ESSAY

FIDUCIARY DEADLOCK

ROBERTO TALLARITA†

In the current ESG debate, one leading theory argues that diversified investors have a financial incentive to reduce negative corporate externalities, such as greenhouse gas emissions, because they internalize those externalities within their investment portfolio. This Essay examines how this "portfolio primacy" theory interacts with the multiple layers of fiduciary duties of investment and corporate managers. Using a hypothetical emissions reduction in ExxonMobil as a paradigmatic case, I show that portfolio primacy creates a fiduciary deadlock: a situation in which multiple fiduciary relationships—between investment advisers and fund investors, between corporate managers and shareholders, and between controlling and minority shareholders—come into conflict with each other. I argue that, within the existing structure of fiduciary law, portfolio primacy will prove ineffective in promoting ambitious social and environmental goals. Indeed, the only way to solve the fiduciary deadlock is to abandon the central tenet of portfolio primacy.

† Lecturer on Law, Terence M. Considine Senior Fellow in Law and Economics, and Associate Director of the Program on Corporate Governance, Harvard Law School. For helpful conversations and comments, I am grateful to Rick Alexander, Lucian Bebchuk, Matthew Conaglen, Will Collins-Dean, Jared Ellias, Marc Gerber, Scott Hirst, Kobi Kastiel, Holger Spamann, and Andrew Tuch. The Harvard Law School Program on Corporate Governance and the John M. Olin Center for Law, Economics and Business provided financial support.

We focus on sustainability not because we're environmentalists, but because we are capitalists and fiduciaries to our clients.
Larry Fink, CEO of BlackRock, Letter to CEOs (2022)[1]

[T]o say that a man is a fiduciary only begins analysis . . . . To whom is he a fiduciary? What obligations does he owe as a fiduciary?
SEC v. Chenery Corp., U.S. Supreme Court (1943)[2]

INTRODUCTION

On December 16, 2021, BlackRock, the world's largest asset manager, received a proposal from The Shareholder Commons (TSC), on behalf of shareholder James McRitchie (the TSC Proposal).[3] The TSC Proposal asked BlackRock to push portfolio companies to reduce the social and environmental costs they impose on society, even if doing so would hurt these companies' stock value.[4]

BlackRock replied that the TSC Proposal violated its fiduciary duties to its clients, who invest their money with BlackRock in order to obtain the

1 Larry Fink, *Letter to CEOs*, HARV. L. SCH. F. ON CORP. GOVERNANCE (Jan. 19, 2022), *https://corpgov.law.harvard.edu/2022/01/19/letter-to-ceos-2*. [https://perma.cc/F3DA-SPC2].

2 Sec. & Exch. Comm'n v. Chenery Corp., 318 U.S. 80, 85-86 (1943).

3 BlackRock, Inc., SEC No-Action Letter, 2022 WL 225966 (Apr. 4, 2022) [hereinafter "BlackRock NAL"].

4 *See id.* at *1. ("[S]hareholders ask that . . . [BlackRock] adopt stewardship practices designed to curtail corporate activities that externalize social and environmental costs . . . even if such curtailment could decrease returns at the externalizing company.").

highest possible return.[5] Therefore, according to BlackRock, shareholders should not have been allowed to vote on the TSC Proposal or, if allowed to vote, should have rejected it.[6] TSC objected, stating that BlackRock should maximize the value of its entire portfolio, not the value of individual companies; and since BlackRock's portfolio mirrors the whole economy, maximizing the value of the portfolio requires minimizing systemic risks and costs for the entire economy, such as climate change, geopolitical risk, and other pressing social threats.[7] The Securities and Exchange Commission (SEC) found that the TSC Proposal did not violate fiduciary law,[8] and BlackRock's shareholders were allowed to vote on the TSC Proposal at the 2022 annual meeting.[9]

The TSC Proposal was explicitly based on the portfolio primacy theory, which states that asset managers should maximize the value of their entire portfolio, rather than the value of individual companies.[10] This theory, which

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5 *Id*. at *6-8; *see also* BlackRock, Inc., 2022 Proxy Statement (Form 14A) 98 (Apr. 14, 2022) ("BlackRock is a fiduciary with a duty to act in the best interests of its clients . . . . [T]he proposal is asking BlackRock to take actions potentially at odds with some clients' stated investment objectives and our fiduciary duties.").

6 BlackRock, Inc., 2022 Proxy Statement, *supra* note 5 at 98.

7 BlackRock NAL, *supra* note 3, at *13.

8 *Id*. at *1. The SEC did not find that the TSC Proposal violated federal law—meaning BlackRock's fiduciary duties under the Investment Advisers Act of 1940—and therefore BlackRock could not exclude the TSC Proposal from the proxy.

9 BlackRock, Inc., 2022 Proxy Statement, *supra* note 5, at 96-97.

10 *See* Madison Condon, *Externalities and the Common Owner*, 95 WASH. L. REV. 1, 81 (2020) ("Institutional investors have the economic incentive to function as 'surrogate regulators,' sacrificing individual firm profits for the benefit of the broader portfolio. This explanation of *why* institutional investors pressure firms to voluntarily reduce emissions has challenged the widespread assumption that shareholders uniformly seek to maximize share value."); Jeffrey N. Gordon, *Systematic Stewardship*, 47 J. CORP. L. 627, 629 (2022) ("[A]dvisors of extensively diversified portfolios, especially broad-based index funds, should focus on addressing the systematic risk elements in their portfolios rather than new forays into firm-specific, performance-focused engagement."); John C. Coffee, Jr., *The Future of Disclosure: ESG, Common Ownership, and Systematic Risk*, 2021 COLUM. BUS. L. REV. 602, 604. ("As more institutions shift to portfolio-wide decision making, there is an optimistic upside: externalities may be curbed by collective shareholder action . . . . [ESG disclosures are] now becoming a force that can effect significant social and economic change . . ."). For a critique of the portfolio primacy theory, see generally Roberto Tallarita, *The Limits of Portfolio Primacy*, 76 VAND. L. REV. 511 (2023) and Marcel Kahan & Edward B. Rock, *Systemic Stewardship with Tradeoffs* 1 (N.Y.U. L. & Econ. Research Paper Series, Working Paper No. 22-01, 2021), https://ssrn.com/abstract=3974697 [https://perma.cc/3EC9-J5C4] ("[Universal owners] will act unilaterally and under cloak of promoting single firm value. But because any serious effort to mitigate climate change will involve tradeoffs, we do not expect universal owners to be effective in controlling carbon emissions."). For an additional example, see Dhammika Dharmapala & Vikramaditya S. Khanna, *Controlling Externalities: Ownership Structure and Cross-Firm Externalities* 2 (Eur. Corp. Governance Inst. L. Working Paper No. 603/2021, 2021), https://ssrn.com/abstract=3904316 [https://perma.cc/XG4U-GSFP] ("Globally, a large fraction of corporations have controlled ownership structures. For these firms, the lack of controller

has recently gained significant support among prominent scholars and practitioners, has fueled the expectation that pressure from large asset managers can become a powerful tool to fight climate change and other pressing social problems. Indeed, TSC's explicit goal was to "find a way to deploy private capital in a manner that prioritizes vital environmental and social system over individual company profits."[11] The hope of TSC and other supporters of portfolio primacy is to harness the power of large asset managers to push corporations toward decarbonization and other social goals.

Although the TSC Proposal obtained only four percent of the votes at BlackRock's annual meeting,[12] similar proposals are likely to be submitted in the future. And as has happened in the past with other social and environmental proposals, such proposals might obtain increasing support from shareholders.[13] Furthermore, shareholder proposals based on portfolio primacy have been submitted to some companies and are likely to be submitted to more companies in the future. For example, a proposal submitted to McDonalds' requested that the board institute a policy on the use of antibiotics, on the grounds that "antimicrobial resistance . . . poses a systemic threat to public health and the economy. When the efficacy and availability of life-saving drugs are compromised, the entire economy suffers. And when the economy suffers, investors lose."[14] A proposal submitted to Meta Platforms, the company that owns Facebook, Instagram, and WhatsApp, requested that the compensation committee consider including compensation metrics for executives that take into account "the costs externalized by Company operations, including costs imposed on the global economy and the environment,"[15] on the grounds that "environmental and social damage . . . harms the economy and the portfolios of diversified shareholders."[16]

This Essay uses a hypothetical scenario involving BlackRock's investment in ExxonMobil (Exxon) to examine how the kind of systematic stewardship advocated by these shareholder proposals interacts with the intricate web of fiduciary duties of investment and corporate managers.

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diversification makes it difficult to identify mechanisms to internalize corporate externalities, besides increasing regulation and enhancing liability . . . .").

11 *About*, S'HOLDER COMMONS, https://theshareholdercommons.com/about/ *[https://perma.cc/P8N5-U7LZ]*.

12 See BlackRock, Inc., Current Report (Form 8-K) (May 27, 2022) (reporting that the TSC Proposal received 4,412,888 votes in favor and 115,721,363 votes against).

13 *See, e.g.*, Roberto Tallarita, *Stockholder Politics*, 73 HASTINGS L.J. 1697, 1724-1729 (2022).

14 McDonald's Corp., 2023 Proxy Statement (Form 14A) 90 (Apr. 14, 2023).

15 Meta Platforms, Inc., 2023 Proxy Statement (Form 14A) 91 (Apr. 14, 2023).

16 *Id.*

How does fiduciary law consider a hypothetical stewardship intervention[17] in which BlackRock, following the portfolio primacy theory, pressures Exxon to reduce its carbon emissions at the expense of Exxon stock value and for the benefit of BlackRock's aggregate portfolio?

I will argue that this scenario creates a fiduciary deadlock: a situation in which multiple fiduciary relationships come into conflict with each other. In our hypothetical, we must examine four different fiduciary relationships involving BlackRock and Exxon. First, BlackRock directors and officers ("D&Os")'s fiduciary duties to BlackRock as a corporation, and to BlackRock shareholders. Second, BlackRock's fiduciary duties as an investment adviser to each of its funds and to the investors in those funds ("fund investors"). Third, BlackRock's potential fiduciary duties, as a major shareholder of Exxon, to the other shareholders of Exxon. Fourth, the fiduciary duties of Exxon D&Os, who are asked to implement the emissions reduction, to Exxon and its shareholders.

