V. BlackRock Cuts Support for Shareholder ESG Proposals

A. Introduction

In recent years, investors have become increasingly concerned about sustainability and social responsibility, rather than their historic primary focus on financial return.[1] Much of this focus has centered on tools for promoting environmental, social, and governance investing, or ESG.[2] ESG investing can theoretically be consistent with maximizing shareholder value, but it does this by promoting corporate sustainability measures, responsible corporate governance principles, and broader goals of social justice and stakeholder consideration.[3] To ensure these goals are consistent with the corporate managerial duty of maximizing shareholder value, management justifies this focus by alleging a long-term increase in shareholder financial returns.[4] The argument is that investing in safety measures, sustainability initiatives, and ethical supply chain management might produce short term costs, but ultimately produces long term value by mitigating risks, creating consumer goodwill, and securing future profits.[5]

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[1] FREDERICK H. ALEXANDER, BENEFIT CORPORATION LAW AND GOVERNANCE: PURSUING PROFIT WITH PURPOSE 44 (2017) ("In fact, however, there is a current movement among many investors to seek investments that have more positive impact on all stakeholders. There are a host of phrases used to describe this phenomenon: socially responsible investing (SRI); environmental, social, and governance investing; responsible investing; impact investing; and others.").

[2] *Id.* at 44-45. ("Globally, institutions are signing on to the Principles for Responsible Investment, a U.N.-sponsored project that has signed up asset owners and managers with $62 trillion in assets under management, under which signatories pledge to incorporate environmental, social, and governance principles into their investing.").

[3] *Id.* at 47 ("The first argument of non-concessionary responsible companies and investors is simply that a business can "do well by doing good." For example, a company might use a more expensive but well-audited supply chain and argue that consumers are willing to pay a premium to buy goods that are ethically sourced.").

[4] *Id.* ("There is also evidence that companies with social and environmental practices are likely to be better managed, so that such practices may be an indicator of good management that will create long-term value.").

[5] *Id.* ("[C]ost cutting on safety or environmental matters may boost the financial bottom line immediately, which may in turn boost share price in the short term (because companies are often valued on the basis of a multiple of profits or cash

While the term ESG is relatively new, forms of socially responsible investing have existed since the nineteenth century.[6] These forms were generally limited to the actions of individual investors, typically concerned with individual social events and movements.[7] An early entity in this space, the Ethical Investment Research Services Ltd., was established to provide research on responsible investment decisions for socially focused investment groups.[8] ESG, as its own term, was first introduced in a series of United Nations reports, which encouraged global financial institutions to "develop guidelines and recommend-dations on how to better integrate environmental, social and corporate governance issues into asset management, securities brokerage services and associated research functions."[9] Relatedly, the United Nations affiliated Principles for Responsible Investment was launched in 2006 and has been signed by worldwide financial institutions representing more than $89 trillion in assets.[10] In the United States between 2010 and 2018, the amount of ESG investment funds has grown from 493 to 1440,

flow). But investing in sustainability measures, while reducing short-term profits, can pay off later, years into the future.").

[6] Robert G. Eccles et al., *The Social Origins of ESG: An Analysis of Innovest and KLD*, 33 ORG. AND ENV'T 575, 576-77 (2020). ("The inclusion of social considerations and restrictions in investment decisions has existed since the 19th century, especially among faith-based organizations.").

[7] *Id.* at 577 ("Gaining momentum due to historical events, such as the Vietnam War, and social concerns, such as civil rights, the environment, and women's rights, these issues were increasingly included in the investment decisions of politically active individuals.").

[8] *Id.* ("Some decades later, SRI efforts specifically targeted investments in apartheid South Africa and countries involved in arms trade (e.g., Sudan), leading, for example, to the creation of the Ethical Investment Research Services Ltd. (EIRIS) in London, which was set up to provide independent research for churches, charities, and NGOs so they could make informed and responsible investment decisions.").

[9] *Id.* ("The term ESG first appeared in a United Nations (UN), Global Compact (2004) report Who Cares Wins: Connecting Financial Markets to a Changing World, for which the former UN Secretary General invited a joint initiative of financial institutions 'to develop guidelines and recommendations on how to better integrate environmental, social and corporate governance issues in asset management, securities brokerage services and associated research functions.'").

[10] *Id.* ("[T]he UN-backed Principles for Responsible Investment, which was launched in 2006 and has attracted as signatories global financial institutions that collectively represent more than U.S.$ 89 trillion in assets.").

and the total assets increased from $569 billion to $11.632 trillion.[11] Yet the metrics for defining what constitutes an ESG investment, and their performance, vary significantly.[12]

B. BlackRock and Shareholder Activism

1. BlackRock Enters the Picture

Large asset managers play a significant role in the conversation about ESG investing, though as the world's largest asset manager, BlackRock, draws the most attention.[13] BlackRock was founded in 1988 by a small group of Wall Street investors, led by current Chief Executive Officer, Larry Fink.[14] In its function as an asset manager, BlackRock merely invests the money of its clients, who range from sovereign wealth funds to individuals.[15] Client-investors primarily bear the risk of losses and the promise of profits.[16] BlackRock primarily offers index funds, a passively managed fund that invests in a portfolio of stocks which tracks a specific benchmark index, like the S&P 500.[17] The term

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[11] *Id.* at 578 fig.1.

