation"); Gargouri, Shabou & Francoeur, *supra* note 187, at 331 (finding corporate "dimensions concerning the environment and employees are positively associated with [earnings management]"). For a discussion about disclosures that make companies look better than they are (often called "greenwashing" or "woke washing"), see Thomas P. Lyon & A. Wren Montgomery, *The Means and End of Greenwash*, 28 ORG. & ENV'T 223, 225–26 (2015) (distinguishing between "greenwashing" and other forms of environmental or social performance disclosure); William S. Laufer, *Social Accountability and Corporate Greenwashing*, 43 J. BUS. ETHICS 253, 259 (2003) ("[A]ccusations of greenwashing and evidence of its practice, decisions to defer third party auditing or to forgo the requirement

> Along these lines, one amusing study found that firms falling short of earnings expectations were more likely to cite social and environmental achievements in their public announcements.[222]

---

entirely strongly undermine an appearance of legitimacy."); Catherine A. Ramus & Ivan Montiel, *When Are Corporate Environmental Policies a Form of Greenwashing?*, 44 BUS. & SOC'Y 377, 409 (2005) ("[B]ecause environmental policy statements are easy to make, stakeholders want companies to make them, and it is hard to control whether they are implemented, companies may be committing to them without a serious intent to implement the policies. In the absence of regulation and without a business rationale for implementation, it is unlikely that even those companies that claim to be committed to sustainable development will move closer to this illusive goal."); Bradley Rudkin, Danson Kimani, Subhan Ullah, Rizwan Ahmed & Syed Umar Farooq, *Hide-and-Seek in Corporate Disclosure: Evidence from Negative Corporate Incidents*, 19 CORP. GOVERNANCE 158, 163 (2019) (contrasting the "reactive approach occurs where companies provide explanations related to a recent event, crisis or scandal within their CSR statements" with the "proactive approach which involves companies providing continuous disclosures . . . as a way of protecting their legitimacy"); Xavier Font, Andreas Walmsley, Sara Cogotti, Lucy McCombes & Nicole Häusler, *Corporate Social Responsibility: The Disclosure-Performance Gap*, 33 TOURISM MGMT. 1544, 1552 (2012) (discussing the gap between what companies say and what they often do); Christopher Marquis, Michael W. Toffel & Yanhua Zhou, *Scrutiny, Norms, and Selective Disclosure: A Global Study of Greenwashing*, 27 ORG. SCI. 483, 500 (2016) (showing evidence of selective disclosure of environmental impacts); Eun-Hee Kim & Thomas P. Lyon, *Greenwash vs. Brownwash: Exaggeration and Undue Modesty in Corporate Sustainability Disclosure*, 26 ORG. SCI. 705, 718 (2015) ("[F]irm growth leads to greenwashing as a result of an anticipation of increased interactions with stake-holders in the regulatory arena."); Marcus J. Milne & Rob Gray, *W(h)ither Ecology? The Triple Bottom Line, the Global Reporting Initiative, and Corporate Sustainability Reporting*, 118 J. BUS. ETHICS 13, 20 (2012) (critiquing the disconnect between sustainability reporting and performance); Güler Aras & David Crowther, *Corporate Sustainability Reporting: A Study in Disingenuity?*, 87 J. BUS. ETHICS 279, 286 (2009) ("[C]orporate concern with sustainability is little more than rhetorical rather than a serious attempt to address the issues involved. This is even more true, when the concept of sustainable development is introduced."); Marcus J. Milne, *Phantasmagoria, Sustain-a-babbling in Social and Environmental Reporting*, *in* THE ROUTLEDGE COMPANION TO ACCOUNTING COMMUNICATION 135, 136–37 (Lisa Jack, Jane Davison & Russell Craig eds., 2013) ("[O]rganizations do little more than report on their social, environmental and/or economic/financial impacts . . . . [T]he content of such reports is organization-centric and limited to organization impacts. It remains largely without social and environmental context."); Pascual Berrone, Andrea Fosfuri & Liliana Gelabert, *Does Greenwashing Pay Off? Understanding the Relationship Between Environmental Actions and Environmental Legitimacy*, 144 J. BUS. ETHICS 363 (2017) (discussing the nature and effects of greenwashing).

[222] Ryan Flugum & Matthew E. Souther, Stakeholder Value: A Convenient Excuse for Underperforming Managers? 34 (July 10, 2023) (unpublished manuscript), https://ssrn.com/abstract=3725828 ("[M]anagers push for the amorphous stakeholder value-

In summary, ESG factors are often subjective, non-quantifiable, incommensurate between themselves, and poorly suited to disclosure regimes. Moreover, they vary according to competing plausible value judgments. It should not be surprising that the third-party intermediaries offering to make sense of corporate ESG data for shareholders come to different conclusions.

Of course, ESG is not unusual. Lots of decisions must be made in similar information environments. So why is it particularly problematic for ESG investors? The reason partly has to do with the incentives and institutional features of investment funds that we have already discussed: there is a lack of resources and relevant expertise among fund managers, so they need quick and easily digestible guidance about ESG. But that is not the entire reason.

IV. SHAREHOLDER GOVERNANCE TOOLS ARE POORLY SUITED TO ESG INTERVENTIONS

Directors and officers of a corporation may advance ESG goals by engaging in operational fine-tuning or testing possible improvements with small-scale experiments. Their tools for addressing ESG issues are suited to the task. Shareholders, in contrast, have only very blunt mechanisms for making changes: interventions (such as shareholder proposals and proxy fights) or dropping a firm from their portfolio. These are binary decisions. Should the shareholders invest their resource-constrained time and money in a company? To make these decisions shareholders need a straightforward identification of which companies merit either an ESG intervention or a refusal to purchase their shares. In other words, the corporate governance tools of shareholders also drive the need for the deeply flawed and overly simplistic ESG ratings and rankings.

A. NEGATIVE SCREENING OR DIVESTMENT

---

focused governance standards when their performance falls short of the objective benchmarks associated with shareholder value-focused governance.").