If BlackRock pressured Exxon to reduce its carbon emissions at the expense of Exxon stock value in order to benefit BlackRock's institutional portfolio,[18] BlackRock would make the following tradeoff: it would accept a loss in Exxon (and possibly in other oil companies it holds) in order to make a greater gain in other companies. But even if BlackRock shareholders benefitted from such tradeoff, many fund investors and many shareholders of Exxon (and other oil companies) would not. This creates a problem for BlackRock, who must act in the interest of all fund investors, and for Exxon D&Os, who cannot favor the specific interests of some Exxon shareholders to the detriment of others.

Is there a way out of this deadlock? I will argue that the fiduciary deadlock is avoided in three distinct scenarios: (1) convergence, (2) prioritization, or (3) specialization. If the interests of all relevant beneficiaries (BlackRock shareholders, Exxon shareholders, fund investors) converge toward the same social goal (emissions reduction), then there is no deadlock, and BlackRock

17 Investment stewardship encompasses the actions taken by investment managers to promote specific practices by their portfolio companies. It includes the monitoring of portfolio companies, the formal exercise of the voting rights attached to the companies' shares, the submission of shareholder proposals, and informal engagement with management. *See* Barbara Novick, Michelle Edkins & Tom Clark, *The Investment Stewardship Ecosystem*, HARV. L. SCH. F. ON CORP. GOVERNANCE (July 24, 2018), https://corpgov.law.harvard.edu/2018/07/24/the-investment-stewardship-ecosystem [https://perma.cc/TB6N-DUK6] (describing Blackrock's approach to investment stewardship); Lucian A. Bebchuk & Scott Hirst, *Index Funds and the Future of Corporate Governance: Theory, Evidence, and Policy*, 119 COLUM. L. REV. 2029, 2044-46 (2019).

18 As I will discuss in Part II, BlackRock advises hundreds of funds, each with a different investment portfolio. It is not always clear whether portfolio primacy advocates the maximization of each fund's portfolio, independently, or the maximization of the aggregate value of the portfolios managed by the same institutions. I will refer to the former as a "fund portfolio" and to the latter as the "institutional portfolio."

and Exxon D&Os can implement the emissions reduction without violating their fiduciary duties (interest convergence). But if the interests of the relevant beneficiaries do not converge (and may not legally be presumed to converge), then all the conflicting interests must be ordered according to legal priority, so that some interests are satisfied at the expense of others (interest prioritization).

I will argue that BlackRock and Exxon D&Os cannot possibly ascertain the actual preferences of all relevant beneficiaries and may not legally presume that their interests converge. In fact, it is reasonable to suppose that the interests of some classes of beneficiaries do conflict, and the resulting conflicts must be resolved by prioritizing some interests over others.

I will also show, however, that not all conflicting interests can be ordered according to legal priority. The structural hierarchy of corporate law dictates the prevalence of the fund investors' interests over the conflicting interests of Exxon shareholders. However, the interests of the fund investors (from the perspective of BlackRock D&Os) and the interests of Exxon shareholders (from the perspective of Exxon D&Os) have equal ranking and therefore must receive equal priority. Since these beneficiaries are likely to have conflicting interests, prioritization does not solve the fiduciary deadlock.

This leaves us with what I call "interest specialization": conflicting interests may coexist as long as the relevant fiduciaries operate on a "specialized," single-entity basis and therefore disregard the portfolio-wide approach. Thus, BlackRock D&Os must make tailor-made stewardship decisions for each investment fund and cannot take an institution-wide approach to the emissions reduction. At the same time, Exxon D&Os must make business decisions with exclusive regard to Exxon, without taking into account the other companies in which Exxon shareholders have invested. Specialization solves the deadlock but renders portfolio primacy ineffective and unable to pursue an ambitious social and environmental agenda.

This Essay is organized as follows: Part I discusses the potential significance of BlackRock's investment stewardship and the aspirations of portfolio primacy. Part II introduces our Exxon hypothetical and analyzes why portfolio primacy creates a fiduciary deadlock. Part III discusses the ways in which the fiduciary deadlock can be avoided and why the only solution to the deadlock renders portfolio primacy ineffective. The conclusion summarizes the implications of the analysis for the environmental, social, and governance (ESG) debate.

I. INVESTMENT STEWARDSHIP AND PORTFOLIO PRIMACY

BlackRock is the world's largest asset manager.[19] It advises mutual funds, exchange traded funds, and other investment vehicles, for a total of over $10 trillion of assets.[20] Its funds invest in thousands of companies and each year its stewardship team meets with more than 2,000 portfolio companies to discuss business, governance, social, and environmental issues.[21] BlackRock votes in more than 17,000 shareholder meetings and on more than 164,000 management and shareholder proposals, including proposals on director elections, executive compensation, and social and environmental issues.[22] BlackRock is also one of the largest—if not the largest—shareholders in many major U.S. companies, owning about seven percent of the shares of S&P 500 companies.[23] How BlackRock exercises such a vast shareholder power is a matter of great economic and political importance, and a reason of concern or hope for many commentators.[24]

Over the years, BlackRock has developed stewardship guidelines disclosing the principles followed by the firm in engaging with portfolio

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19 *See* Richard Henderson, *Blackrock Attracts Record Inflows as Stock Markets Soar*, FIN. TIMES (Jan. 15, 2020), https://www.ft.com/content/1d727e02-3786-11ea-a6d3-9a26f8c3cba4 [https://perma.cc/92G3-7UGB] ("BlackRock attracted a record amount of money from investors last year, as the bull market in stocks and bonds cemented its status as the world's largest asset manager.").

20 *See* BlackRock, Inc., 2021 Annual Report (Form 10-K) 2 (Feb. 25, 2022) (reporting a total of assets under management, as of December 31, 2021, equal to $10,010,143 million).

21 BLACKROCK, INC., 2021 INVESTMENT STEWARDSHIP ANNUAL REPORT 57-58 (2022), https://www.blackrock.com/corporate/literature/publication/annual-stewardship-report-2021.pdf [https://perma.cc/C4BT-J46L].

22 *Id.* at 59-60.

23 Lorraine Woellert & Catherine Boudreau, *Blackrock Throws Its Weight Around*, POLITICO (July 20, 2021, 12:09 PM), https://www.politico.com/newsletters/the-long-game/2021/07/20/blackrock-throws-its-weight-around-493653 [https://perma.cc/53PR-58B3].

24 For discussions of potential risks and problems posed by the growing concentration of equity ownership in the hands of a few large index fund managers, including BlackRock, see generally Lucian A. Bebchuk, Alma Cohen & Scott Hirst, *The Agency Problems of Institutional Investors*, 31 J. ECON. PERSPS. 89 (2017) for a discussion of corporate governance problems; John C. Coates IV, *The Future of Corporate Governance Part I: The Problem of Twelve* 13-19 (Harv. L. Sch. Pub. L. Working Paper No. 19-07, 2019), https://ssrn.com/abstract=3247337 [https://perma.cc/FS27-A6M6] for a discussion of the excessive concentration of power and consequent political issues; José Azar, Martin Schmalz & Isabel Tecu, *Anticompetitive Effects of Common Ownership*, 73 J. FIN. 1513, 1538-39 (2018) for a discussion of the effects of concentrated ownership in the airline industry on ticket prices; Einer Elhauge, *Horizontal Shareholding*, 129 HARV. L. REV. 1267, 1316-17 (2016) for a discussion of antitrust implications from horizontal stock acquisitions; Itzhak Ben-David, Francesco Franzoni, Rabih Moussawi & John Sedunov, *The Granular Nature of Large Institutional Investors*, 67 MGMT. SCI. 6629, 6653 (2021) for a discussion of the risk of increased volatility in stock prices as a result of institutional ownership; and Holger Spamann, *Indirect Investor Protection: The Investment Ecosystem and Its Legal Underpinnings*, 14 J.L. ANALYSIS 16 (2022) for a discussion of the risk of weakened "indirect investor protection."

companies and exercising its voting rights.[25] Among other things, these guidelines express BlackRock's concern for social and environmental issues such as climate change, sustainable use of natural resources, workforce diversity, reduction of inequalities, and human rights.

However, BlackRock is quite clear that its concern for social and environmental issues is merely instrumental as a means to maximize the value of portfolio companies, not as an end in itself. The recurring theme throughout these guidelines is that BlackRock cares about social and environmental issues because these issues can affect the share value of individual portfolio companies.

For example, BlackRock argues that "companies are best placed to deliver value for shareholders when they also consider the interests of their other key stakeholders";[26] that "climate change has become a critical factor in companies' long-term profitability";[27] and that "[f]ailure to address human rights-related risks can reverberate across a company's entire value chain" and "impact shareholder value."[28]

Despite the score of references to climate risk, human rights, gender equality, and other social problems, BlackRock's stewardship approach sits firmly within the mainstream shareholder primacy paradigm, according to which corporations should maximize shareholder value. In other words, BlackRock states that it cares about social and environmental issues only

25 *See, e.g.*, BLACKROCK, INC., BLACKROCK INVESTMENT STEWARDSHIP: ENGAGEMENT PRIORITIES 3 (Feb. 2022), https://www.blackrock.com/corporate/literature/publication/blk-stewardship-priorities-final.pdf [https://perma.cc/KTU2-HA6W] (explaining how engagement improves understanding of business risk and opportunities and informs voting decisions); BLACKROCK, INC., BLACKROCK INVESTMENT STEWARDSHIP: GLOBAL PRINCIPLES 3-4 (Feb. 2022), https://www.blackrock.com/corporate/literature/fact-sheet/blk-responsible-investment-engprinciples-global.pdf [https://perma.cc/K7GP-UNTF] (expressing belief in certain fundamental rights for shareholders); BlackRock, Inc., OUR APPROACH TO ENGAGEMENT WITH COMPANIES ON THEIR HUMAN RIGHTS IMPACTS 1 (Feb. 2022), https://www.blackrock.com/corporate/literature/publication/blk-commentary-engagement-on-human-rights.pdf [https://perma.cc/P2WT-3ZV2] (recognizing need to implement processes to identify, manage, and prevent adverse human rights impacts); BlackRock, Inc., CLIMATE RISK AND THE GLOBAL ENERGY TRANSITION 1 (Feb. 2022), https://www.blackrock.com/corporate/literature/publication/blk-commentary-climate-risk-and-energy-transition.pdf [https://perma.cc/D7HL-76CA] (discussing long-term strategies in transition to a low-carbon economy).