[12] *Id.* at 577 ("[T]here are over 100 organizations collecting some form of ESG data, whereas other studies count about 500 ESG rankings, 170 ESG indices, 100+ ESG awards, and 120 voluntary ESG standards.").

[13] Nathan Reiff, *How BlackRock Makes Money*, INVESTOPEDIA, https://www.investopedia.com/articles/markets/012616/how-BlackRock-makes-money.asp (Nov. 19, 2022) ("BlackRock Inc. (BLK) is by some measures the biggest investment management company across the globe, with more than $10.0 trillion in assets under management (AUM) as of Dec. 31, 2021 . . . with a market capitalization of about $112.3 billion. . . .").

[14] *The Rise of BlackRock*, THE ECONOMIST, (Dec. 5, 2013) https://www.economist.com/leaders/2013/12/05/the-rise-of-BlackRock ("Established in 1988 by a group of Wall Streeters led by Larry Fink, BlackRock succeeded in part by offering 'passive' investment products, such as exchange-traded funds, which aim to track indices such as the S&P 500.").

[15] *Id.* ("Its clients, ranging from Arab sovereign-wealth funds to mom-and-pop investors, save billions in fees as a result.").

[16] *Id.* ("Unlike banks, whose loans and deposits go on their balance-sheets as assets and liabilities, BlackRock is a mere manager of other people's money. It has control over investments it holds on behalf of others—which gives it great influence—but it neither keeps the profits nor suffers the losses on them.").

[17] Lucian Bebchuck & Scott Hirst, *Index Funds and the Future of Corporate Governance: Theory, Evidence, and Policy*, 119 COLUM. L. REV. 2029, 2044 (2019) ("[I]ndex funds invest in portfolios that attempt to track the performance of specified benchmark indexes, such as the S&P 500 or the Russell 3000.").

index fund is an umbrella term that encompasses several investment vehicles, including mutual funds and exchange traded funds (ETFs).[18] When investors choose to place their money in one of BlackRock's funds, it is spread out across many different investments in which BlackRock subsequently controls a large stake.[19]

BlackRock is joined by Vanguard and State Street in the so-called "Big Three" of index fund managers.[20] The three entities collectively voted 25% of the shares in all S&P 500 companies, a proportion that could reach 40% by approximately 2040.[21] The reasons for the Big Three's dominance largely derives from the economies of scale inherent in operating index funds and the liquidity provided by their immense asset pool, which gives little opportunity for future entrants to take market share from the existing players.[22]

2. How Investment Managers like BlackRock Influence Corporate Policy through Shareholder Voting Rights

When index funds invest the assets of their investors in a portfolio of companies, they control shares in that wide array of companies.[23] As the manager of these shares, index fund managers have

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[18] *Id.* ("The term 'index fund' encompasses both mutual funds and exchange traded funds (ETFs), or any other investment vehicle that mechanically tracks an index.").

[19] *The Rise of BlackRock*, *supra* note 14 ("It has control over investments it holds on behalf of others—which gives it great influence—but it neither keeps the profits nor suffers the losses on them.

[20] Lucian Bebchuck & Scott Hirst, *supra* note 17, at 2033 ("The sector is dominated by three index fund managers BlackRock, Inc. (BlackRock), State Street Global Advisors, a division of State Street Corporation (SSGA), and the Vanguard Group (Vanguard), often referred to as the 'Big Three.'").

[21] *Id.* ("[T]he Big Three collectively vote about 25% of the shares in all S&P 500 companies…the average proportion of shares in S&P 500 companies voted by the Big Three could reach as much as 40% within two decades. . . .").

[22] *Id.* at 2044 ("The dominant incumbents have significant structural advantages that derive from the economies of scale of operating index funds; the funds' branding; and—in the case of ETFs—the liquidity benefits for funds with large asset bases.").

[23] *Id.* at 2033 ("[W]e document that the Big Three collectively vote about 25% of the shares in all S&P 500 companies; that each holds a position of 5% or more in a large number of companies; and that the proportion of equities held by index funds has risen dramatically over the past two decades and can be expected to continue growing strongly.").

a duty to act as stewards, exercising the voting power of their shares to maximize value on behalf of their own investors.[24] This principle is known as stewardship.[25] A primary function of stewardship for institutional investors is a duty to vote at shareholder meetings.[26] BlackRock is a member of the Investor Stewardship Group ("ISG"), a non-profit organization dedicated to promoting structure for corporate governance and responsible investment stewardship for institutional investors.[27] The ISG has developed a framework of stewardship principles for institutional investors: requiring fidelity to their own investors, setting guidelines for disclosing conflicts of interest in proxy voting, and requiring transparency in methods for evaluating corporate governance, amongst other recommendations.[28] Importantly, the guidelines promoted by the ISG are non-binding and members can adopt stricter, or more lenient, policies as they wish.[29] BlackRock has a team of approximately 70 professionals focused on corporate governance as it relates to proxy voting and investor stewardship.[30]

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[24] *Id.* at 2044-45. ("In the literature on institutional investors, stewardship refers to the actions that investment managers can take in order to enhance the value of the companies that they invest in on behalf of their own beneficial investors.").

[25] *Id.* ("In the literature on institutional investors, stewardship refers to the actions that investment managers can take in order to enhance the value of the companies that they invest in on behalf of their own beneficial investors.").

