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Recent ESG-Developments Affecting The Energy Industry

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▸ Climate activists' election to Exxon's board of directors, Chevron's approval of emissions cuts to its energy products and a court ruling ordering Shell to lower carbon emissions by 45 percent are a series of ESG events presented to the world just weeks ago. What does this have in store for the energy industry?

On Wednesday, May 26, 2021, a series of events transpired that could have long-lasting impacts on the energy industry and which seem likely to accelerate that industry's evolving responses to environmental, social and governance (ESG) issues. In what is being widely reported as a significant victory for shareholder activists focused on climate issues, Engine No. 1, supported by some of Exxon's largest investors, gained three seats on Exxon's board of directors. In addition, a significant majority of Chevron's shareholders approved a resolution backing a call for the company to cut emissions from the end-use of its energy products. Finally, in what is being characterized as a "landmark" ruling with significant implications for the energy industry and beyond, a Dutch court found that Shell has contributed to climate change and ordered one of the world's largest energy producers to slash its carbon emissions by 45 percent by the end of 2030.

Climate Activists Elected to Exxon Board of Directors

In what may prove to be a significant development in terms of how climate issues may impact corporate governance more broadly, three directors nominated by Engine No. 1 won seats on Exxon's board of directors. Engine No. 1 nominated four directors for consideration at the company's annual meeting of shareholders. Two nominees were elected following the initial vote count during the meeting, while the status of the third nominee was not clear until the company disclosed "preliminary" voting results in a Form 8-K filed on June 2, 2021. A fourth nominee was not elected. The relatively small investment fund's efforts were backed by some of Exxon's largest investors, including BlackRock. As we discussed in February, BlackRock and other large asset managers have been updating proxy voting guidelines and are at the forefront of pushing boards of directors to "address board quality and composition issues, emphasizing its commitment to net zero emissions and climate risk disclosures." In Exxon's case, BlackRock, which reportedly owns approximately 7 percent of Exxon's issued and outstanding common stock, indicated that Exxon's board needs to "further assess the company's strategy and board expertise against the possibility that demand for fossil fuels may decline rapidly in the coming decades." Following the election of its third nominee, Engine No. 1 stated that "Exxon's future financial stability depends on the company diversifying its operations."

Shareholders Approve Resolution Requesting Chevron to Focus on Cutting End-User Emissions

In another significant ESG-related development for the energy industry, Chevron's shareholders adopted a resolution requesting the company to slash carbon emissions by consumers of its fuel products. The resolution, which was supported by approximately 61 percent of the company's shareholders, calls on Chevron to focus on cutting what are known as "Scope 3" emissions, which are emissions generated by the end-users of energy products. The resolution reflects broader efforts by climate-focused activists to compel energy producers to focus on selling fewer products that contribute to climate change, rather than producing energy in a more environmentally friendly manner or producing "cleaner" products.

Court Rules Shell Must Accelerate Cutting Emissions

In what is widely being characterized as a watershed, albeit controversial, ruling, a Dutch court found that Shell has significantly contributed to climate change and ordered the energy company to cut its carbon emissions by 45 percent no later than 2030. The court's ruling comes shortly after its shareholders approved the company's "energy transition strategy." Several media reports characterized that strategy as containing "detailed plans of the company's targets and actions to reduce emissions and promote a net zero future, including short- medium- and long-term emissions reductions goals, the company's decarbonization strategy and milestones and its capital allocation plans." The judge in the case, however, was not persuaded, stating that the company's transition strategy was subject to too many conditions and not sufficiently specific relative to achieving milestones. While several energy industry observers do not believe the judge's ruling will survive on appeal, this ruling is likely to cause market actors to continue evaluating how climate issues present operational, reputational and legal risks to their businesses, as well as reinforcing the need for mitigation strategies relative to those risks. Shell's CEO recently stated that while it disagrees with the ruling and intends to appeal, it will nonetheless "rise to the challenge" of meeting the court's ruling and it does not change Shell's commitment to reducing emissions. Rather, the ruling represents "an acceleration of our strategy...to become a net-zero emissions business by 2050, in step with society's progress towards achieving the goal of the Paris Agreement."

What Does It All Mean?

Each of these developments may be expected to have significant impacts in the United States, as well as in Europe and the United Kingdom. In the United States, for instance, the impact of these developments, taken together with recent pronouncements by the U.S. Securities and Exchange Commission (SEC) and others, suggests that companies across a wide array of industries need to continue focusing on ESG issues, particularly in areas relating to climate change. The SEC is clearly concentrating on a wide variety of ESG-related issues, having recently launched an ESG-focused web page and announcing that ESG issues are expected to be a point of emphasis for 2021 examinations. Relatedly, as we discussed recently, at the Conference on Market Regulation, SEC Chair Gary Gensler discussed the SEC's ongoing efforts to develop a robust reporting framework for ESG issues and it has been widely reported that SEC staff and other federal lawmakers are particularly focused on developing more qualitative and quantitative disclosure requirements for climate-related issues. For instance, congressional Democrats recently reintroduced the "Climate Risk Disclosure Act,"

which is intended to require the SEC to promulgate one or more rules requiring public companies to include disclosures regarding how climate change potentially affects their business operations and how these risks are being mitigated. It is clear from the Exxon board vote that shareholder activists are committed to making a significant push for companies to more aggressively address ESG considerations as part of their broader strategic and commercial decision-making processes.

In addition, across Europe, governments are continuing to expand the scope and applicability of regulations relating to climate risk disclosures as well as announcing new measures. As we discussed in a recent blog post, for instance, the Financial Conduct Authority (FCA) recently launched two consultation papers on new mandatory climate-linked disclosure requirements for FCA-authorized asset managers, certain investment advisors, life insurers, certain pension providers and standard listed companies. Additionally, European energy companies also continue to face increasing levels of shareholder activism regarding their energy transition strategies consistent with the shareholder activism faced by corporates in the United States. One shareholder activist group, Follow This, was, once again, very active in the annual general meeting (AGM) season this year, proposing climate related resolutions at the general meetings of a number of traditionally oil and gas focused companies which, broadly speaking, called for a more aggressive reduction in emissions. Finally, we also expect to see increasing levels of climate change litigation across Europe targeted at corporates and governments. As a recent post-Shell example, environmental activists have recently launched a claim in the European Court of Human Rights requesting the court to rule that Norway's drilling for oil in the Arctic breaches human rights–an indication that a new wave of human rights based litigation (as opposed to liability based litigation seeking damages for past actions) may be on the horizon following the Shell decision. ■