26 BLACKROCK, INC., OUR APPROACH TO ENGAGEMENT WITH COMPANIES ON THEIR HUMAN RIGHTS IMPACTS, *supra* note 25, at 1.

27 BLACKROCK, INC., CLIMATE RISK AND THE GLOBAL ENERGY TRANSITION, *supra* note 25, at 2.

28 BLACKROCK, INC., OUR APPROACH TO ENGAGEMENT WITH COMPANIES ON THEIR HUMAN RIGHTS IMPACTS, *supra* note 25, at 3.

insofar as these issues may affect profits and the value of individual portfolio companies.[29]

Portfolio primacy seeks to change this approach by requiring investors, such as BlackRock, to push individual companies to reduce their social and environmental externalities, not only when doing so is instrumentally beneficial for shareholder value, but even when it comes at the expense of shareholder value. The TSC Proposal is an emblematic application of this theory. In its exact words:

> [S]hareholders ask that, to the extent practicable, consistent with fiduciary duties, and otherwise legally and contractually permissible, the Company adopt stewardship practices designed to curtail corporate activities that externalize social and environmental costs that are likely to decrease the returns of portfolios that are diversified in accordance with portfolio theory, even if such curtailment could decrease returns at the externalizing company.[30]

The above is a pointed formulation of the portfolio primacy theory.[31] Portfolio primacy theory begins with the recognition that companies impose costs on society through "harmful emissions, resource depletion, and the instability and lost opportunities caused by inequality."[32] Because companies profit from the activities that generate these costs, forcing individual companies to reduce these social costs means hurting the value of these companies. Therefore, at the individual company level, reducing social costs is financially unsound. However, diversified investors such as index funds are mostly interested in how the market does as a whole, rather than in the performance of individual companies. As a result, these investors seek to maximize not the value of individual companies but the value of their entire portfolio.

Large asset managers, in particular, invest broadly across many industries and countries; therefore, the argument goes, they have strong financial incentives to address systemic risks that threaten the global economy, even at the expense of some individual portfolio companies. According to this view, BlackRock should not merely address social and environmental costs and risks that threaten the value of individual companies; it should also address the costs and risks that these companies impose on other companies and sectors

29 For a discussion of such instrumental conception of corporate social responsibility, also known as "enlightened shareholder value," see generally Lucian A. Bebchuk, Kobi Kastiel & Roberto Tallarita, *Does Enlightened Shareholder Value Add Value?*, 77 BUS. LAW. 731 (2022).

30 BlackRock NAL, *supra* note 3, at *1.

31 *See generally* Tallarita, *supra* note 10.

32 BlackRock NAL, *supra* note 3, at *13.

of the economy, because these costs and risks are internalized within BlackRock's "universal" portfolio.

In promoting the TSC Proposal, TSC has an explicit goal: harnessing the power of large asset managers to address climate risk and other pressing social problems.[33] This is not a financial goal, but rather a social and political one. However, the portfolio primacy framework that TSC adopts relies entirely on a financial rationale, because reducing social and environmental externalities is, according to this theory, financially beneficial to the broadly diversified portfolios of asset managers. According to portfolio primacy, for example, BlackRock should pressure major carbon emitters to cut their emissions, even if this would hurt the emitters' value, because the consequent climate-related benefits for all the other portfolio companies would net BlackRock a profit.

While the implicit and explicit assumptions of the portfolio primacy theory are not as straightforward and compelling as their supporters make them to be,[34] here I am concerned with a narrower but crucial question. Suppose that aggressive social and environmental stewardship at the expense of some portfolio companies would indeed be profitable for large asset managers: How does fiduciary law shape asset managers' stewardship, and what does this mean for portfolio primacy and the corporate sustainability agenda? I will address these questions in the following Parts.

II. A WEB OF FIDUCIARY RELATIONSHIPS

A. *A Motivating Hypothetical*

The fiduciary issues raised by portfolio primacy are many and complicated. To make the analysis less abstract and more easily intelligible, I will focus on a concrete scenario in which BlackRock D&Os must decide whether to push Exxon, one of the major carbon emitters in the world,[35] to reduce its carbon emissions at the expense of Exxon's own market value, on the grounds that the emissions reduction, although financially harmful for Exxon, would be beneficial for the global stock market as a whole. Similarly,

33 *See* S'HOLDER COMMONS, *supra* note 11.

34 *See generally* Tallarita, *supra* note 10.

35 Paul Griffin, CDP CARBON MAJORS REPORT 8 (2017), https://climateaccountability.org/pdf/CarbonMajorsRpt2017%20Jul17.pdf [https://perma.cc/X7VG-MTZA] (stating that the "highest emitting companies since 1968 that are investor-owned include: ExxonnMobil . . .")

if BlackRock decides to push for the emissions reduction, Exxon D&Os will have to decide whether to implement such reduction.[36]

To examine the fiduciary implications of this hypothetical, we must first identify the various "players," then agree on a working definition of the scope of the fiduciary duty of loyalty that is consistent with the portfolio primacy theory, and finally examine whether the implementation of the Exxon emissions reduction would be compatible with the relevant fiduciary relationships.

B. *The Players*

Let us first introduce the "players" of our Exxon hypothetical. First, there is Exxon, a publicly traded company in the oil industry. Exxon is a New Jersey corporation,[37] but I will also consider what would change if Exxon were incorporated in Delaware, the jurisdiction of choice of most U.S. public companies.

Then, there is BlackRock, a publicly traded company in the financial services industry. With 4.6% of the outstanding shares, BlackRock is the third largest shareholder of Exxon.[38] However, BlackRock does not own Exxon stock directly or for itself. Several subsidiaries and affiliates of BlackRock—including BlackRock Fund Advisers, BlackRock Financial Management, Inc., BlackRock Investment Management LLC, and many others—serve as investment advisers of mutual funds and exchange traded funds which own Exxon stock. These funds are owned by institutional and retail investors.[39]

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36 This paradigmatic application of portfolio primacy is used also by Madison Condon in her compelling defense of portfolio primacy, and by Marcel Kahan and Edward Rock in their critique of portfolio primacy. *See* Condon, *supra* note 10, at 45-47; Kahan & Rock, *supra* note 10, at 6-11. I analyze more broadly the incentives of BlackRock, State Street and Vanguard (the so-called "Big Three") as advisers of index funds investing in Exxon in Tallarita, *The Limits of Portfolio Primacy*, *supra* note 10, at 558-563.

Note that some might claim that decarbonization would benefit Exxon itself, at least in the long run, for example, because regulation and changes in consumer preferences will result in a transition of the economy away from fossil fuels. This is, however, an argument based on traditional firm value maximization and is not relevant for the analysis presented here.

37 Exxon Mobil Corp., Restated Certificate of Incorporation (June 20, 2001).

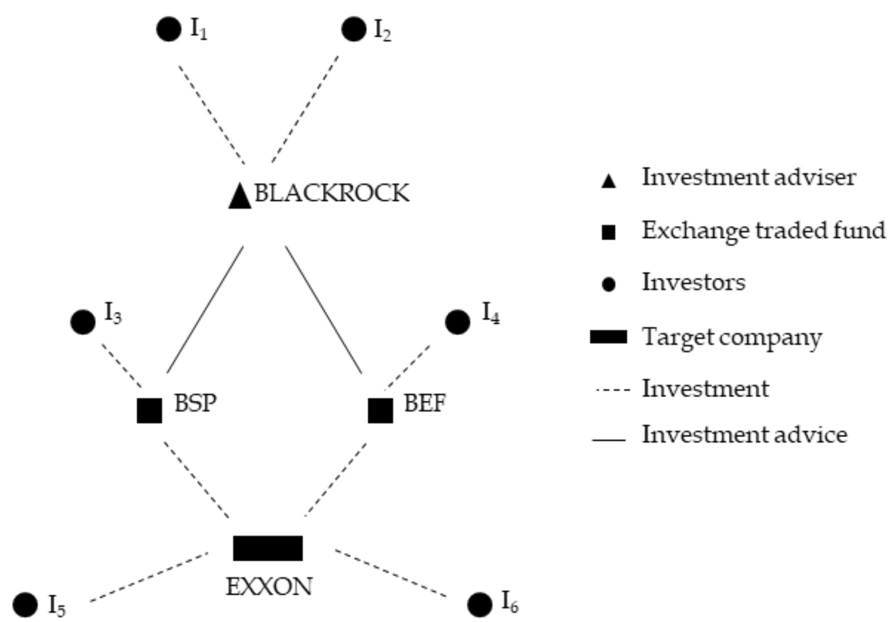
38 All stock ownership data used in this Essay were collected from the FactSet Ownership database on April 30, 2022.

39 Some of the most important clients of BlackRock and other asset managers are pension plans, whose managers have strict fiduciary duties toward plan members who are saving for retirement. An argument can be made that pension plan managers have a duty to monitor the investment manager's decision to make sure that they are consistent with the interests of the plan members. This Essay will ignore this further layer of fiduciary relationships, which would make the implementation of portfolio primacy even more complicated. For a discussion of this aspect, see generally 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 (2020) and

There are 170 funds advised by BlackRock affiliates that hold shares in Exxon. For simplicity, I will consider two of the funds with the largest stakes: iShares Core S&P 500 ETF (BlackRock SP500), an exchange traded fund (ETF) tracking the S&P 500 index, and iShares U.S. Energy ETF (BlackRock Energy), which invests in U.S. energy companies. Taken together, these two funds account for thirty percent of BlackRock's equity stake in Exxon. The conclusions of my analysis would not materially change if we also considered the other 168 funds.

Finally, there are the other Exxon shareholders: other mutual funds and ETFs (25%), other large institutional investors (24%), company insiders (0.2%), and retail investors and small institutions (46%). Figure 1 shows a stylized illustration of the relationships among these players. BlackRock is owned by its shareholders (I_1, I_2) and is the investment adviser of funds BlackRock SP500 (BSP) and BlackRock Energy (BEF), which in turn are owned by fund investors (I_3, I_4). BlackRock SP500, BlackRock Energy, and other shareholders (I_5, I_6) own stock in Exxon.