[26] *Id.* at 2045 ("Shareholders vote on the election of directors to manage the corporation; charter and bylaw amendments; mergers, dissolutions, and other fundamental changes in the corporation; and advisory votes on executive compensation and shareholder proposals.").

[27] *Signatories and Endorsers*, INVESTOR STEWARDSHIP GROUP, https://isgframework.org/signatories-and-endorsers/ (last visited Oct. 13, 2023) (indicating which companies are signatories of investor stewardship group (ISG), and which are endorsers).

[28] *Frequently Asked Questions*, INVESTOR STEWARDSHIP GROUP, https://isgframework.org/faq/ (last visited Oct. 13, 2023) (detailing stewardship principles for institutional investor signatories).

[29] *Id.* ("The ISG is a voluntary group but members are expected ensure that their policies and practices meet or exceed the principles contained in the Framework.").

[30] BLACKROCK INVESTMENT STEWARDSHIP, BLACKROCK 2023 GLOBAL VOTING SPOTLIGHT 3 (2023) ("BIS' team of approximately 70 dedicated professionals, work across 10 global offices1 and focus most of our efforts on corporate governance.").

3. Regulatory Restrictions on Investment Manager Voting Activity

Beyond voluntary commitments like the ISG guidelines, there are few actual regulations restricting investment managers' proxy voting decisions. Investment funds are formed as business trusts or corporations under state law, and thus must be operated for the benefit of their shareholders, which in this case are the fund investors.[31] As the fund is the Beneficial Owner of its portfolio securities, the fund's managers have the authority to vote as a shareholder for these securities, a responsibility that is typically delegated to the fund's investment adviser.[32] The manager or adviser is a fiduciary that owes the fund and its shareholders a duty of the "utmost good faith, and full and fair disclosure," which extends to all functions of the fund, including proxy voting, where funds must vote in a manner "consistent with the best interest of the fund and its shareholders."[33] Beyond this general fiduciary duty, there is no specific regulation guiding funds on how to vote on shareholder proposals. The Securities and Exchange Commission ("SEC") does require management investment companies to "disclose in [their] registration statement the policies and procedures that [they] use . . . to determine how to vote proxies relating to portfolio securities," and make available their voting record for their portfolio securities.[34]

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[31] Disclosure of Proxy Voting Policies and Proxy Voting Records by Registered Management Investment Companies, 68 Fed. Reg. 6564, 6565 (Feb. 7, 2003) (to be codified at 17 C.F.R. pts. 239, 249, 270, and 274) ("Mutual funds are formed as corporations or business trusts under state law and, as in the case of other corporations and trusts, must be operated for the benefit of their shareholders.").

[32] *Id.* ("Because a mutual fund is the beneficial owner of its portfolio securities, the fund's board of directors, acting on the fund's behalf, has the right and the obligation to vote proxies relating to the fund's portfolio securities."); *see also* Andrew Ancheta, *Beneficial Ownership Meaning and Regulation*, INVESTOPEDIA, https://www.investopedia.com/terms/b/beneficialowner.asp (Nov. 27, 2022) ("A beneficial owner is a person who enjoys the benefits of ownership though the property's title is in another name.").

[33] Disclosure of Proxy Voting Policies and Proxy Voting Records by Registered Management Investment Companies, 68 Fed. Reg. at 6565.

[34] *Id.* at 6574.

4. *Break Down of BlackRock's Recent Voting Trends*

In their 2023 Investment Stewardship Voting Spotlight report, BlackRock states that "[a]s part of our fiduciary duty to our clients, we consider it one of our responsibilities to promote sound corporate governance as an informed, engaged shareholder on their behalf."[35] The firm asserts that consideration of sustainability in oversight is a core component of a corporate governance framework, and that "well-managed companies will effectively evaluate and address material sustainability-related risks and opportunities relevant to their businesses."[36] Yet despite this strong stated support for sustainability, much reporting recently has focused on BlackRock's retreat from advocating for ESG principles.[37] BlackRock founder and Chief Executive Officer, Larry Fink, was quoted in early 2023 stating he had stopped using the term ESG because it had been overly politicized by figures across the political spectrum.[38] An initial review of BlackRock's proxy voting in 2023 seems to support the idea that the company is backing away from sustainability advocacy. In 2023, in its role as a steward, BlackRock voted on 171,555 proposals, of which 85,890 were director elections and board proposals, 20,3777 were compensation proposals, and a mere 813 of which were shareholder proposals.[39] Amongst these shareholder proposals, BlackRock voted against 742 of them, approximately 91%.[40] Regarding those proposals concerning climate and natural capital and company impacts on people, BlackRock supported only 26 out of the 399 proposals it voted on globally, a mere

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[35] BLACKROCK INVESTMENT STEWARDSHIP, *supra* note 30, at 3.
[36] *Id.*
[37] Patrick Temple-West & Brooke Masters, *BlackRock's support for climate and social resolutions falls sharply*, FINANCIAL TIMES, (Aug. 23, 2023), https://www.ft.com/content/06fb1b85-56ba-48cd-b6f6-75f8b8eee7e1 ("Earlier this year, Larry Fink, the firm's chief executive, said he had stopped using the acronym ESG—the catchall term for such proposals—because it had been 'weaponised' by political figures on both the right and the left.").
[38] *Id.*
[39] BLACKROCK INVESTMENT STEWARDSHIP, *supra* note 30, at 16 figs.3 & 4 (depicting numerical figures indicating voting in BlackRock's clients' financial interests and proposals voted on).
[40] *Id.* at 12 ("Given the increased proportion of prescriptive proposals or those lacking economic merit, coupled with continued improvements in company practices and disclosures, BIS voted against 742 (~91%) out of a total of 813 shareholder proposals we voted on globally (~9% supported).").