Selling or refusing to purchase the shares of companies with poor ESG track records is the most common ESG investing strategy today.[223] It is popular with investors because it is easy, and compared with various types of shareholder engagement, it is cheap. Of course, it depends on actually knowing who the bad ESG performers are, and as we have seen, shareholders do not know this.[224] However, they may feel they can at least identify the bad industries (this is often the point when negative screening turns into divestment).[225] To get some idea of how coarse negative screening is in practice, one group of scholars found negative screening for carbon emissions was only applied to companies in three industries: oil and gas, utilities, and automobiles.[226] This means negative screening was not used in relation to companies in all other industries, regardless of those companies' total emissions or relative emission intensity.

The goal of negative screening or divestment is to get corporations, or entire sectors of the economy, to change their behavior by applying pressure to their share price and thus their cost of capital. In theory this should be impossible. Unlike other goods and services, the value of a corporate share is not derived from the intersection of supply and demand, but from the future cash

---

[223] Trinks & Scholtens, *supra* note 169, at 193.

[224] *See* FISCHEL, *supra* note 30, at 13–14 (observing that the lists of the "worst polluters" targeted by two different divestment groups contain very little overlap); *see also supra* discussion accompanying note 180.

[225] The main divestment targets these days are the energy companies. *See, e.g.*, Dennis Halcoussis & Anton D. Lowenberg, *The Effects of the Fossil Fuel Divestment Campaign on Stock Returns*, 47 N. AM. J. ECON. & FIN. 669, 669 (2019) (noting the number of institutions pledging divestment from fossil fuels doubled from 74 in 2011 to 171 in 2014); Irene Henriques & Perry Sadorsky, *Investor Implications of Divesting from Fossil Fuels*, 38 GLOB. FIN. J. 30, 30 (2018) (documenting universities, pension funds, charitable foundations, among other entities facing pressure from stakeholders to divest from fossil fuels); Callum Macpherson, The Potential Impact of Investor Fossil Fuel Divestment Behaviour on Oil Prices 2–3 (Feb. 17, 2019) (unpublished manuscript), https://papers.ssrn.com/sol3/papers.cfm?abstract_id=3382739 (noting "grassroots awareness campaigns . . . and global investors calling for climate change mitigation and fossil fuel divestment").

[226] *See* Bolton & Kacperczyk, *supra* note 132, at 7 ("[W]hen we exclude the industries with the highest CO2 emissions (oil & gas, utilities, and motor industries) then there is no significant exclusionary screening at all by institutional investors . . . .").

flows of the corporation.[227] If demand for hula hoops declines, the price of hula hoops will decline as well, and so manufacturers will make fewer hula hoops. In the graph familiar to all Econ 101 students, the demand curve for hula hoops slopes downwards.[228] Stocks, on the other hand, derive their value from the cash flows of the underlying business.[229] Their demand curve is a horizontal line.[230] Stated simply, undervalued companies tend not to remain undervalued for long, as less socially engaged investors buy the companies' shares until their price once again reflects the expected gain from holding the shares.

There are other problems with negative screening as a method of advancing social or environmental goals. Even if divestment were capable of reducing certain companies' share prices over the long term, that might not impact those companies' cost of capital. As we have seen, equity is no longer the source of long-term capital for America's largest companies.[231] Indeed, "the harm from a higher cost of equity capital is limited by the frequency with which firms tap external equity markets, and this frequency is low."[232]

Another problem is that if assets are being consistently undervalued in the public markets, they will migrate to private markets. When Talisman Energy bowed to shareholder and public pressure to sell its interests in certain fields in Sudan in 2002, those interests were purchased by the national oil company of India, which joined a consortium made up of the national oil company of

---

[227] RICHARD BREALEY, STEWART MYERS & FRANKLIN ALLEN, PRINCIPLES OF CORPORATE FINANCE 80–84 (11th ed. 2013).

[228] *The Hula Hoop Market of 1958*, ECON EDLINK, https://www.econedlink.org/wp-content/uploads/legacy/961_hula_hoops.pdf [https://perma.cc/9Z62-HM7T].

[229] *See How to Value Stocks: Cash Flow-Based Valuations*, MOTTLEY FOOL (Mar. 7, 2017, 4:12 PM), https://www.fool.com/how-to-invest/how-to-value-stocks-cash-flow-based-valuations.aspx [https://perma.cc/DHT9-B6V3] ("[C]ash flow . . . is probably the most common measurement used by investment bankers for valuing public and private companies.").

[230] *See* Antti Petajisto, What Makes Demand Curves for Stocks Slope Down? 1 (Jan. 16, 2003) (unpublished manuscript), https://www.bus.umich.edu/pdf/mitsui/workshopdocs/DemandcurvesAntti.pdf [https://perma.cc/JQ5H-DYAQ] ("The supply of a stock should not affect its price, implying that demand curves for stocks are (almost) perfectly horizontal.").

[231] *See supra* discussion accompanying notes 55–56.

[232] Shaun William Davies & Edward Dickersin Van Wesep, *The Unintended Consequences of Divestment*, 128 J. FIN. ECON. 558, 571 (2018).

Malaysia and a national oil company of China.[233] Needless to say, many observers believe Talisman's departure "may have caused more harm than good."[234] In fact, already nearly 60% of corporate carbon emissions in the world are generated by private state-owned companies.[235]

Many divestment campaigns or negative screens simply target companies whose core activities generate adverse social and environmental outcomes. There is nothing those companies can do to meet shareholder demands.[236] An oil company cannot stop looking for new hydrocarbon reserves, investing in new projects, or producing oil. The only option available to oil company managers is to simply ignore this segment of shareholder opinion.

The final problem with negative screening is that, to the extent it does work, it may reward, rather than punish, corporate leaders for poor ESG performance. One recent attempt to model the impact of negative screening campaigns on the CEOs in targeted industries found that "very few executives would be hurt by a divestment campaign of any size. A large majority would not be meaningfully affected even under the most favorable conditions for campaigners . . . . [S]ome managers would benefit substantially from a divestment campaign."[237] The problem is that companies, pushed by their shareholders, have adopted long-term compensation schemes that make the short-term declines in share prices caused by

[233] *See* Kyle Bakx, *Oil, Politics and Human Rights: A Look Back at Talisman,* CBC NEWS (Feb. 22, 2015, 5:00AM), https://www.cbc.ca/news/business/oil-politics-and-human-rights-a-look-back-at-talisman-1.2964715 [https://perma.cc/AH7E-K548] (discussing the sale of Talisman's Sudanese oil interests in 2002); Stephen J. Kobrin, *Oil and Politics: Talisman Energy and Sudan*, 36 N.Y.U. J. INT'L L. & POL. 425, 435, 437 (2004) (explaining the background of the consortium, called the Greater Nile Petroleum Operating Company).