Figure 1: The BlackRock-Exxon Hypothetical



Bernard S. Sharfman, *The Conflict between BlackRock's Shareholder Activism and ERISA's Fiduciary Duties*, 71 CASE W. RSRV. L. REV. 1241 (2021).

C. *Fiduciary Duty*

A web of fiduciary relationships connects our "players." The most relevant for our analysis are the following four relationships: (1) between BlackRock D&Os and BlackRock shareholders; (2) between BlackRock and the investors in BlackRock SP500 and BlackRock Energy; (3) between BlackRock and the other Exxon shareholders; and (4) between Exxon D&Os and Exxon shareholders. These fiduciary relationships are of different sorts: some are relationships between directors and the corporation in which they serve (and its shareholders) under state corporate law, others are relationships between investment adviser and investment funds (and fund investors) under federal investment law, and others are relationships among shareholders under state corporate law.

Although the precise scope of these fiduciary relationships is not always unambiguous,[40] the core fiduciary duty that is relevant for our discussion is fairly well-defined and uncontroversial. We can call it the "duty to act in the financial interest of the beneficiary." There is a time-honored debate in corporate law around whether directors' fiduciary duties are owed only to shareholders or also to other corporate constituencies,[41] and a distinct, and more recent, debate around whether acting in the interest of shareholders means acting only in accordance with their financial preferences or also in accordance with their social and moral preferences.[42] However, portfolio primacy does not require to reach and solve these controversial questions.

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40 *See, e.g.*, Julian Velasco, *Fiduciary Principles in Corporate Law*, *in* THE OXFORD HANDBOOK OF FIDUCIARY LAW 61, 61 (Evan J. Criddle, Paul B. Miller, & Robert H. Sitkoff eds., 2019) ("Fiduciary duty in corporate law . . . is riddled with significant tensions.").

41 For an overview of this debate, and references to recent literature, see generally Lucian A. Bebchuk & Roberto Tallarita, *The Illusory Promise of Stakeholder Governance* 106 CORNELL L. REV. 91 (2020); Edward B. Rock, *For Whom Is the Corporation Managed in 2020? The Debate over Corporate Purpose*, 76 BUS. LAW. 363 (2021); 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 (2021); Jill E. Fisch & Steven Davidoff Solomon, *Should Corporations Have a Purpose?*, 99 TEX. L. REV. 1309 (2021); Stavros Gadinis & Amelia Miazad, *Corporate Law and Social Risk*, 73 VAND. L. REV. 1401 (2020).

Some states explicitly authorize directors to take into account the interests of stakeholders when evaluating an acquisition offer or, in some cases, when making all kinds of business decisions (so called "constituency statutes"). *See* Lucian A. Bebchuk, Kobi Kastiel & Roberto Tallarita, *For Whom Corporate Leaders Bargain*, 94 S. CAL. L. REV. 1467, 1485-95 (2022). New Jersey, the state of incorporation of Exxon, has adopted a constituency statute. I will discuss this in subsection I.D.4.

42 Some authors have compellingly argued that corporate management should maximize shareholder welfare, which includes their prosocial preferences, not just shareholder value. *See* Oliver Hart & Luigi Zingales, *The New Corporate Governance*, 1 U. CHI. BUS. L. REV. 195 (2022); Oliver Hart & Luigi Zingales, *Companies Should Maximize Shareholder Welfare Not Market Value*, 2 J.L. FIN. & ACCT. 247, 250 (2017) ("The ultimate shareholders of a company (in the case of institutional investors, those who invest in the institutions) are ordinary people who in their daily lives are concerned about money, but not just about money. They have ethical and social concerns.").

Indeed, the theory is entirely based on the financial interests of investors, not on altruistic motives or stakeholder welfare. Therefore, in order to work, portfolio primacy must be compatible with the basic, uncontroversial core of the fiduciary duty of loyalty: that the fiduciary must act in accordance with the financial interests of the beneficiary.

More expansive and controversial definitions of fiduciary duties could complicate our analysis in some respects, and I will note some of these complications. In general, however, I will focus on the basic "duty to act in the financial interest of the beneficiary."

D. *Fiduciary Relationships*

To begin the analysis, let us examine the four fiduciary relationships that are most relevant in the Exxon hypothetical and assess whether the emissions reduction seems compatible, prima facie, with the duties of the fiduciaries in those relationships.

1. BlackRock D&Os and BlackRock Shareholders

Both BlackRock, Inc., the publicly traded parent company that heads the BlackRock group and received the TSC Proposal, and BlackRock Fund Advisors, the BlackRock subsidiary managing and advising BlackRock SP500 and BlackRock Energy, are corporations, incorporated in Delaware or California.[43] Therefore, the respective D&Os owe fiduciary duties to the corporation and its shareholders.[44]

Portfolio primacy argues that pushing Exxon to reduce its emissions would ultimately benefit BlackRock shareholders financially.[45] Indeed, the assumption behind portfolio primacy is that even if Exxon's stock value would suffer, the stock value of other companies—which bear the costs of Exxon's carbon emissions—would benefit from the emissions reduction. Therefore, if we accept this assumption, it seems reasonable to conclude that the fiduciary duties of BlackRock D&Os to BlackRock shareholders would require pushing

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43 *See* BlackRock, Inc., Amended and Restated Certificate of Incorporation, filed as Exhibit 3.1 to the Current Report (Form 8-K) (May 28, 2021); iShares Trust, 2022 Annual Report for iShares Core S&P 500 ETF 134 (Mar. 31, 2022).

44 Under Delaware law, directors owe fiduciary duties "to the corporation and its stockholders." Arnold v. Soc'y for Sav. Bancorp, Inc., 678 A.2d 533, 539 (Del. 1996). Officers of the corporation "owe fiduciary duties that are identical to those owed by corporate directors." Gantler v. Stephens, 965 A.2d 695, 708 (Del. 2009). Under California law, a director must perform their duties "in a manner such director believes to be in the best interests of the corporation and its shareholders." CAL. CORP. CODE § 309 (West 2023).

45 BlackRock could profit either through an increase of value of the fund portfolios or through an increase of the flows of funds invested in BlackRock funds.

for the emissions reduction.[46] Indeed, part of the theoretical appeal of portfolio primacy is precisely that the theory is entirely based on the financial interests of asset managers rather than on a desire to improve the world, which some regard as less realistic and therefore less reliable than relying on financial motives.

2. BlackRock and Fund Investors

As BlackRock decisionmakers, however, BlackRock D&Os must also comply with BlackRock's fiduciary duties as investment adviser to BlackRock SP500 and BlackRock Energy. Like many ETFs, BlackRock SP500 and BlackRock Energy are organized as Delaware statutory trusts. In particular, they are two different series or portfolios of iShare Trust,[47] which is a management investment company registered with the SEC under the Investment Company Act of 1940.[48] Investment companies collect money from public investors and invest it in stock, bonds, and other securities.[49]

iShares Trust is governed by a board of trustees;[50] however, all investment decisions regarding its portfolios, including BlackRock SP500 and BlackRock Energy, are delegated to BlackRock Fund Advisors under an investment advisory agreement.[51] This is a typical governance feature of mutual funds and ETFs: funds are separate legal entities—usually corporations, common law trusts, or statutory trusts[52]—with their own governing bodies (board of

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46 An important caveat to this conclusion, however, is that BlackRock D&Os cannot pursue profits by violating the law. A knowing violation of the law would be a breach of their fiduciary duties to the corporation. See, e.g., Desimone v. Barrows, 924 A. 2d 908, 934-35 (Del. Ch. 2007) ("[B]y consciously causing the corporation to violate the law, a director would be disloyal to the corporation[.]"). This is another way to frame the problem raised by the fiduciary deadlock discussed in Section E.

47 *See* iShares Trust, 2022 Annual Report for iShares Core S&P 500 ETF, *supra* note 43, at 128 ("[iShare] Trust is organized as a Delaware statutory trust and is authorized to have multiple series or portfolios.").

48 *Id.*

49 Under the Investment Company Act, an investment company is "any issuer which . . . is . . . engaged primarily . . . in the business of investing, reinvesting, or trading in securities." Investment Company Act § 3(a)(1)(A); 15 U.S.C. § 80a-3(a)(1)(A).

50 *See* iShares Trust, 2022 Annual Report for iShares Core S&P 500 ETF, *supra* note 43, at 146 ("The Board of Trustees has responsibility for the overall management and operations of the Funds, including general supervision of the duties performed by [BlackRock Fund Advisors] and other service providers.").

51 *Id*. at 134; iShares Trust, 2022 Annual Report of iShares U.S. Energy ETF 63 (Apr. 30, 2022). For a discussion of mutual fund governance and the problem of "separation of funds and managers," see John Morley, *The Separation of Funds and Managers: A Theory of Investment Fund Structure and Regulation*, 123 YALE L.J. 1228 (2014).

52 See Eric D. Roiter, *Disentangling Mutual Fund Governance from Corporate Governance*, 6 HARV. BUS. L. REV. 1, 62-63 (2016).

directors or trustees), but the actual management is delegated to an investment adviser registered under the Investment Advisers Act of 1940.[53]

More than 100 million Americans have savings invested in mutual funds and almost twelve million U.S. households own ETFs.[54] The people managing this money owe strict fiduciary duties to the fund investors.[55] In theory, there are two different layers of fiduciary duties owed to fund investors: by the fund trustees and by the investment adviser. In our hypothetical, both the trustees of iShares Trust and BlackRock have fiduciary duties to fund investors.[56] In practice, however, the duties of the fund trustees are limited to monitoring what the investment adviser does. It is BlackRock, in its capacity as investment adviser, that makes investment stewardship decisions concerning the funds.

The SEC has made it clear that investment advisers must act "in a manner consistent with the best interests of the fund and its shareholders,"[57] and that such duty applies to "all aspects of investment management, including voting."[58] By logical extension, fiduciary duties also apply to other stewardship decisions, such as the approval of voting guidelines, the monitoring of portfolio companies, the engagement with corporate management, and so forth.[59]

Among the various facets of the fiduciary "duty to act in the financial interest of the beneficiaries," the most important for our purposes is the prescription to avoid conflicts of interests.[60] Protection of investors from

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53 Investment Advisers Act of 1940 § 3; 15 U.S.C. § 80b-3.