7%.[41] The 2023 numbers represent a trend of declining support for such proposals, down from 22% support in 2022 and 47% in 2021.[42]

However, this retrenchment in support is not unique to BlackRock.[43] The median support for shareholder ESG proposals has been falling across the board, from 32% industry wide in 2021 to 25% in 2022 to a low of 15% in 2023.[44] Looking at one of BlackRock's peer firms, State Street's support of such proposals has fallen from 49% in 2021 to 44% in 2022 to 32% in 2023, a significant decline to be sure, but less precipitous than BlackRock.[45] While separate from shareholder proposal voting, the broader financial market has also shown wariness towards ESG investing principles.[46] The US has around 656 sustainable funds as of June 2023, but some of the largest fund managers have unwound more than two dozen ESG funds in 2023.[47] In September 2023, BlackRock announced plans to "close a pair of sustainable emerging-market bond funds with total assets of around $55 million."[48] The company may not be in full-on retreat however, as BlackRock

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[41] *Id.* ("Considering only those proposals on climate and natural capital and company impacts on people, BIS supported 26 out of 399 we voted on globally (~7% supported).").

[42] Patrick Temple-West, *supra* note 37 ("That represented a significant decline from last year, when it backed 22 per cent globally, and the 2021 proxy season, when it voted in favour of 47 per cent.

[43] *Id.* ("Indeed, BlackRock argued that its declining support for ESG proposals was reflective of a broader pullback among investors.").

[44] *Id.*

[45] *Id.* ("The Boston-based asset manager, which publishes its voting record using a different timeline, backed 32 per cent of ESG resolutions in the first half of this year, down from 44 per cent in the same period of 2022 and 49 per cent in 2021.").

[46] Silla Brush, *BlackRock, State Street Among Money Managers Closing ESG Funds*, BLOOMBERG LAW, (Sep. 21, 2023), https://www.bloomberglaw.com/bloomberglawnews/esg/X1VA0RP4000000?bna_news_filter=esg#jcite ("More US sustainable funds have closed in 2023 than the prior three years combined, the data show. Investors pulled more money from the funds in the first half of the year than they put into them.").

[47] *Id.* ("State Street Corp., Columbia Threadneedle Investments, Janus Henderson Group Plc and Hartford Funds Management Group Inc., among others, unwound more than two dozen ESG funds this year.").

[48] *Id.*

launched several ESG and sustainability focused ETFs, and a sustainable global equity mutual fund in 2023.[49]

C. Examining Reasons for Decline in ESG Shareholder Proposal Support

1. BlackRock's Own Rationale

BlackRock acknowledges that it has reduced support for shareholder sustainability and climate proposals, but despite Larry Fink's public comments,[50] it maintains this is due to the nature of the proposals rather than a change in BlackRock's principles.[51] The company asserts that in 2023 there were a record number of shareholder proposals that focused on ESG and climate—so many that for the first time those proposals outnumbered proposals that focused on governance.[52] However, representatives claimed that a smaller proportion of proposals warranted support, citing many "were overly prescriptive or unduly constraining on management decision-making."[53] Additionally, there was an increase in "single-issue proposals where the request made did not have economic merit."[54] Many of these proposals did not

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[49] *Id.* ("While it's closing those two funds, BlackRock launched two broad ESG ETFs this year with a total of about $9 million of assets, an environmental solutions ETF with about $3.7 million and a sustainable global equity mutual fund with about $10 million, according to data compiled by Bloomberg.").

[50] Patrick Temple-West, *supra* note 37. ("Earlier this year, Larry Fink, the firm's chief executive, said he had stopped using the acronym ESG—the catchall term for such proposals—because it had been 'weaponised' by political figures on both the right and the left.").

[51] BLACKROCK INVESTMENT STEWARDSHIP, *supra* note 30, at 12 ("Overall, we observed an increase in the number of shareholder proposals that did not warrant BIS support. These often addressed relevant issues but sought simplistic outcomes that overlooked the competing priorities companies were balancing and the complexity and interconnected nature of the issues.").

[52] *Id.* ("Globally, we saw a record number of shareholder proposals addressing issues such as climate and natural capital (environmental), as well as company impacts on people (social)—including their human capital and the communities in which they operate—submitted to a vote this proxy year. The increase was largely driven by shareholder activity in the U.S. In this market, these proposals combined outnumbered governance-related proposals for the first time.").

[53] *Id.*

[54] *Id.*

account for the fact that the companies had already substantively met their request.[55]

BlackRock decides whether to vote on shareholder proposals based on their "economic merit, considering the company's individual circumstances and maintaining a singular focus on the proposal's implications for long-term financial value creation."[56] They maintain that their role is not to achieve a "specific decarbonization outcome," for climate proposals, but rather simply to act as a fiduciary to their clients by voting on proposals that maximize long term value for clients.[57] BlackRock refrains from supporting proposals that overly direct or constrain management, maintaining that minority shareholders like themselves should not be attempting to direct companies, as that is the responsibility of company management with board oversight.[58]

While this rationale seems logical, the lack of significant regulation on investment manager proxy voting decisions, along with BlackRock's own policies, makes it clear that BlackRock has a great deal of discretion regarding which shareholder proposals it supports, and which shareholder proposals it does not. This idea is supported by the huge deviation in support for environmental proposals at prominent index funds, all of whom have the same fiduciary duty to vote in the best interests of their investors.[59] There are other potential factors, which will be explored in the following sections, which could be influencing BlackRock's lessening support for shareholder ESG related proposals.