[234] Bakx, *supra* note 233.

[235] *New Report Shows Just 100 Companies Are Source of Over 70% of Emissions*, CDP (July 10, 2017), https://www.cdp.net/en/articles/media/new-report-shows-just-100-companies-are-source-of-over-70-of-emissions [https://perma.cc/6LGR-TBJR].

[236] *See* von Wallis & Klein, *supra* note 13, at 65 (noting that "companies that produce alcohol, tobacco, or are engaged in gambling are charged higher cost of capital due to their underlying business, which leaves little room for improvement"); *see generally* Hong & Kacperczyk, *supra* note 156 (examining impacts of social norms on the stocks of companies that produce alcohol, tobacco, and gaming).

[237] Davies & Van Wesep, *supra* note 232, at 559.

negative screening quite accretive to executives receiving annual equity grants.[238]

Most of the empirical research on the impact of negative screens on corporate behavior has been conducted in connection with the divestment campaign against companies doing business in apartheid-era South Africa. This research seems to vindicate economic theory. First, the divestment campaign had no impact on the price of affected companies' shares.[239] Second, the share prices of companies that announced they were leaving South Africa *declined* relative to companies that refused to leave, reflecting market expectations that departure was politically—not financially—motivated.[240] Third, qualitative assessments of the impact of the divestment campaign conclude it had little impact on corporate behavior—or the decisions of South African political leaders.[241]

B. POSITIVE SCREENING

---

[238] *See id.* at 571 (noting that the common practice regarding compensation plans is to emphasize long-term measures).

[239] *See* Laurian Casson Lytle & O. Maurice Joy, *The Stock Market Impact of Social Pressure: The South African Divestment Case*, 36 Q. REV. ECON. & FIN. 507, 519 (1996) ("It appears that portfolio divestment announcements by major pension funds and endowment associations had no important impact on stock prices of firms doing business in South Africa."); Siew Hong Teoh, Ivo Welch & C. Paul Wazzan, *The Effect of Socially Activist Investment Policies on the Financial Markets: Evidence from the South African Boycott*, 72 J. BUSINESS 35, 79 (1999) ("[T]he announcement of legislative or shareholder pressure had *no* discernable effect on the valuation of banks and corporations with South African operations . . . ."); Wallace N. Davidson III, Dan L. Worrell & Abuzar El-Jelly, *Influencing Managers to Change Unpopular Corporate Behavior Through Boycotts and Divestitures: A Stock Market Test*, 34 BUS. & SOC'Y 171, 191 (1995) (finding that "the [stock market] reaction to announced divestitures was not significant").

[240] *See* Lytle & Joy, *supra* note 239, at 521 (finding that the firms that left were "penalized by the market").

[241] *See* Davidson, Warrell & El-Jelly, *supra* note 239, at 190 (finding that "[d]ivestitures do not seem to motivate change" at affected companies); Teoh, Welch & Wazzan, *supra* note 239, at 35 (finding "little visible effect on the financial markets"); Paul Lansing & Sarosh Kuruvilla, *Business Divestment in South Africa: In Who's Best Interest?*, 7 J. BUS. ETHICS 561, 573 (1988) ("[T]he imposition of economic sanctions and disinvestment has, if anything, only strengthened the economic power of the Whites, and perhaps increased their determination to keep apartheid.").

The idea behind positive screening is that ESG investors will preferentially buy high-performing ESG companies, lowering the cost of capital of those companies.[242] This will encourage the development of ESG-friendly business plans, as well as advantage socially responsible companies relative to their less responsible competitors. In other words, the ESG funds will pay a premium to own the shares of socially responsible companies, accepting, in consequence, lower portfolio returns.[243] (Of course, the frequently mentioned claim that ESG investing will produce higher returns is incompatible with the strategy of paying extra to own ESG stocks.)[244]

There are studies claiming that companies scoring highly according to an ESG rating scheme find it easier to raise capital[245] and possibly benefit from a lower cost of capital.[246] However, it is difficult to understand how these empirical findings are compatible

---

[242] *See* Suzanne McGee, *ESG Investors Face a Choice: Do You Use a Positive or Negative Screen?,* WALL ST. J. (Nov. 1, 2022, 10:00 AM), https://www.wsj.com/articles/esg-investing-companies-screening-11667226822 [https://perma.cc/S7SB-UD9T] ("[W]ith positive screens, investors tend to be more inclusive when building their portfolios, perhaps using them to find companies that score high on certain ESG criteria compared with peers . . . ."); *see also Screening*, PRINCIPLES FOR RESPONSIBLE INVEST. (May 29, 2020), https://www.unpri.org/introductory-guides-to-responsible-investment/an-introduction-to-responsible-investment-screening/5834.article [https://perma.cc/UC7M-642E] ("Positive screening was deployed across USD $1.8 trillion in assets and norms-based screening across USD $4.7 trillion in assets.").

[243] *See Unlocking the ESG Premium: How to Capitalise on Green Investment*, EMITWISE (Aug. 17, 2022), https://emitwise.com/resources/blog/unlocking-the-esg-premium/ [https://perma.cc/YP7T-R8HB] ("25% of executives and investors would pay a 20-50% premium to acquire a company with a positive ESG record, and even those who believe ESG has no effect on shareholder value would still pay a 10% premium for strong ESG companies.").

[244] *See supra* note 144 and associated discussion.

[245] *See* Beiting Cheng, Ioannis Ioannou & George Serafeim, *Corporate Social Responsibility and Access to Finance*, 35 STRATEGIC MGMT. J. 1, 16 (2014) (finding that companies "with better . . . performance face lower capital constraints").