54 *See* INVESTMENT COMPANY INSTITUTE, 2021 INVESTMENT COMPANY FACTBOOK 64, 113 (2021), https://www.ici.org/system/files/2021-05/2021_factbook.pdf [https://perma.cc/HY4H-56PY].

55 For a discussion of fiduciary duties in mutual funds, see generally Deborah A. DeMott, *Fiduciary Contours: Perspectives on Mutual Funds and Private Funds*, *in* RESEARCH HANDBOOK ON THE REGULATION OF MUTUAL FUNDS 57-77(William A. Birdthistle & John Morley eds., 2018).

56 Strictly speaking, it's BlackRock Fund Advisors, not BlackRock, Inc., which owes fiduciary duties to the funds and their investors. For our purposes, this further complication is not very relevant, and I will disregard it.

57 Disclosure of Proxy Voting Policies and Proxy Voting Records by Registered Management Investment Companies, Securities Act Release No. 8188 (68 Fed. Reg. 6564, 6574) (Feb. 7, 2003) (codified at 17 C.F.R. pts. 239, 249, 270, 274).

58 SEC. & EXCH. COMM'N, DIVISION OF CORPORATION FINANCE, STAFF REPORT ON CORPORATE ACCOUNTABILITY (Sept. 4, 1980) (printed for the use of Senate Comm. on Banking, Housing and Urban Affairs, 96th Cong., 2d Sess.), at 391.

59 For an overview of the various stewardship activities typically performed by large asset managers, see generally Bebchuk & Hirst, *supra* note 17, at 2044-46.

60 On the fiduciary duty of loyalty, see generally Paul B. Miller, *Dimensions of Fiduciary Loyalty*, *in* RESEARCH HANDBOOK ON FIDUCIARY LAW; Andrew S. Gold, *The Fiduciary Duty of Loyalty*, *in* THE OXFORD HANDBOOK OF FIDUCIARY LAW, *supra* note 40, at 385-403. Theorists of fiduciary law disagree on whether fiduciary loyalty is a mere negative obligation to avoid conflicts or also a positive obligation to do what is in the best interests of the beneficiaries. Lyman Johnson calls these two different aspects of fiduciary loyalty the "minimal" and the "maximum" conditions of fiduciary

conflicts of interests is one of the main goals of the Investment Advisers Act. As recognized by the U.S. Supreme Court in *SEC v. Capital Gains*, the Act "reflects . . . a congressional intent to eliminate, or at least to expose, all conflicts of interest which might incline as investment adviser—consciously or unconsciously—to render advice which was not disinterested."[61]

BlackRock may not pursue its own conflicted interests (conflicts of interests) or the conflicted interests of others, including those of other clients (conflicts of duties). This entails two main consequences. First, BlackRock may not make decisions that benefit itself at the expense of fund investors. Second, since BlackRock advises hundreds of different funds with different investment strategies, its stewardship decisions may not benefit some funds at the expense of others.[62]

In our hypothetical, the decision to push Exxon to cut its emissions might very well violate both such facets of the duty of loyalty. Consider the investors in BlackRock Energy. BlackRock Energy has $3.5 billion of assets under management, 96% of which are invested in oil production and refining, gas production, oil and gas pipelines, and oilfield services and equipment.[63] More than 60% of BlackRock Energy's portfolio is invested in Exxon, Chevron, ConocoPhillips, EOG Resources, Marathon Petroleum, Pioneer Natural Resources, Occidental Petroleum, and Schlumberger[64]—that is, the six largest U.S. oil companies and the largest offshore oil drilling company in the world.[65]

loyalty. Lyman Johnson, *After Enron: Remembering Loyalty Discourse in Corporate Law*, 28 DEL. J. CORP. L. 27, 37-38 (2003). Other conceptions of loyalty include the duty of "being true" or the duty to comply with a "hypothetical bargain" between the parties. *See, e.g.*, Andrew S. Gold, *The Loyalties of Fiduciary Law*, *in* PHILOSOPHICAL FOUNDATIONS OF FIDUCIARY LAW 176, 183-188 (Andrew S. Gold & Paul B. Miller eds., 2014). We do not need to debate these questions. The fiduciary deadlock discussed in this Essay would be problematic even under the minimal conception of the duty of loyalty, which is a duty to avoid conflicts of interests and conflicts of duties.

61 Sec. & Exch. Comm'n v. Cap. Gains Rsch. Bureau, Inc., 375 U.S. 180, 191-92 (1963).

62 For a discussion of the conflicts of interests within a family of funds, see for example Sean J. Griffith & Dorothy S. Lund, *Conflicted Mutual Fund Voting in Corporate Law*, 99 B.U. L. REV. 1151, 1183-1185 (2019); Ann M. Lipton, *Family Loyalty: Mutual Fund Voting and Fiduciary Obligation*, 19 TENN. J. BUS. L. 175, 178-183 (2017); Utpal Bhattacharya, Jung H. Lee, & Veronika K. Pool, *Conflicting Family Values in Mutual Fund Families*, 68 J. FIN. 175, 178-83 (2013). For a recent discussion of the agency problem of Big Three's delegated voting authority, see Bernard S. Sharfman, *Opportunism in the Shareholder Voting and Engagement of the "Big Three" Investment Advisers to Index Funds*, 48 J. CORP. L. (forthcoming 2022).

63 Data collected from the FactSet database on April 30, 2022.

64 *Id*.

65 *See* N. Sönnichsen, *Leading Oil and Gas Companies in the United States Based on Market Capitalization as of October 2022*, STATISTA (Oct. 17, 2022), https://www.statista.com/statistics/241625/top-10-us-oil-and-gas-companies-based-on-market-value/ [https://perma.cc/9RMR-PTES] (providing an analysis of the leading oil and gas companies in the United States).

BlackRock Energy's investment objective is "to track the performance of the Russell 1000 Energy RIC 22.5/45 Capped Index . . . which measures the performance of the energy sector of the U.S. equity market . . . ."[66] The fund prospectus warns investors that one major risk affecting the return on their investment regards "the success of companies in the energy sector."[67]

Given these facts, can we establish that the interests of BlackRock Energy investors-investors who deliberately chose to bet on the success of oil and gas companies—are consistent with the decision of BlackRock to cut oil companies' emissions at the expense of these companies' value? It seems implausible.

If the rationale for the emissions reduction is that other BlackRock funds, such as BlackRock SP500, will make a profit as a result of the reduction in climate damage, BlackRock is making a decision that benefits some funds (BlackRock SP500) at the expense of other funds (BlackRock Energy). Furthermore, if the emissions reduction produces a net gain for BlackRock itself because it increases the aggregate value of its management fees, BlackRock is making a decision for its own advantage and the advantage of its own shareholders, at the expense of some fund investors, namely the investors in BlackRock Energy. Either way, pushing for the emissions reduction is likely to violate BlackRock's duty of loyalty to fund investors.

3. BlackRock and Exxon Shareholders

a. *The Interests of Exxon Shareholders*

What about the interests of the other Exxon shareholders? Table 1 reports some data on the composition of Exxon shareholders, collected from FactSet Ownership. The twenty-five largest shareholders are mutual funds and ETFs. Many of them are funds tracking the S&P 500 Index, the CRSP US Total Market Index, or other broad-based indices. One can make a plausible argument that if BlackRock forces Exxon to cut its emissions for the benefit of the whole economy, these broad-based funds will benefit in the aggregate, even if they lose on their Exxon investment. In reality, the empirics of portfolio primacy are less straightforward than this simple intuition suggests, and under plausible conditions carbon mitigation decisions that are socially desirable might very well result in a net loss for the S&P 500 or other broad-based indices.[68] For our purposes, however, I will assume that Exxon's emissions reduction would result in a net gain for broad-based funds, which will have a financial interest to support it.

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66 iShares Trust, 2021 Prospectus of iShares Core S&P 500 ETF S-2 (Aug. 1, 2022), at S-2.

67 *Id.* at 18.

68 For a discussion of this issue, see Tallarita, *supra* note 10, at 24-26.

Table 1: Exxon Shareholders

SHAREHOLDERS	EXXON STOCK
25 Largest Shareholders	17%
- *Broad-Based Funds*	*11%*
- *Energy Funds*	*3%*
- *Value/High-Dividend/ Large Cap Funds*	*3%*
Other Mutual Funds and ETFs	10%
Other Investment Managers	20%
Pension Funds	2%
Private banking / Wealth Management	2%
Large Hedge Funds	1%
Exxon Management	<1%
Other Large Institutions	2%
Retail and Small Institutions	46%

The same is not true, however, for many other Exxon shareholders. To begin with, many mutual funds and ETFs are overexposed to oil and gas companies, and benefit from an increase in the stock value of these companies. This group includes funds focused on the energy sector, such as BlackRock Energy, which invests almost all its assets in oil and gas companies, but also multi-industry funds with particular investment styles, such as high-dividend funds, value funds, and large-cap funds, in which oil and gas companies are overrepresented. For example, whereas oil and gas companies account for about 4% of Vanguard Total Stock Market, an index fund mirroring the industry composition of the whole U.S. stock market, they account for about 19% of Goldman Sachs International Opportunities and 97% of Vanguard Energy.[69] For these funds, which are shareholders of Exxon, sacrificing the value of energy companies for the benefit of the stock market as a whole is unlikely to be financially profitable.

Furthermore, a nontrivial fraction of Exxon stock is owned by hedge funds, which pick specific companies to beat the market, rather than owning a fully diversified portfolio to mirror the market. For these shareholders, just like for energy-focused funds, an emissions reduction would plausibly result in a loss.

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[69] Data collected from the FactSet Ownership database on April 30, 2022, a few weeks before the annual meeting of BlackRock voting on the TSC Proposal.

Finally, about 46% of Exxon stock is owned by investors with no duty to disclose their identity. This includes small institutional investors and retail investors, who dominate Exxon stock ownership.[70] Retail investors invest their savings directly in the companies of their own choosing, rather than buying shares in a mutual fund and delegating the investment decisions to a management company. The protection of retail investors is one of the uppermost concerns for the securities regulator,[71] and a retail investor buying Exxon stock is presumably interested in seeing the value of Exxon increasing, not decreasing.