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[55] *Id.* ("Importantly, many proposals failed to recognize that companies had already substantively met their request.").

[56] *Id.*

[57] *Id.* at 30 ("Our role is to help our clients navigate investment risks and opportunities; it is not our role to engineer a specific decarbonization outcome in the real economy.").

[58] *Id.* at 3 ("As one of many minority shareholders, BlackRock cannot—and does not try to—direct a company's strategy or its implementation. Rather, we taka constructive, long-term approach with companies and focus on the drivers of risk and financial value creation in their business models.").

[59] Caleb N. Griffin, Environmental and Social Voting at Index Funds, 44 DELAWARE JOURNAL OF CORPORATE LAW 167, 1 (2020) ("In the most recent proxy season, the Big Three supported between 7.1% and 22.7% of such proposals. Other funds supported E&S proposals at far higher rates (e.g., Deutsche Bank at 77.9%) and far lower rates (e.g., Dimensional at 0%).").

2. *SEC Regulatory Change on Board Elections*

One external factor that may confirm BlackRock's rationale is a recent SEC regulation that has led to an increase in shareholder proposals.[60] The new rule promotes changes to leadership elections at companies' annual meetings.[61] Previously, unless shareholders attended the annual meeting in person, they had no choice but to vote for either the company's slate of board members, or a rival slate of board members proposed by activists.[62] But now, shareholders can pick and choose individual directors from the individual ballots, regardless of whether they attend the meeting in person.[63] By making it easier for activist shareholders to elect board members of their choosing, this change increases the leverage that shareholders have over company managers.[64] As a result, managers may be more likely to consider the priorities of activist shareholders, including ESG proposals.[65] The SEC regulation was adopted in September 2022, and a record 340 ESG proposals were voted on as of August 2023, up from 300 in all of 2022.[66] If this facilitation of shareholder activism has led to lower quality shareholder proposals, that could explain BlackRock's reduction in support for ESG initiatives. However, this SEC regulation was only adopted halfway

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[60] Patrick Temple-West, *How a SEC rule change has opened more doors for activists*, FINANCIAL TIMES, (Jun. 24, 2023), https://www.ft.com/content/74c0bf2f-5fdb-4dd4-9902-c1f06097c7ac ("[T]he Securities and Exchange Commission introduced a rule change to make it easier for shareholder activists to elect board nominees . . .").

[61] *Id.*

[62] *Id.* ("Previously, unless shareholders turned up in person to an AGM, they were forced to vote for a slate of the company's nominees in contested elections or those of the activists.").

[63] *Id.* ("[The new universal proxy rule] also allows shareholders to pick and choose individual directors.").

[64] *Id.* ("Hester argued any activist 'need only to dangle the possibility of buying a few shares and putting forward directors to scare management into the negotiating room'.").

[65] Richard J. Grossman et al., *How the New Proxy Rules Will Affect US Companies Facing Activist Campaigns*, SKADDEN, (Winter 2023), https://www.skadden.com/insights/publications/2023/02/the-informed-board/how-the-new-proxy-rules-will-affect-us-companies ("New 'universal' proxy card rules may increase the number of activist campaigns if activists believe the rules give them a better chance to win seats in contested elections.").

[66] Patrick Temple-West, *supra* note 37. ("This year, a record 340 ESG proposals have already been voted on in the US, up from 300 in all of 2022, according to Institutional Shareholder Services, the proxy voting group.").

through 2022, and BlackRock's support of ESG initiatives had already declined by that point.[67]

3. *Political Backlash to ESG*

As ESG investing has become more salient, the amount of controversy and pushback seems to have increased as well. A 2023 survey by The Conference Board polled more than 100 large U.S. companies, and found that almost half had experienced ESG backlash.[68] Amongst those companies, 61% expect the backlash to persist or intensify in the next two years.[69] Amongst the sources of backlash, the most significant was from state and federal political candidates and policymakers.[70] Between the federal and state levels, legislators filed ninety-nine "ESG backlash" bills by May of 2023, in contrast with a total of thirty-nine in 2022.[71]

In March of 2023, a coalition of nineteen U.S. state governors issued a joint statement, warning companies to focus on maximizing shareholder value, rather than spreading a "woke ideology."[72] Beyond this mere advocacy, states are demanding more information and scrutinizing ESG policies more closely. State officials have been requesting information, even issuing civil investigative demands or

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[67] *Id.* ("The median support for these resolutions fell to 15 per cent in 2023 from 25 per cent in 2022 and 32 per cent in 2021, according to BlackRock and ISS data.").

[68] Paul Washington & Andrew Jones, *ESG Backlash Is Real and Growing. What to Know.*, BARRON'S, (Aug. 22, 2023, 9:05 AM), https://www.barrons.com/articles/esg-backlash-is-real-and-growing-what-to-know-264ec4f6 ("In a recent survey by The Confrence Board of more than 100 large U.S. companies, nearly half said they have already experienced ESG backlash. . . .").