[246] *See* Dan S. Dhaliwal, Oliver Zhen Li, Albert Tsang & Yong George Yang, *Voluntary Nonfinancial Disclosure and the Cost of Equity Capital: The Initiation of Corporate Social Responsibility Reporting*, 86 ACCT. REV. 59, 94 (2011) (describing a "reduction in the cost of equity capital" as a benefit); Sadok El Ghoul, Omrane Guedhami, Chuck C.Y. Kwok & Dev R. Mishra, *Does Corporate Social Responsibility Affect the Cost of Capital?*, 35 J. BANKING & FIN. 2388, 2400 (2011) (confirming that firms with higher scores exhibit "lower cost of equity capital"); Sudheer Chava, *Environmental Externalities and Cost of Capital*, 60 MGMT. SCI. 2223, 2244 (2014) (highlighting ESG measures that can impact the cost of capital of firms).

with the research, discussed earlier, that finds investment managers do not sacrifice returns in their ESG investments.[247] One likely explanation is that the research on positive screening uses the same ESG ratings that we know are invalid.[248] In contrast, the best research on fund manager attitudes and the absence of a "greenium" for ESG securities do not depend on these problematic ESG ratings.[249]

It is also hard to reconcile the claim that ESG companies enjoy lower costs of capital with common sense. How could a set of companies consistently enjoy higher share prices relative to their financial cash flows than their peers? Any non-ESG investor could sell shares of the high-ESG companies and buy shares of their undervalued competitors until the arbitrage opportunity disappeared. Three well-respected law and finance professors at Stanford summed up the theoretical situation as follows: "When can investments or divestments in public capital markets have impact by affecting the behavior of portfolio companies directly through purchasing company securities? The answer is *virtually never*."[250] We saw in relation to the South Africa divestment campaign that markets were relatively efficient in pricing corporate cash flows, regardless of the behavior of some institutional investors.[251] It is unclear how positive screening today could produce very different results.

The mechanism through which positive screening supposedly operates is facilitating a lower cost of capital for strong ESG companies. Obviously, this mechanism only operates for those companies that raise capital through the issuance of new shares.[252] These financings would, presumably, be conducted at a substantial premium to market; the premium represents the subsidy given to the company by ESG investors. However, a search of the finance literature fails to turn up any instance of this premium being

---

[247] *See supra* text accompanying note 129.

[248] *See supra* text accompanying note 180.

[249] *See* Larcker & Watts, *supra* note 128, at 2 ("[T]he greenium . . . is precisely equal to zero.").

[250] Brest, Gilson & Wolfson, *supra* note 72, at 13.

[251] *See supra* note 239.

[252] *See* Davies & Van Wesep, *supra* note 232, at 571 (noting that this is rare).

paid.[253] (In contrast, there is plenty of evidence for premiums in private markets, where there is no secondary market in a company's shares, and thus no arbitrage opportunities, so financings can be priced to include an ESG premium through negotiations between the company and "impact" investors.)[254]

There are other significant barriers to effective positive screening. Positive screening requires investors to know a lot more details about companies, their plans, their operations, their customers, and their suppliers than negative screening does.[255] As we have already seen, there is little evidence shareholders have the necessary information to make these kinds of decisions.[256]

As discussed earlier, some of the very same energy companies targeted for negative screening (and thus unlikely to benefit from positive screening) turn out to be the ones producing the most valuable and important green patents.[257] The largest reduction of carbon emissions in the world occurred in the United States as a result of the fracking industry, allowing natural gas to be produced so cheaply that it supplanted coal as a power source.[258] This transition occurred despite the explicit lack of support of these energy firms by ESG investors.[259] Indeed, the transition occurred over a decade when energy companies, particularly those involved

---

[253] *See* Brest, Gilson & Wolfson, *supra* note 72, at 15 ("[W]e do not recall ever having seen an offering by a public company that has this characteristic [paying an ESG premium] . . . .").

[254] *See supra* text accompanying note 31.

[255] *See* Joakim Sandburg, *Socially Responsible Investment and Fiduciary Duty: Putting the Freshfields Report into Perspective*, 101 J. BUS. ETHICS 143, 156 (2011) (explaining the difference between negative and positive screening).

[256] *See supra* notes 120–126, 173–196.

[257] *See* Cohen, Gurun & Nguyen, *supra* note 109, at 30 ("We find consistent and robust markers that the quantity and quality of green patenting is higher for traditional energy firms. Perhaps surprisingly, energy producers produce more—and significantly higher quality—green innovation, on average.").

[258] *See* David Blackmon, *Like That Cleaner Air You're Breathing? Fracking Says, 'You're Welcome!'*, FORBES (Sept. 5, 2018, 1:39 PM), https://www.forbes.com/sites/davidblackmon/2018/09/05/like-that-cleaner-air-youre-breathing-fracking-says-youre-welcome/?sh=412b40836610 (noting the reduction in carbon emissions from the shift away from coal).

[259] *Fracking is Going Electric and Not Everyone Is Impressed*, BLOOMBERG (Oct. 6, 2021, 9:00 AM), https://www.bloomberg.com/news/articles/2021-10-06/fracking-for-oil-gas-with-electric-or-natural-gas-fleets-more-common-in-u-s#xj4y7vzkg [https://perma.cc/4XHS-7C5V] (noting the traditional "attention of environmentalists and investors scrutinizing [fracking's] ESG").

in shale production, were the subject of high-profile campaigns against them by the environmental movement more generally.[260]

It is unlikely that public market institutional shareholders, who only seem to manage negative screening on the basis of what industry a company belongs to, have sufficient information and resources to identify the companies most likely to advance ESG objectives.[261] Anecdotally, most positive screens discussed by ESG funds also seem to depend mainly on the broad industry a firm belongs to, such as electric vehicles or alternative energy. This ignores most of the companies that matter (because it ignores most companies) and it seems likely to continually produce rude surprises when shareholders learn, for instance, that companies in these favored industries have their own serious environmental issues.[262] Even if firm-specific analyses were possible from