From the above analysis, it seems clear that the emissions reduction would run against the interests of various categories of Exxon shareholders, owning in aggregate a significant fraction, and perhaps even a majority, of Exxon stock. Then, the question is whether BlackRock owes any fiduciary duties to these shareholders, and whether, in making its stewardship decisions, it must give due regard to their interests.

b. *The Question of Control*

As a general principle of corporate law, shareholders do not have fiduciary duties to one another. They may freely pursue their own individual interest, even if it is in conflict with the interests of other shareholders.[72] A "controlling shareholder," however, is in a very different position.[73] It owes fiduciary duties to noncontrolling shareholders, and therefore cannot take advantage of its dominant position at the expense of the other shareholders.

Delaware law recognizes two types of controlling shareholders: majority shareholders, who own a majority of stock and therefore are formally able to appoint directors and unilaterally determine shareholder decisions, and minority controlling shareholders, who own a minority stake but nonetheless control the corporation.[74] Delaware courts have held that "there is no absolute percentage of voting power that is required in order for there to be a finding

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70 *See* Michael Boyd, *Exxon Mobil Stock: Retail Investors Are Coming Back*, SEEKING ALPHA (Sept. 8, 2021, 4:23 PM), https://seekingalpha.com/article/4454115-exxon-mobil-retail-investors-are-coming-back [https://perma.cc/T3VZ-M4DS] ("Exxon Mobil ownership is dominated by retail investors . . . .").

71 See, e.g., Donald C. Langevoort, *The SEC, Retail Investors, and the Institutionalization of the Securities Markets*, 95 VA. L. REV. 1025, 1025 (2009) ("[T]hroughout the SEC's history and culture, the rhetorical stress has been on the plight of average investors, ones who lack investing experience and sophistication so as to need the protection of the securities laws.").

72 *See, e.g.*, In re Franchise Servs. of N. Am., Inc. v. U.S. Trustee, 891 F.3d 198, 211 (5th Cir. 2018) ("Under Delaware law, a shareholder is generally free to act in its self-interest, unencumbered by any fiduciary obligation.").

73 *Id.*

74 *See id.* (describing the distinctions between majority and minority shareholders).

that a [minority] controlling shareholder exists."[75] The test to establish the existence of de facto control has been variously expressed in terms of "actual control,"[76] "coercive power" over the board,[77] the ability to control given by the combination of voting power and managerial authority,[78] and "the ability to dominate the corporate decision-making process."[79] Determining whether a minority shareholder is a controlling shareholder requires a difficult factual assessment and is impossible to codify.

Following these malleable standards, courts have found, for example, that a shareholder owning 20.6% of the stock was a controlling shareholder;[80] that a private equity firm owning 1% of the company was *not* a controlling shareholder despite the fact that the company's officers were employees of the private equity firm, because the firm did not have "the power to exact retribution by removing [the company's] directors from their offices if they did not bend to [its] will";[81] and that a 35% holding was enough to establish control at the pleading stage. As one opinion put it, "there is no magic formula."[82]

In our hypothetical, it is extremely unlikely that a court would find that BlackRock controls Exxon. There is little doubt that BlackRock is an important shareholder, and therefore, Exxon management is likely to pay considerable attention to BlackRock's preferences. However, BlackRock's equity holding is too small and its "coercive power" on the Exxon board is likely too weak for a court to conclude that BlackRock controls Exxon. If law is "the prophecies of what the courts will do in fact,"[83] then it is safe to conclude that BlackRock is not a controlling shareholder of Exxon.

Yet, the aspiration of portfolio primacy to produce significant social and environmental progress is predicated on the assumption (or, at the very least, the expectation) that BlackRock stewardship *will* influence corporate business

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75 In re PNB Holding Co. S'holders Litig., No. Civ.A. 28-N 2006 WL 2403999, at *9 (Del. Ch. Aug. 18, 2006).

76 *See In re Franchise Servs.*, 891 F.3d, at 213 (describing the test for existence of control as who has "actual control").

77 *See* In re KKR Fin. Holdings LLC S'holder Litig., 101 A.3d 980, 992 (Del. Ch. 2014) (describing control as having "coercive power" to persuade decisionmaking).

78 *See* In re Tesla Motors, Inc. S'holder Litig., No. 12711-VCS, 2020 WL 553902, at *5 (Del. Ch. Feb. 4, 2020) ("The fact that the minority blockholder's 'combination of stock voting power and managerial authority . . . *enables* him to control the corporation, if he so wishes' is what makes him a controlling stockholder.").

79 Superior Vision Servs., Inc. v. ReliaStar Life Ins. Co., No. CIV.A. 1668-N, 2006 WL 2521426, at *4 (Del. Ch. Aug. 25, 2006).

80 Traub v. Barber, 452 N.Y.S.2d 575, 575 (N.Y. App. Div. 1982).

81 *In re KKR Fin. Holdings LLC S'holder Litig.*, 101 A.3d at 995.

82 Calesa Assocs., L.P. v. Am. Cap., Ltd., No. CV 10557-VCG, 2016 WL 770251, at *11 (Del. Ch. Feb. 29, 2016).

83 Oliver Wendell Holmes, *The Path of the Law*, 10 HARV. L. REV. 457, 461 (1897).

decisions. If, for example, TSC believed that BlackRock could not successfully push at least some of its portfolio companies to reduce carbon emissions and other negative externalities, the purpose for submitting the TSC Proposal would be lost. Indeed, the core belief of portfolio primacy is that if all large asset managers asked their portfolio companies to reduce their externalities, portfolio companies will oblige due to the coercive power of large asset managers as shareholders. Therefore, the more asset managers succeed in pushing major carbon emitters to bear significant costs for the benefit of the market as a whole, the more likely it is that these asset managers are found to be minority controllers.

c. *Parallel Stewardship*

A separate question is whether all the asset managers pushing the same company to reduce its externalities should be considered as a control group. In our hypothetical, the aggregate holdings in Exxon of BlackRock, Fidelity, Geode Capital Management, Northern Trust, State Street, and Vanguard (some of the largest U.S. asset managers) are equal to 23%, similar to those of shareholders that have been found by courts to be minority controllers. Hence, the question is whether the "parallel stewardship" by these institutions—that is, the sum of identical stewardship interventions (for example, pressuring Exxon to reduce its carbon emissions) without any agreement or preordination—would be considered a form of joint control or just a spontaneous and irrelevant alignment of interests.

The question is thorny, but as the law stands now, equating parallel stewardship to joint control would be a bold, and unlikely, move for a court to make. Parallel stewardship in favor of Exxon's emission cut would be based on the recognition that each asset manager has independent financial incentives to push for the emissions reduction. There would be neither a formal contract nor an informal arrangement between the institution; by contrast, under current law, some form of legally relevant connection is a prerequisite for a controlling group.[84]

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84 *See, e.g.*, In re Crimson Expl. Inc. S'holder Litig., No. CIV.A. 8541-VCP, 2014 WL 5449419, at *15-16 (Del. Ch. Oct. 24, 2014):

Under Delaware law, in appropriate circumstances, multiple stockholders together can constitute a control group . . .[when they are] connected in some legally significant way—such as by contract, common ownership, agreement, or other arrangement—to work together toward a shared goal. The law does not require a formal written agreement, but there must be some indication of an actual agreement. Plaintiffs must allege more than mere concurrence of self-interest among certain stockholders to state a claim based on the existence of a control group (internal quotations omitted).

However, the doctrine is riddled with inconsistencies,[85] and, if portfolio primacy proved effective, the doctrinal landscape would likely need to evolve to account for the phenomenon. If the largest asset managers decided to aggressively and systematically use their shareholder power to shift corporate America from a traditional share value maximization system to a centralized control of negative externalities, it is unlikely that the current controlling shareholder doctrine would remain unaffected. The resulting paradox would be that portfolio primacy would likely raise controlling shareholder fiduciary issues precisely in the cases in which it succeeded in transforming corporate decisionmaking.

4. Exxon D&Os and Exxon Shareholders

If BlackRock's fiduciary duties to Exxon shareholders are merely potential, those of Exxon D&Os are actual. U.S. state courts have vigorously affirmed the doctrine that directors and officers owe fiduciary duties to the corporation and its shareholders.[86] Under New Jersey law, which governs the corporate fiduciary duties of Exxon, "corporate directors owe a fiduciary duty to the stockholders."[87] Therefore, if the emissions reduction harms Exxon share value and the interests of Exxon shareholders (or, at least, the interests of those shareholders that do not benefit from the portfolio primacy effect from which BlackRock benefits), it seems reasonable to conclude that the fiduciary obligation of the Exxon D&Os is to disregard BlackRock's stewardship push for the emissions reduction and continue doing business as usual.

New Jersey law authorizes directors to take into account, in addition to the interests of shareholders, the interests of other stakeholders, such as employees, suppliers, creditors, customers, and the local community.[88] The interpretation of this and other similar statutes is controversial. In particular, it is debated whether they authorize directors to act in the interest of other stakeholders only when these interests are compatible with the interests of shareholders or also when they are in conflict with them.[89]

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85 *See, e.g.*, Ann M. Lipton, *After Corwin: Down the Controlling Shareholder Rabbit Hole*, 72 VAND. L. REV. 1977, 1998 (2019) (arguing that in *Tesla*, the Delaware Chancery Court did consider the concurrent but independent interests of Tesla directors in concluding the acquisition of Solar City—because they owned Solar City stock—as a relevant factor to establish the existence of a control group).

86 *See supra* note 44.

87 Torsiello v. Strobeck, 955 F. Supp. 2d 300, 311 (D.N.J. 2013).

88 N.J. STAT. ANN. § 14A:6-1 (West 2022).

89 For a discussion of this interpretive question, see Bebchuk, Kastiel & Tallarita, *For Whom Corporate Leaders Bargain*, *supra* note 41, at 1531-32.