[69] *Id.* (". . . [A]nd 61% of [surveyed U.S. companies] expect [backlash] to persist or intensify in the next two years.").

[70] Cydney Posner, Tackling ESG Backlash, JD SUPRA, (Aug. 14, 2023), https://www.jdsupra.com/legalnews/tackling-esg-backlash-1212429/ ("According to the survey, the most significant sources for ESG backlash were state policymakers and candidates (31%) and federal policymakers and candidates (22%).").

[71] *Id.* ("In May, *Reuters* reported that, at that point, legislators had filed about 99 so-called 'ESG backlash' bills compared with only 39 in 2022;").

[72] *Id.* ("To illustrate, the paper makes reference to a March 2023 joint statement from a group of 19 governors announcing that they are seeking to '[ensure] corporations are focused on maximizing shareholder value rather than the proliferation of woke ideology.'").

subpoenas, on how ESG metrics are actually calculated, including which groups the financial sector is coordinating with in determining what to value in these calculations.[73] Some state officials have been targeting BlackRock directly. In 2022, Louisiana State Treasurer John M. Schroder announced plans to sell $794 million of investments under BlackRock's management, stating "this divestment is necessary to protect Louisiana from actions and policies that actively seek to hamstring our fossil fuel sector."[74] The North Carolina State Treasurer wrote a letter calling on BlackRock CEO, Larry Fink, to resign, though they did not remove state funds from BlackRock's management, citing a fiduciary duty "to find the best value with the lowest cost and highest margin of safety" for state beneficiaries.[75] Additionally, in the wake of the Supreme Court's decisions invalidating affirmative action in colleges, a group of attorneys general published a letter warning Fortune 100 companies to avoid utilizing race based preferences in the hiring and promotions process.[76]

4. ESG Focused Litigation Risk

In addition to the explicitly political backlash to ESG, there has been a flurry of litigation around ESG policies and proposals from both public and private entities. A group of twenty-six states and several private parties jointly sued the Department of Labor ("DOL") over a rulemaking that plaintiffs alleged allowed fiduciaries regulated by the Employment Retirement Income Security Act ("ERISA") to consider

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73 Rick S. Horvath et al., *The Developing Litigation Risks from the ESG Backlash in the United States*, HARV. L. SCH. F. ON CORP. GOVERNANCE, (July 12, 2023), https://corpgov.law.harvard.edu/2023/07/12/the-developing-litigation-risks-from-the-esg-backlash-in-the-united-states/ ("To date, the state officials have requested information—and in some cases sent civil investigative demands (CIDs) or subpoenas—on the mechanics of calculating ESG factors, whether the implementation of such factors were coordinated within the financial sector, and whether the financial industry is specifically aligning with particular groups or policy positions, among other details.").

74 Ron Lieber, Politicians Want to Keep Money Out of E.S.G. Funds. Could It Backfire?, N.Y. TIMES, (Jan. 30, 2023), https://www.nytimes.com/2023/01/30/your-money/red-states-esg-funds-BlackRock.html.

75 *Id.*

76 Cydney Posner, *supra* note 70 ("[A] July letter from a group of state attorneys general warned Fortune 100 companies 'against race-based preferences in hiring, promotions and contracting after the Supreme Court's recent decision finding affirmative action unconstitutional.').

ESG factors in investment decisions, which would undermine pecuniary considerations.[77] In September 2023, a federal district court granted the defendants' motion for summary judgment.[78] The Court deferred to the DOL's interpretation of ERISA: "where a fiduciary reasonably determines that an investment strategy will maximize risk-adjusted returns, a fiduciary may pursue the strategy, whether pro-ESG, anti-ESG, or entirely unrelated to ESG."[79]

In a separate suit concerning ESG and ERISA, a group of American Airlines pilots filed a class action suit against American Airlines regarding the usage of ESG considerations in the management of their 401(k) plans.[80] The plaintiffs alleged that the inclusion of options that pursue ESG goals is inconsistent with the plan administrators' duties under ERISA.[81] Furthermore, the ESG funds allegedly violated fiduciary duties because they were more expensive, did not perform as well as peer funds, and engaged in shareholder activism meant to pursue goals beyond mere maximization of benefits.[82] The litigation is still proceeding in the District Court of the Northern District of Texas as of October 2023.[83]

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[77] Utah v. Walsh, 2:23-CV-016-Z, 2023 WL 6205926, at *1-2 (N.D. Tex. Sep. 21, 2023) ("Private Plaintiffs allege they will be 'forced to expend additional time and resources monitoring and reviewing recommendations from the plan's investment advisors, without the benefit of recordkeeping requirements or strict regulations, to assure the advisors are focusing only on pecuniary considerations and not collateral ESG factors.'").

[78] *Id.* at 1.

[79] *Id*. at 5.

[80]Hovarth, *supra* note 73 ("alleged breaches of fiduciary duty under ERISA relating to the consideration of ESG principles in the management of the class plaintiffs' 401(k) plan.").

[81] *Id.* ("According to the complaint, the selection and inclusion of investment options that pursue ESG policy goals via investment strategies, proxy voting, and shareholder activism is inconsistent with the defendants' fiduciary duties under ERISA.").

[82] *Id.* ("The complaint further alleges that including ESG funds in the American Airlines 401(k) plan necessarily breaches fiduciary duties because, purportedly based on selected third-party analyses and reports, ESG funds are more expensive, do not perform as well as their peers, and engage in shareholder activism in the pursuit of goals beyond the maximization of financial benefits.").