---

[260] *See* Anthony E. Ladd, *Introduction* to FRACTURED COMMUNITIES: RISK, IMPACTS, AND PROTEST AGAINST HYDRAULIC FRACKING IN U.S. SHALE REGIONS 19 (Anthony E. Ladd, ed., 2018) (describing the increase of antifracking movements since the release of the documentary *Gasland*); Christopher Bateman, *A Colossal Fracking Mess*, VANITY FAIR (June 21, 2010), https://www.vanityfair.com/news/2010/06/fracking-in-pennsylvania-201006 [https://perma.cc/TQ6N-9GQ9] (describing Damascus Citizens for Sustainability's campaign against fracking in the Delaware River Watershed by Chesapeake, an oil-and-gas company); Julian Matthews & Anders Hansen, *Fracturing Debate? A Review of Research on Media Coverage of "Fracking,"* 3 FRONTIERS COMMUNIC'N 1, 2–3 (Sept. 21, 2018), https://www.frontiersin.org/articles/10.3389/fcomm.2018.00041/full [https://perma.cc/6BUN-PJCP] (describing anti-fracking movements that grew after environmental arguments against fracking became popular); Sorell E. Negro, *Fracking Wars: Federal, State and Local Conflicts over the Regulation of Natural Gas Activities*, ZONING & PLAN. L. REP. at 1, 1 (Feb. 2012), https://rc.com/documents/Negro_FrackingWars_2012.pdf [https://perma.cc/ AE6S-FDK7] (describing state regulations of fracking due to environmental concerns). The campaign included the feature movies PROMISED LAND (Focus Features 2012) and GASLAND (International WOW Company 2010).

[261] *See supra* discussion accompanying notes 220–223.

[262] *See* Theocharis Tsoutsos, Niki Frantzeskaki & Vassilis Gekas, *Environmental Impacts from the Solar Energy Technologies*, 33 ENERGY POL'Y 289, 289 (2005) (finding the impacts of solar energy technologies include greenhouse gas emission, water and soil pollution, impacts on sensitive ecosystems and energy consumption among others); R. Saidur, N.A. Rahim, M.R. Islam & K.H. Solangi, *Environmental Impact of Wind Energy*, 15 RENEWABLE & SUSTAINABLE ENERGY REV. 2423, 2426–28 (2011) (finding negative impacts on the environment of wind farms include impacts on wildlife, noise impacts, and visual impacts among others); Victoria Flexer, Celso Fernando Baspineiro & Claudia Inés Galli, *Lithium Recovery from Brines: A Vital Raw Material for Green Energies with a Potential Environmental Impact in its Mining and Processing*, 639 SCI. TOTAL ENV'T 1188, 1190 (2018) (finding the process of lithium extraction for batteries is a chemical intensive, heavily water-dependent process).

institutional investors, it is hard to see how positive screening would have any effect on public firms because of the presence of arbitrageurs. The Stanford professors put it this way: "[T]reat the presence of any public equities in a self-styled impact fund as the thirteenth strike of the clock, which calls the others into question."[263]

C. SHAREHOLDER ENGAGEMENT

If investor purchasing and selling decisions seem unlikely to materially impact corporate ESG performance, the use of the powers given to shareholders by corporate and securities laws might seem more promising. They permit firm-specific interventions and, at least in theory, are much more finely calibrated than simply giving a thumbs up or down on a company (or, in practice, an entire industry), which is all positive and negative screening can do.

The evidence around shareholder engagement on ESG matters is discouraging. For example, a recent law review paper on "Millennial" corporate governance argues that index funds "have been outspoken, confrontational, and effective stewardship . . . in challenging management and voting against directors to advance board diversity and corporate sustainability."[264] The paper's only examples of this advocacy, though, are the campaigns to increase board diversity and address climate change.[265]

A recent study finds index funds had a direct impact on increasing the number of female directors of their portfolio companies.[266] However, it is hard to extrapolate a general rule about shareholders and ESG from this example. Board diversity is, by far, the easiest social issue in business today: it is very simple to collect accurate information about board diversity (just count the gender of

[263] Brest, Gilson, & Wolfson, *supra* note 72, at 27.

[264] Michal Barzuza, Quinn Curtis & David H. Webber, *Shareholders Value(s): Index Fund ESG Activism and the New Millennial Corporate Governance*, 93 S. CAL. L. REV. 1243, 1243 (2020).

[265] *See id.* at 1272 (finding index funds strongly advocate for board diversity and climate change).

[266] *See* Todd A. Gormley, Vishal 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, 331 (2023) (finding campaigns by the "Big Three" index funds are "associated with a reduction in all-male boards").

Georgia Law Review, Vol. 58, No. 1 [2023], Art. 5

the directors in the information circular); there are no trade-offs involved, as we know that diversity makes no difference in economic outcomes;[267] it is relatively uncontroversial (no one is in favor of excluding women from boards as a matter of principle); it is directly connected to one of the few governance powers of the shareholders (electing directors); and resolution of the issue lies straightforwardly within the board's control.

Climate change in contrast is, like most social problems ESG investors purport to address, much more complicated and involves actual financial trade-offs. We have already seen that unlike board diversity, the presence of a company in an ESG fund's portfolio is instead often connected with higher carbon emissions and pollution offenses.[268] The former Chief Investment Officer for Sustainable Investing at Blackrock has recently observed that when it comes to climate change, Blackrock's activity "actually amounts to little more than marketing."[269]

The highest profile (and arguably most successful) climate change engagement by a shareholder so far is Engine No. 1's successful proxy battle against Exxon in the spring of 2021. This was widely seen as a major triumph for ESG advocates as a great deal of the rhetoric around the dispute dealt with Exxon's lack of plans to transition away from its current business.[270] However, even a casual reading of Engine No. 1's argument in favor of a shake-up of Exxon's board shows that its main argument was that Exxon has

---

[267] Tingle, *What Do We Really Know?*, *supra* note 17, at 306–11 (finding gender diversity has a neutral statistical impact on financial performance); Miguel A. Fernández-Temprano & Fernando Tejerina-Gaite, *Types of Director, Board Diversity and Firm Performance*, 20 CORP. GOVERNANCE 324, 328–37 (2020) (finding no evidence of gender diversity influence on firm performance).