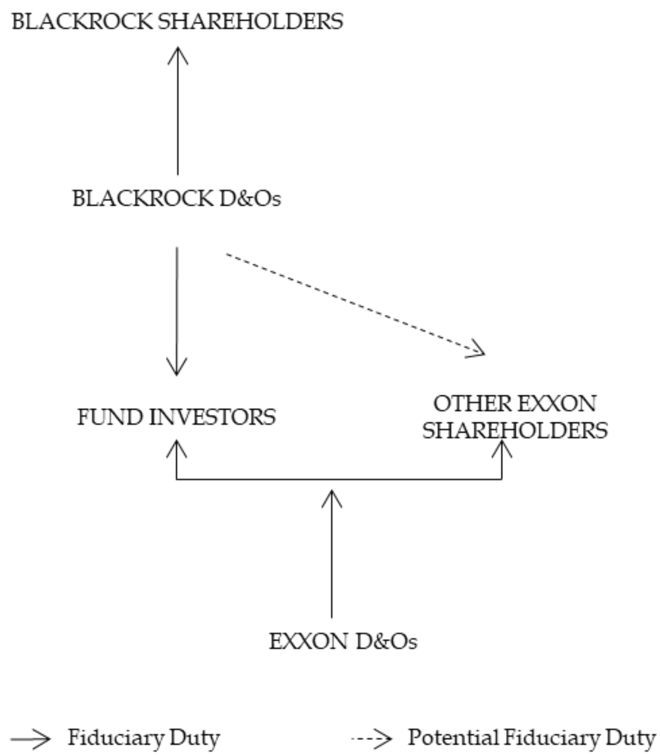
However, as discussed in Section C, *supra*, portfolio primacy does not rely on stakeholder welfare, but on shareholders' financial interests. Although a (controversial) argument can be made that Exxon D&Os have the authority to cut carbon emissions under the New Jersey constituency statute, this would be an argument based on a different theory than portfolio primacy. Without this additional theory (which, incidentally, is unlikely to apply in Delaware, where about half of the U.S. public companies are incorporated),[90] portfolio primacy would result in yet another fiduciary conflict.

E. *The Fiduciary Deadlock*

The picture resulting from Section D is what I call a "fiduciary deadlock": a situation in which various, interconnected fiduciary relationships may potentially come into conflict with one another. Figure 2 visually recaps the problem.

90 *See* Sarath Sanga, *Network Effects in Corporate Governance*, 63 J.L. & ECON. 1, 19 (2020) (finding that 50% of U.S. public companies are incorporated in Delaware). For the view that under Delaware law stakeholder interests are not relevant for directors if they conflict with shareholder interests, see Leo E. Strine, Jr., *The Dangers of Denial: The Need for a Clear-Eyed Understanding of the Power and Accountability Structure Established by the Delaware General Corporation Law*, 50 WAKE FOREST L. REV. 761, 773 (2015) (discussing how Delaware law permits directors to consider the interests of other stakeholders but only "[a]s a means to the end of increasing stockholder welfare . . . and not as an end").

Figure 2: The BlackRock-Exxon Fiduciary Deadlock



Let us consider BlackRock's options with respect to the proposed Exxon emissions reduction. If the emissions reduction decreases Exxon's value but increases BlackRock's overall management fees (as portfolio primacy predicts), then BlackRock shareholders, some fund investors (perhaps those investing in BlackRock's broad-based funds), and other broad-based funds investing directly in Exxon will likely benefit from the emissions reduction. However, many categories of Exxon shareholders as well as the investors in BlackRock's energy funds will almost certainly be financially harmed. Thus, the fiduciary duties owed to BlackRock shareholders seem to be prima facie in conflict with the fiduciary duties owed to some BlackRock fund investors (and potentially to some other Exxon shareholders). (Although, as we will see in Section III.C, this conflict is solved by the law.)

Let us now consider the position of Exxon D&Os. If BlackRock D&Os, despite the aforementioned conflict of duties, push for an emissions reduction that is beneficial for some Exxon shareholders but not for others, Exxon D&Os seem to face a similar prima facie conflict of duties. By implementing the emissions reductions, they would harm the financial interests of some shareholders; but by not implementing the emissions reductions, they would harm the financial interests of other shareholders.

Can we solve this fiduciary deadlock? And, if so, how does the solution affect portfolio primacy? I will address these questions in Part III and then draw some brief conclusions.

III. How to Solve the Fiduciary Deadlock

A. *The Need for a Solution*

The apparent conclusion from the analysis proposed in Part II is that investment and corporate managers are bound to be stuck in legal paralysis. Some beneficiaries want *A*, other beneficiaries want *B*, and *A* and *B* are incompatible. Thus, no valid choice is permitted.

But such a conclusion would be absurd. We must seek a solution that allows for decisions and action. In this Part, I examine three potential solutions. I call them: (1) interest convergence, (2) interest prioritization, and (3) interest specialization.

The first potential solution is "interest convergence." If the interests of all relevant beneficiaries (BlackRock shareholders, fund investors, and Exxon shareholders) converge (or can be legally presumed to converge) toward the same goal (in our hypothetical, the environmental benefits of the emissions reduction), then the deadlock is avoided: BlackRock D&Os can push for the emissions reduction and Exxon D&Os can implement the emissions reduction without violating their fiduciary duties. We have seen in Part II that, prima facie, the interests of the beneficiaries do not converge. Here, I will examine the question in more detail but will ultimately confirm the provisional conclusion reached in Part II.

The second potential solution is "interest prioritization." If the interests of the relevant beneficiaries do not converge, then we could solve the deadlock by giving priority to the interests of some beneficiaries over the interests of other beneficiaries. In this case, corporate law establishes a structural hierarchy that dictates the prevalence of the interests of fund investors over those of BlackRock shareholders. But since different groups of fund investors (from the perspective of BlackRock D&Os) and different groups of Exxon shareholders (from the perspective of Exxon D&Os) get equal priority but have conflicting interests, prioritization does not completely solve the deadlock.

The third potential solution is "interest specialization." If conflicting interests can neither be reduced to a convergent goal nor be ordered according to legal priority, they must somehow coexist despite the conflict. I will argue that this is possible as long as the relevant fiduciaries operate on a "specialized," single-entity basis and therefore disregard the portfolio primacy approach. Thus, BlackRock D&Os must make tailor-made stewardship decisions for each investment fund and cannot take an institution-wide approach to the emissions reduction. At the same time, Exxon D&Os must make business decisions with exclusive regard to Exxon, without taking into account the other companies in which Exxon shareholders have invested. Specialization solves the deadlock but renders portfolio primacy ineffective and unable to pursue an ambitious social and environmental agenda. In the following Sections, I will discuss each potential solution in more detail.

B. *Convergence*

It may seem a tautology to assert that if the interests of the beneficiaries converge, then there is no deadlock. In practice, however, determining the interests of the beneficiaries is a complex task that involves an understanding and interpretation of both empirical and legal questions.

In Part II, I provisionally concluded that it would be against the interests of investors in BlackRock Energy to implement an emissions reduction that would harm the value of energy companies. A possible objection, however, would be that today's investors are, or at least should be, fully diversified.[91] Modern portfolio theory recommends individual investors to diversify away stock market idiosyncratic risks;[92] therefore, in accordance with what is widely considered sound investment strategy, the best interests of investors should coincide with the maximization of portfolio value, not with the maximization of the value of an individual company, such as Exxon.

Following this view, one might argue that since BlackRock Energy's investors, Exxon's retail investors, and the beneficial owners of hedge funds and other undiversified funds, are ultimately diversified at the level of their overall individual portfolio, these investors would benefit from the emissions reduction as well. Indeed, even if these investors are *locally* undiversified and would therefore be directly harmed by the emissions reduction, they are nonetheless *generally* diversified, because they presumably own other assets according to an investment strategy that neutralizes company-level risks.

Although appealing, this theory does not seem compatible with the existing structure of fiduciary law. In the real world, people choose all kinds of investment strategies, which are not always in accordance with what finance textbooks prescribe. In particular, the empirical literature documents

91 This argument is proposed by TSC in defending the TSC Proposal against BlackRock's argument that it would violate fiduciary law. BlackRock NAL, *supra* note 3, at 25-26.

92 *See generally* Harry Markowitz, Nobel Prize Lecture: Foundations of Portfolio Theory (Dec. 7, 1990), https://bit.ly/2RWnU4o [https://perma.cc/PF7L-TH2J].

a strong correlation between diversification and financial literacy.[93] Furthermore, diversification can be attained in different ways and therefore investors with a similar degree of overall diversification might be affected in very different ways by an emissions reduction that disproportionately harms oil companies. More generally, an investor buying stock in Exxon might also have investments in companies and industries that would neutralize Exxon's idiosyncratic risk. However, she might very well be overexposed to Exxon and to the oil and gas industry, either fortuitously or deliberately, perhaps because she believes that such overexposure will be profitable.

Mutual fund managers cannot possibly learn what the actual investment strategies and interests of their investors are, and even if they could, they would not be able to make tailor-made stewardship decisions based on the circumstances of millions of investors. At the same time, mutual fund managers should not rely on an abstract all-encompassing model of the investor, based on ideal assumptions concerning all the financial interests of such a theoretical individual, including interests that are not connected with the specific fiduciary relationship. Doing so would obliterate all the differences among distinct financial products and among distinct fiduciary relationships, as such an ideal investor would be the same in any and all cases. In other words, while the real-life investor is too specific to serve as a normative model, the ideal all-encompassing investor is too abstract, to the point that her financial interests have no connection with the specific investment at issue.

Therefore, the object of a mutual fund manager's fiduciary loyalty must be found in an intermediate conceptual space between the unworkable extremes of the actual investor and the ideal all-encompassing investor, and the natural reference point to anchor this intermediate model is the specific fund in which the beneficiaries have invested. It is the specific fiduciary mandate that delineates the scope of the fiduciary's duty of loyalty, not an idealized model of the overall welfare of the beneficiary. We can call this relationship-based model of the investor, the "typical" investor, who is a generic investor within the concrete boundaries of the specific type of investment.[94]

93 *See generally* Daniel Dorn & Gur Huberman, *Talk and Action: What Individual Investors Say and What They Do*, 9 REV. FIN. 437 (2005); Luigi Guiso & Tullio Jappelli, *Financial Literacy and Portfolio Diversification* (Einaudi Inst. for Econ. & Fin. Working Paper No. 12/08, 2008); John R. Graham, Campbell R. Harvey & Hai Huang, *Investor Competence, Trading Frequency, and Home Bias*, 55 MGMT. SCI. 1094 (2009); Anthony Bellofatto, Catherine D'Hondt, & Rudy De Winne, *Subjective Financial Literacy and Retail Investors' Behavior*, 92 J. BANKING & FIN. 168 (2018).