[83] Spence v. American Airlines, Inc., 4:23-cv-00552-O (N.D. Tex. Oct. 9, 2023) (BL, Court Dockets). (indicating that reply last filed by American Airlines, Inc., American Airlines Employee Benefits Committee on October 13, 2023 to motion to dismiss amended complaint).

Municipal government entities have also been under fire for promoting ESG and sustainability considerations in financial decision making. After a group of New York City pension administrators divested pension plans from allegedly $4 billion worth of fossil fuel investments to minimize climate impact, a group of pension beneficiaries filed suit.[84] The plaintiffs alleged these divestments sacrificed potential financial gains in pursuit of a policy agenda, representing a breach in fiduciary duties of loyalty and care.[85] The litigation is still proceeding in the Supreme Court of New York County as of October 2023.[86]

Much of this litigation directly concerns the administration of retirement plans regulated by ERISA, whereby plan administrators must act solely in the interest of plan beneficiaries and for the sole purpose of paying plan benefits and expenses.[87] The litigation shows state officials and private litigants are becoming bolder in challenging fiduciaries who consider ESG factors in making investment decisions. Much of this litigation is ongoing or unsuccessful thus far, but future litigation, especially if successful, could have a chilling effect on investment managers and further contribute to the retrenchment of ESG investments more broadly. BlackRock may very well be wary of litigation targeting its role in promoting ESG as an asset manager and accusing

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[84] Rick S. Hovarth, *supra* note 73 ("Plaintiffs benefitting from New York City's Qualified Pension Plans (the "Plans") sued their respective pension administrators for breaches of fiduciary duty relating to the Plans' decision to divest from fossil fuel investments in an effort to combat climate change.").

[85] *Id.* ("Plaintiffs claim that the alleged 'blunderbuss divestments' represented the administrators' 'zealous pursuit of a policy agenda' over their mandate to maximize returns for pension participants.").

[86] Wong v. N.Y.C. Emps.' Ret. Sys., 0652297/2023 (Sup. Ct. N.Y.C. Cnty. Oct. 11, 2023) (WestLaw) (indicating that memorandum of law filed on November 8, 2023).

[87] *Fiduciary Responsibilities,* U.S. DEP'T OF LAB., https://www.dol.gov/general/topic/retirement/fiduciaryresp (last visited Nov. 1, 2023) ("The Employee Retirement Income Security Act (ERISA) protects your plan's assets by requiring that those persons or entities who exercise discretionary control or authority over plan management or plan assets, anyone with discretionary authority or responsibility for the administration of a plan, or anyone who provides investment advice to a plan for compensation or has any authority or responsibility to do so are subject to fiduciary responsibilities.").

the company of not truly acting in a manner consistent with the best interest of the fund and its shareholders.[88]

D. Investor Voting Choice: A Potential Path Forward

In early 2022, BlackRock introduced a new policy to allow certain institutional investors to vote their own shares in the shareholder proxy voting process.[89] Clients invested in pooled investment funds can either implement their own voting policy or choose from selected policies created by third-party proxy voting providers, namely Institutional Shareholder Services and Glass Lewis.[90] For clients invested in pooled funds, their choice of policy applies to their "pro-rata portion of the shares held by the pooled fund."[91] Clients with "Separately Managed Accounts" can vote their shares themselves, authorize an asset manager or other professional to vote on their behalf, select a third-party proxy voting provider's policy, or go with a hybrid of the former approaches and BlackRock's default voting judgment.[92] Clients can still choose to rely on BlackRock for all voting decisions, but other groups of

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[88] Disclosure of Proxy Voting Policies and Proxy Voting Records by Registered Management Investment Companies, 68 Fed. Reg. 6564 (Feb. 7, 2003) (to be codified at 17 C.F.R. pts. 239, 249, 270, and 274) (An investment adviser voting proxies on behalf of a fund, therefore must do so in a manner consistent with the best interests of the fund and its shareholders.").

[89] *Empowering investors through BlackRock Voting Choice*, BLACKROCK, https://www.BlackRock.com/corporate/about-us/investment-stewardship/BlackRock-voting-choice#BlackRock-voting-choice-faqs (last visited Oct. 13, 2023) ("We launched BlackRock Voting Choice in the beginning of 2022 to make proxy voting easier and more accessible for eligible institutional clients and are committed to a future where every investor can participate in the shareholder voting process.").

[90] *Id.* ("This option gives institutional clients in certain institutional pooled vehicles the ability to apply their preferred voting policy, meaning the client has either one that they have designed themselves or has chosen a third-party policy. . . .").

[91] BLACKROCK, VOTING CHOICE FAQ 3 (April 2023) ("For institutional clients invested in pooled investment funds in scope for Voting Choice, BlackRock has made available through Voting Choice a variety of off-the-shelf voting policies provided by third-party proxy voting providers as well as a mechanism for implementing a client's own voting policy, for the client's pro-rata portion of the shares held by the pooled fund.").