[268] Raghunandan & Rajgopal, *supra* note 31, at 35 ("[O]n average, ESG funds pick firms with worse employee treatment and environmental practices than non-ESG funds." (emphasis omitted)); Brandon et al., *supra* note 131, at 17 (finding PRI signatories have lower environmental scores).

[269] Gabriel Friedman, *Here's Why the Former Head of Sustainable Investing at BlackRock Says Don't Believe the ESG Marketing Hype*, FIN. POST (May 7, 2021), https://financialpost.com/investing/heres-why-the-former-head-of-sustainable-investing-at-blackrock-says-dont-believe-the-esg-marketing-hype [https://perma.cc/NSM4-RVZV].

[270] *See, e.g.*, Matt Phillips, *Exxon's Board Defeat Signals the Rise of Social-Good Activists*, N.Y. TIMES (June 9, 2021), https://www.nytimes.com/2021/06/09/business/exxon-mobil-engine-no1-activist.html (describing Engine No. 1's successful efforts to change Exxon's board of directors).

been financially underperforming as a result of "an undisciplined capital allocation strategy."[271] This key observation was wrapped up in some ESG rhetoric, connecting Exxon's declining total shareholder returns relative to its peers to Exxon's failure to prepare for a carbonless future.[272] The nature of this connection was notably never spelled out. Chevron and Shell have outperformed Exxon, but is it because of ESG steps they have taken? Engine No. 1's presentation is silent on this point outside of arguing Exxon needs to invest in fields with a lower production cost per barrel.[273] This is kind of related to ESG concerns, but "we need to find more profitable oil reserves" isn't exactly a message to warm environmentalists' hearts. In any event, no one could seriously suggest that Exxon's financial performance issues over the past decade have been caused by widespread decarbonization, because oil demand has only increased over that time.[274]

Engine No. 1 actually had no concrete suggestions about what Exxon could do to reduce its emissions profile or prepare for a carbonless future.[275] For those familiar with the materials generated by activist shareholders in proxy contests, the most interesting thing about Engine No. 1's presentation is how closely it hews to the traditional playbook.[276] Almost all of its presentation is

---

[271] ENGINE NO. 1, REENERGIZE EXXONMOBIL: INVESTOR PRESENTATION 6 (May 2021), https://reenergizexom.com/documents/Investor-Presentation-May-2021-v2.pdf [https://perma.cc/YKF5-USZX].

[272] *See id.* (arguing that "[a] refusal to accept that fossil fuel demand may decline in decades to come" is part of what has "left ExxonMobil unprepared" and "threatens long-term value destruction").

[273] *See id.* at 10 ("Irresponsible spending resulted in ExxonMobil having the highest oil break-even price of any of its peers . . .").

[274] *See World Oil Supply and Demand, 1971-2020*, INT'L ENERGY AGENCY (Jul. 29, 2021), https://www.iea.org/data-and-statistics/charts/world-oil-supply-and-demand-1971-2020 [https://perma.cc/4BQN-R32W] (showing an increase in oil demand over time).

[275] *See* Jinjoo Lee, *Exxon Mobil Activist Victory Isn't Really All About Climate,* WALL ST. J. (June 3, 2021, 7:03 AM), https://www.wsj.com/articles/exxon-mobil-activist-victory-isnt-really-all-about-climate-11622718180 ("The main takeaway . . . is that the supermajor isn't earnestly addressing the risk.").

[276] *See* David Nicklaus, *Exxon Board Fight Wasn't About Being Woke. It Was About Poor Performance*, ST. LOUIS POST DISPATCH (June 4, 2021), https://www.stltoday.com/business/subscriber/article_53207bb5-a365-5642-b347-39ff623c030a.html ("[Exxon] and its board . . . weren't really being criticized for being insufficiently woke. They were being criticized for being bad capitalists.").

on financial underperformance, supported by corporate governance arguments (misaligned incentives and directors with a poor record of value creation in other businesses, for example).[277] The only new thing is the occasional and vague allusion to the need for energy transition and decarbonization. These ESG appeals no doubt helped it secure support, particularly from index funds, but there is little evidence they are more than window dressing.[278] Activist funds have historically used claims of corporate governance failures in a similar fashion.[279] Once the dust settled, two of Engine No. 1's three new directors were long-time oil company executives.[280]

Some of the most useful data we have on shareholder engagement with ESG issues comes out of studies on shareholder proposals. We have a long history of proposals driven by ESG concerns, so we are not dependent on anecdotal evidence. Also, shareholder proposals have historically been the only way shareholders got to vote on ESG matters. The first thing to note about shareholder proposals is that outside of a narrow circle of "gadflies" and some union pension funds, institutional investors don't bring them.[281] When ESG shareholder proposals are brought,

---

[277] *See generally* ENGINE NO. 1, *supra* note 271 (providing bases for shareholder realignment based on Exxon's underperformance).

[278] *See* Nicklaus, *supra* note 276 (characterizing Engine No. 1's actions as "nothing new" in shareholder activism); Bernard S. Sharfman, *The Illusion of Success: A Critique of Engine No. 1's Proxy Fight at Exxon Mobil,* 12 HARV. BUS. L. REV. 1, 21 (2021) ("Engine No. 1's activism created a *deadly distraction* in our fight against climate change, a fight that should be taken on by governments all over the world, not hedge fund activists.").

[279] *See* Tingle, *Expressive Voting*, *supra* note 74, at 24 (describing how "[t]he majority of communications in a proxy campaign explicitly reference the quality of corporate governance, even when there is also a clear disagreement on economic strategy at the heart of the campaign").

[280] *See* Jennifer Hiller & Svea Herbst-Bayliss, *Engine No. 1 Extends Gains with a Third Seat on Exxon Board*, REUTERS (June 2, 2021, 12:03 AM), https://www.reuters.com/business/energy/engine-no-1-win-third-seat-exxon-board-based-preliminary-results-2021-06-02/ [https://perma.cc/UL4T-2WAR] (noting that two of Engine No. 1's nominees came from a Finnish oil refiner and Marathon petroleum, while the third came from Alphabet Inc.).

[281] *See* Gilson & Gordon, *supra* note 74, at 887–88; Romano, *supra* note 40, at 231 (arguing that union pension fund managers receive private benefits from bringing shareholder proposals); John G. Matsusaka, Oguzhan Ozbas & Irene Yi, *Opportunistic Proposals by Union Shareholders* 32–33 (Univ. S. Cal. L. Sch., Legal Studies Working Paper No. 177, 2015), law.bepress.com/cgi/viewcontent.cgi?article=1313&context=usclwps-lss (finding union pension funds bring proposals to enhance their bargaining positions); Geeyoung Min & Hye

institutional shareholders almost never support them.[282] Over a three-year period, just 2.5% of the 633 ESG proposals brought to vote in the companies making up the Russell 3000 received enough votes to pass.[283] The number of ESG shareholder proposals have actually been declining over the period that ESG marketing language from investment funds has been increasing.[284]

If we look at the way shareholders support proposals with their buying and selling decisions, we find little evidence that they care. The market reaction to shareholder proposals is either negative or indifferent.[285] A recent review of the seventeen long-run price

---

Young You, *Active Firms and Active Shareholders: Corporate Political Activity and Shareholder Proposals*, 48 J. LEGAL STUD. 81, 106 (2019) (finding public pension funds target Republican-leaning firms).

[282] *See* Min & You, *supra* note 281, at 109 (demonstrating institutional investors rarely supported environmental and social proposals); Griffin, *supra* note 142 (finding that Vanguard supports 7.5%, Blackrock supports 7.1%, and State Street supports 22.7% of ESG proposals); Rao, *supra* note 140 (noting that ESG funds regularly vote against ESG proposals); Tao Li, S. Lakshim Naaraayanan & Kunal Sachdeva, Conflicting Objectives of ESG Funds: Evidence from Proxy Voting 26 (Feb. 6, 2023) (unpublished manuscript), https://ssrn.com/abstract=3760753 ("[A]ctive ESG funds and non-ESG focused institutions are more likely to cast votes against E&S proposals").

[283] *See* Alex Knowlton, *No Support for ESG Proposals? Leverage Voting Power Elsewhere*, EQUILAR RSCH. (Feb. 5, 2018), https://www.equilar.com/blogs/357-how-to-gain-support-for-esg-proposals.html ("Of the 633 ESG proposals in the Russell 3000 from 2015 to 2017, just 2.5% received enough votes to pass (or 16 total).").

[284] *See* ELIZABETH ISING ET AL., GIBSON DUNN, SHAREHOLDER PROPOSAL DEVELOPMENTS DURING THE 2020 PROXY SEASON 1 (2020) https://www.gibsondunn.com/wp-content/uploads/2020/08/shareholder-proposal-developments-during-the-2020-proxy-season.pdf (noting that "[t]he number of social and environmental proposals significantly decreased").

[285] *See* Denes, Karpoff & McWilliams, *supra* note 63, at 410–11 (reviewing 17 long-run price studies on shareholder proposals and concluding that "the available evidence is most consistent with the conclusion that shareholder proposals are not associated with significant long-run stock returns" or "increases in the target firms' operating performance"); *see also* Johnathan M. Karpoff, Paul H. Malatesta & Ralph A. Walkling, *Corporate Governance and Shareholder Initiatives: Empirical Evidence*, 42 J. FIN. ECON. 365, 392 (1996) ("Proposals sponsored by institutions have insignificant stock price effects."); Stuart L. Gillan & Laura T. Starks, *Corporate Governance Proposals and Shareholder Activism: The Role of Institutional Investors*, 57 J. FIN. ECON. 275, 303 (2000) ("Proposals sponsored by the so-called gadflys . . . garner fewer votes and are associated with a slight positive impact on stock prices. In contrast, proposals sponsored by institutional investors . . . appear to have some small . . . negative impact on stock prices."); Nickolay Gantchev & Mariassunta Giannetti, *The Costs and Benefits of Shareholder Democracy,* 34 REV. FIN. STUD. 5629, 5630 (2021) ("We show that proposals by active individual sponsors destroy shareholder value if they are implemented.");

studies about the impact of shareholder proposals of all types, concludes that, "the available evidence is most consistent with the conclusion that shareholder proposals and negotiations are not associated with long-run stock returns."[286] The same thing is true if we look at the shareholder proposal studies that use return on assets, return on equity, and return on sales as the key variables.[287]

Of the ESG proposals that are brought, 40% are withdrawn in a typical year (compared to only 10% of governance proposals).[288] It is unlikely that these ESG proposals are withdrawn because of meaningful concessions by corporate management, as there is no evidence of consequent amendments to the corporation's articles or bylaws, which would make the ESG concessions binding on management, and which are visible to the public.[289] If we look at the climate change proposals filed in 2020, we find that only sixteen were voted on, and of the sixteen that were voted on, fourteen asked for more corporate disclosure and one was for the creation of a climate-risk board committee.[290] These cannot be understood as meaningful attempts to drive ESG change in the miniscule number of firms impacted.

In terms of support for activist campaigns, one study on this topic was conducted in the UK after its Stewardship Code for

2 JOAO DOS SANTOS & CHEN SONG, U.S. CHAMBER OF COMMERCE, ANALYSIS OF THE WEALTH EFFECTS OF SHAREHOLDER PROPOSALS 15 (2009) ("[T]here is no conclusive evidence of measurable improvements in (short-term or long-term) stock market or (long-term) operating performance in target companies as a result of shareholder proposals."); Jun Yang, Eric Zengxiang Wang & Yunbi An, *Canadian Exceptionalism: Shareholder Proposals, Filer Identities, and Voting Outcomes*, 38 MANAGERIAL FIN. 456, 461–76 (2012) ("[F]irms receiving proposals from public pension funds experience decreases of shareholder wealth.").

[286] Denes, Karpoff & McWilliams, *supra* note 63, at 410.

[287] *See id.* at 411 ("Most non-hedge fund activism does not prompt significant changes in any of the . . . earnings measures.").

[288] *See* Sarah C. Haan, *Shareholder Proposal Settlements and the Private Ordering of Public Elections*, 126 YALE L.J. 262, 301 n.146 (2016) (citing the reported withdrawal rates for ESG proposals).