[92] *Id.* ("Eligible institutional clients with Separately Managed Accounts (SMAs) may choose whether to vote themselves or authorize someone else, such as their asset manager to vote assets on their behalf.").

institutional clients can select the preceding options.[93] According to BlackRock, as of the second quarter of 2023, $2.3 trillion of their total $4.8 trillion total index equity was eligible for the Voting Choice program, and institutional investors representing $586 billion were participating.[94] Though the BlackRock program does give investors a say on the voting process, BlackRock remains the owner of the shares in pooled funds, thus BlackRock still effectively retains a great deal of control over how investors engage in voting.[95]

Some of the third-party proxy advisers' plans are specifically tailored to ESG goals and initiatives, and the difference in voting policies can be quite pronounced depending on the plan selected.[96] In 2022, BlackRock supported 16% of "Environmental and Safety" shareholder proposals at S&P 500 companies, while an ISS Sustainability Policy plan supported 67% of such proposals, and a Glass Lewis ESG Policy plan supported 86% of such proposals.[97]

By giving clients the option to have a degree of control and choice over proxy voting, BlackRock may be effectively neutralizing both threats from environmental and social activists, and anti-ESG lawsuits and legislation. BlackRock can scale back its support of ESG activism at its managed companies because it can simply point clients to voting choice alternatives that allow clients to vote in alignment with their desired principles as they relate to ESG. This would allow BlackRock to strengthen its case in any potential disputes with anti-ESG activists or investors that allege BlackRock is focused on factors other than the pecuniary interests of its clients.

While the Voting Choice program is only available for institutional clients, representing around half of BlackRock's total index equity, the firm has begun expanding the program to retail investors. In

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[93] *Id.* ("Clients rely on BlackRock's informed judgment for all voting decisions: This option gives institutional clients the choice to rely on BlackRock for all of their voting decisions.").

[94] *Empowering investors through BlackRock Voting Choice*, *supra* note 89 (including graphic that depicts Index Equity clients participating in Voting Choice as of June 30 in Q2 of 2023).

[95] BLACKROCK, *supra* note 91 ("Voting Choice does not change ownership of shares held by institutional pooled funds—these pooled funds continue to be the owners of the shares they hold.

[96] *Voting Choice - Voting Policy Comparison*, BLACKROCK, https://www.BlackRock.com/corporate/literature/brochure/voting-choice-voting-policy-comparison.pdf (May 2023) (illustrating voting policy details by index to provide percent of votes against management across holdings of named index).

[97] *Id.*

July 2023, BlackRock announced plans to allow retail investors in its iShares Core S&P 500 ETF, a fund holding $305 billion in assets, to choose among voting plans provided by ISS and Glass Lewis.[98] In the coming years, BlackRock could continue to expand these voting options to a larger class of investors and assets. The two other largest investment managers, Vanguard and State Street, have announced similar investor proxy voting options, indicating that the industry as a whole is responding to the concerns about their control and influence.[99]

E. Conclusion

BlackRock and fellow investment managers have come to play an outsized role in the modern investment marketplace.[100] It is natural that their decisions regarding proxy voting have come under increased scrutiny.[101] This scrutiny and legal action around ESG investment decisions may have played a key role in investment managers' reduction

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[98] Ross Kerber, *BlackRock to expand proxy voting choice to retail ETF investors*, REUTERS, (July 17, 2023) ("investors in its iShares Core S&P 500 ETF (IVV.P) will be able to cho[o]se among a range of policies to determine how the fund votes their shares at corporate annual meetings.").

[99] *Vanguard Launches Proxy Voting Choice Pilot*, VANGUARD, (Feb. 1, 2023) https://corporate.vanguard.com/content/corporatesite/us/en/corp/who-we-are/pressroom/press-release-vanguard-launches-proxy-voting-choice-pilot-020123.html ("The voluntary pilot will empower investors to make their voices heard by choosing from a selection of proxy voting policy options that will direct how the funds vote on important shareholder matters at portfolio companies held in the funds."); *Extending Proxy Voting Choice to More Investors*, *About Us*, STATE STREET GLOBAL ADVISERS, https://www.ssga.com/us/en/intermediary/etfs/about-us/what-we-do/asset-stewardship (last visited Oct. 13, 2023) ("[O]ur recently expanded program to offer more investors the power to choose a voting policy that directs the proxy votes of shares owned in the index equity funds in which they are invested, including those owning certain US index equity SPDR ETFs and US mutual funds.").

[100] Lucian Bebchuck & Scott Hirst, *supra* note 17, at 2033 ("[T]he Big Three collectively vote about 25% of the shares in all S&P 500 companies…the average proportion of shares in S&P 500 companies voted by the Big Three could reach as much as 40% within two decades . . .").

[101] Horvath, supra note 73 ("In the past year, environmental, social, and governance ('ESG') practices have faced heightened scrutiny in the United States from state attorneys general, state and federal legislators, other government officials, and private parties.")

in support of shareholder policy proposals that focus on ESG issues.[102] Though BlackRock maintains that this is not the case, their decision to devolve voting authority to institutional and retail investors may be a way of avoiding this voting scrutiny and removing itself from the controversy over ESG investing. Consequently, asset managers may continue to expand the ability of their investors to make their own decisions in proxy voting. It remains to be seen whether this will spare BlackRock from further legal and regulatory scrutiny, or whether criticism of its own investment stewardship activities will continue going forward.

Michael Gersho[103]

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[102] Patrick Temple-West, *supra* note 37 (detailing a trend of declining Blackrock's support of ESG shareholder proposals, only 7% in 2023 down from 47% in 2021).
[103] Student, Boston University School of Law (J.D. 2025).