[289] *See id.* at 302 ("Social and environmental proposals are generally not brought in the form of amendments to the certificate of incorporation or the bylaws. . . . Instead, social and environmental standards are typically established in the sort of downstream corporate policies that are not available to shareholders and the public.").

[290] *See* ISING ET AL., *supra* note 284, at 13 ("Sixteen climate change proposals were voted on in 2020 . . . . Fourteen of the climate change proposals . . . included requests for reports . . . . [O]ne was board-focused, requesting the establishment of a climate-risk board committee . . . .").

institutional investors came into effect.[291] Though the activism it examined rarely contained ESG elements, the study is useful in evaluating whether investment funds that have an explicit ESG mandate are likely to support activist hedge funds.[292] It finds that in the presence of hedge fund activists (who are assumed to have shorter term financial objectives) institutional investors strengthen their voting support of corporate managers.[293] "[T]he findings suggest that institutional investors . . . may have reservations over the value created by some activist demands or may view their own role as limited to stewardship over a narrow range of governance and sustainability matters."[294] This suggests Engine No. 1's success in relation to Exxon may not be easily repeated.

For their part, corporate managers themselves seem to believe that shareholder engagement is mostly about financial performance. A group of scholars looked at so-called "close call" votes on shareholder proposals.[295] These are votes that either only slightly pass the 50% requirement for adoption or that slightly fail to reach this level.[296] The assumption in these types of studies is that whether a proposal in this group fails or not is random.[297] The ones that fail can therefore be used as controls to evaluate the impact of a proposal that passes. The scholars found that companies that had a shareholder proposal pass "experience significantly slower growth in goodness [ESG] scores than firms in which the proposals narrowly fail."[298] In other words, when shareholders

---

[291] *See* Suren Gomtsian, *Different Visions of Stewardship: Understanding Interactions between Large Investment Managers and Activist Shareholders* 37–70 (Tilburg Univ., TILEC Discussion Paper No. DP 2021-002, 2021), https://ssrn.com/abstract=3787348 (using data from the UK to examine the interactions between activist shareholders and institutional investors).

[292] *Cf.* Gilson & Gordon, *supra* note 49 at 869 (arguing that activists can solve the incentive and information problems that beset more passive investors).

[293] *See* Gomtsian, *supra* note 291, at 9 ("[T]he presence of a hedge fund activist may even strengthen the alignment of large investment managers with corporate management during voting.").

[294] *Id.* at 10.

[295] *See* Cheng, Hong & Shue, *supra* note 61, at 5 (describing the study of the relationship between close votes and shareholder proposals).

[296] *Id.* at 20.

[297] *See id.* at 5 ("The identifying assumption is that close votes around the 50 percent cut-off are random in terms of whether a governance proposal is passed . . . .").

[298] *Id.*

successfully engage with managers, managers respond by cutting back on ESG initiatives.[299] Managers could be wrong about what will improve their relationship with activist shareholders, but it seems unlikely.

Most ESG investors emphasize that they engage informally with corporate managers to improve performance;[300] this activity, of course, would not be reflected in the kinds of studies we have been discussing. Fortunately, a very recent study allows us to see the impact of informal ESG engagement by looking at how corporate behavior changes following an influx of ESG capital.[301] Eschewing the usual ratings because of concerns about their validity, the study looked at employee satisfaction (using data from Glassdoor), workplace safety (using data from the Occupational Safety and Health Administration), and pollution (using data from the Environmental Protection Agency).[302] At this point, it should be no surprise that "we find no evidence that SRI [socially responsible investment] funds have any impact on corporate [ESG] conduct."[303]

V. CONCLUSION

As regulators around the world prepare to leap into regulating ESG disclosure and investing, it is valuable to step back and ask if institutional shareholders are really a meaningful solution to the world's environmental and social problems. Vesting shareholders with the status of standard carriers for ESG never made much sense. Why pick the one corporate constituency whose interests most directly conflict with the recipients of ESG investments and decide they are the solution to advancing the interests of those other recipients?

---

[299] *See id.* at 6 ("[I]mprovements in managerial incentives and governance lead to a reduction in firm goodness . . . .").

[300] *See* Gomtsian, *supra* note 291, at 4 (discussing some of the ways in which different investment managers can interact with corporate managers to improve company performance).

[301] *See* Davidson Heath, Daniele Macciocchi, Roni Michaely & Mathew C. Ringgenberg, *Does Socially Responsible Investing Change Firm Behavior?* 5 (ECGI Working Paper Series in Finance, Working Paper No. 762/2021, 2023) ("Using our Morningstar research design, we test whether [socially responsible investment] funds impact firm behavior.").

[302] *See id.* at 3 (noting the source of the data used in the study).

[303] *Id.* at 28.

The ultimate human beneficiaries of investment funds do have a strong interest in ESG outcomes. As Professor Leo Strine observes, the clients of institutional investors have an "economic and human interest in having companies create quality jobs and act responsibly toward their consumers and the environment as part of [fund managers'] decision making process."[304] The problem is that there is little evidence for this behavior from investment fund managers and little reason, in theory, to expect it.[305] As Professor Strine points out, in practice "stewardship has been more a name for the investment industry[,] blaming those who manage real companies for every problem, when as a matter of linguistics, stewardship requires something more inward and responsibility-accepting."[306]

The continuing effort to plow resources of all kinds—financial, human, political, academic—into ESG investing is a waste of resources that would be better expended on more effective regulatory schemes. Indeed, to the extent these reforms transfer yet more power from corporate managers to shareholders, the best evidence is that these reforms will continue to worsen the circumstances of other corporate constituencies, including employees and the environment.

---

[304] Strine, *supra* note 9, at 17.

[305] *See, e.g.*, *id.* at 2 n.2 ("Evidence collected . . . shows that there is a trend . . . to focus on short-term benefits of shareholders rather than on the long-term interests of the company.").

[306] *Id.* at 2.

Georgia Law Review, Vol. 58, No. 1 [2023], Art. 5

https://digitalcommons.law.uga.edu/glr/vol58/iss1/5