94 The proposed view is aligned not only with common sense (if I buy an energy ETF, it is reasonable to assume that I prefer energy stocks to gain not to lose) but also with the most common contemporary theories on the nature of the fiduciary relationship. According to some of these theories, fiduciary duties are either an instrumental tool to make sure that the fiduciary fulfills her

If the fiduciary mandate concerns investing in the S&P 500, the typical investor will want the appreciation of S&P 500 companies; if the fiduciary mandate concerns investing in the oil and gas industry, the typical investor will want growth in the value of oil and gas companies. In this light, the various fiduciary relationships described in Figure 2 do have diverging goals, and therefore by trying to be loyal to all beneficiaries at the same time, BlackRock would find itself in an insoluble conflict.[95]

A similar approach can be used to determine the interests of the "typical" Exxon shareholder. Just like buying units of BlackRock Energy creates a fiduciary relationship whose scope is constrained by the specific objective of BlackRock Energy (which is the appreciation of U.S. energy stocks), buying Exxon stock creates a fiduciary relationship whose scope is constrained by the specific objective of Exxon (which is to be a profitable business).[96] Under this view, the interests of the typical Exxon shareholder are not compatible with those of BlackRock shareholders or those of investors in broad-based BlackRock funds.

non-fiduciary duties, or an elusive concept whose actual content can only be found in the specific relationship. For the first thesis, see generally MATTHEW CONAGLEN, FIDUCIARY LOYALTY: PROTECTING THE DUE PERFORMANCE OF NON-FIDUCIARY DUTIES (2010). For the second thesis, see generally Deborah A DeMott, *Beyond Metaphor: An Analysis of Fiduciary Obligation*, 37 DUKE L.J. 879, 879 (1988). In both views, it is the particular relationship—in our case, the decisions concerning an investment in the S&P 500 or in the energy sector—that drives the specific content of the duty of loyalty.

According to another theory, the content of the duty of loyalty corresponds to what the parties would have agreed to if they had bargained on that specific issue. For a classic presentation of this view, see generally Frank H. Easterbrook & Daniel R. Fischel, *Contract and Fiduciary Duty*, 36 J.L. & ECON. 425 (1993). For a modern restatement of the economic theory of fiduciary law, see Robert H. Sitkoff, *An Economic Theory of Fiduciary Law*, *in* PHILOSOPHICAL FOUNDATIONS OF FIDUCIARY LAW, *supra* note 60, at 197. Reconstructing such a "hypothetical bargain" requires some educated guessing and making inferences from the explicit investment objectives of the fund in which the beneficiary has actually invested seems more justified than making inferences on the basis of a theoretical model of perfectly diversified investor. *Id.* at 8.

95 There are two other possible versions of the convergence argument, which do not rely on investor financial preferences as portfolio primacy argues. First, that the pro-social preferences of all the beneficiaries are similar, namely, that despite the different financial interests, all parties still favor the emissions reduction based on their social and moral preferences. Second, that the emissions reduction is aligned with the pro-social preferences of some beneficiaries and the financial interests of BlackRock shareholders. Both arguments, just like the diversification argument discussed in the text, require either an impracticable customization based on the individual preferences of investors or a somewhat arbitrary model of theoretical investors that has no anchor in the fiduciary mandate. In any event, they are not what portfolio primacy suggests.

96 Once again, this conclusion would change under a more expansive conception of Exxon's corporate purpose, such as one that encompasses the interests of Exxon stakeholders or the nonfinancial preferences of Exxon shareholders. However, this theory would not be based on the portfolio-wide financial interests of shareholders, which is the theoretical basis of portfolio primacy.

C. *Prioritization*

If the interests of the various beneficiaries do not converge toward the same goal, the fiduciary deadlock could be solved by prioritizing some interests over others. Generally speaking, the law follows different approaches to resolve conflicts of fiduciary duties. Sometimes courts try to weigh and balance duties of different natures (for example, attorney-client privilege and an economic interest) and give priority to the most important; other times, courts inquire into the origin of the conflict to assess whether some of the conflicting duties derive from inappropriate conduct or determine priority in ranking based on priority in time.[97]

In the realm of financial services firms, courts have used a property theory to conclude that confidential information obtained from a client cannot be disclosed to another client, despite the fact that it is in the best interest of the second client to learn such information; they have applied a traditional tort doctrine to distinguish whether the situation was actively created by the investment adviser by violating another duty; and they have relied on the traditional distinction between acts and omissions (according to which omissions are judged more leniently than acts).[98]

In our case, however, corporate law establishes a structural hierarchy between some of the fiduciary relationships at issue. To begin with, the fiduciary duties owed to BlackRock shareholders are fiduciary duties of BlackRock D&Os as directors and officers of BlackRock and concern the internal affairs of BlackRock as a corporation; by contrast, the fiduciary duties to the fund investors and the potential fiduciary duties to Exxon shareholders are fiduciary duties of BlackRock as a legal entity and therefore are external to BlackRock. Internal fiduciary duties regulate how BlackRock, as an entity, makes its decisions; in particular, BlackRock D&Os, acting on behalf of BlackRock, should do what is best for BlackRock shareholders. External fiduciary duties, however, act as a constraint on what BlackRock can decide to do. The set of opportunities that BlackRock D&Os can pursue on behalf of BlackRock shareholders is limited by the constraints imposed by BlackRock's external fiduciary duties.

By logical and juridical necessity, internal preferences cannot override external obligations; if they could, corporate shareholders might very well decide to violate the corporation's obligations to third parties for less noble ends than the reduction of negative externalities. In our hypothetical, whenever the emissions reduction benefits BlackRock shareholders but harms

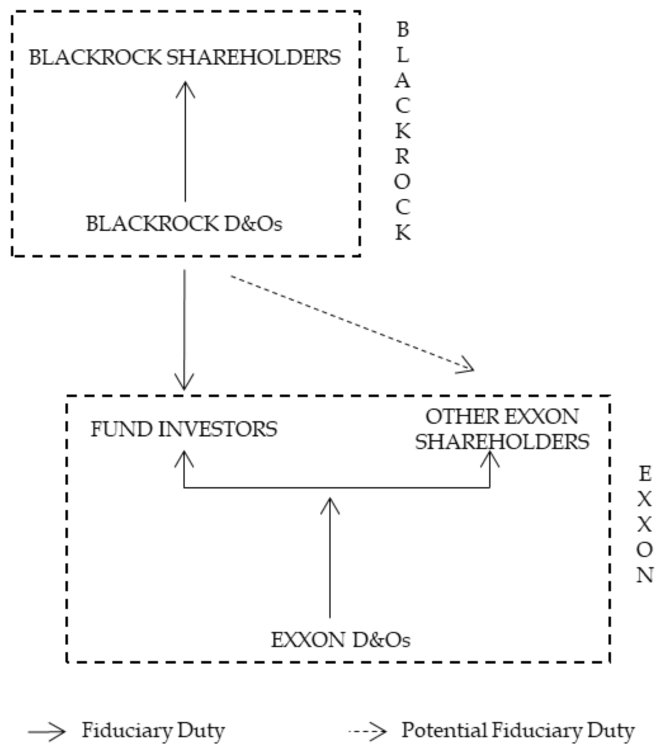
97 For an overview of various approaches to solve conflicts of duties, see Arthur B. Laby, *Resolving Conflicts of Duty in Fiduciary Relationships*, 54 AM. U.L. REV. 75, 86-98 (2004).

98 *Id.* at 133-41.

some fund investors, fiduciary law tells BlackRock D&Os to give priority to the typical interests of the fund investors.[99]

The same corporate relationship exists between Exxon D&Os and Exxon shareholders, including both the BlackRock funds and the other shareholders. Figure 3 illustrates this structural separation of the fiduciary relationships.

Figure 3: The BlackRock-Exxon Fiduciary Deadlock



But what happens when different fund investors (from the perspective of BlackRock D&Os) and different shareholders (from the perspective of Exxon D&Os) have different typical interests? In our hypothetical, the interests of investors in BlackRock SP500 and those of investors in BlackRock Energy do not coincide, yet the fiduciary relationships between BlackRock and the two groups of fund investors are structurally ranked equal: there is no logical or juridical priority between them. Similarly, among Exxon shareholders, the

99 A formal way to express this point is that since BlackRock and BlackRock D&Os are separate persons, there is no conflict of fiduciary duties in the first place. *See* Andrew Tuch, ***A General Defense of Information Fiduciaries***, 98 WASH. U.L. REV. 1897, 1901-02, 1910 (2021).

interests of a hedge fund with a concentrated position in Exxon and those of a broad-based index fund do not coincide but enjoy equal structural ranking. In other words, prioritization solves some conflicts but not all. The deadlock still survives.

D. *Specialization*

If conflicting interests can neither be reduced to a single goal nor ordered according to legal priority, they must somehow coexist despite the conflict. But how can conflicting fiduciary relationships coexist without legal paralysis? I contend that the solution implicit in corporate and investment law is quite simple and intuitively appealing: fiduciaries must operate on a "specialized" basis, by compartmentalizing homogenous classes of typical interests. Since the scope of the typical interest, as discussed in Part II.D.2, is determined by the specific fiduciary mandate, and each specific fiduciary mandate is connected to a specific legal entity or "fund" (BlackRock SP500, BlackRock Energy, Exxon, etc.), then conflicting fiduciary duties can coexist if the relevant fiduciaries act on a narrow, individual-entity (or individual-fund) basis.

What does this mean in practice? Let us first consider BlackRock's conflicting duties to BlackRock SP500 and BlackRock Energy. Specialization suggests that BlackRock should make *two different* stewardship choices. It should support the emissions reduction on behalf of BlackRock SP500, and it should oppose it on behalf of BlackRock Energy. Only a fund-specific stewardship strategy fulfills the goals of fiduciary loyalty in our hypothetical.[100]

Let us now consider Exxon D&Os' conflicting duties to diversified and non-diversified shareholders. Specialization suggests that Exxon D&Os should decide based on a company-specific analysis, thus disregarding shareholders' financial interests other than those directly concerning Exxon. The other investments of Exxon shareholders are the competence of other fiduciaries, not of Exxon D&Os. Exxon D&Os must act on a narrowly specialized basis, delimited by Exxon as a legal entity. Thus, Exxon D&Os cannot choose a strategy that deliberately harms Exxon, and they must oppose the emissions reduction.

As a result, each fiduciary has a legally preferred course of action to pursue, and legal paralysis is avoided. The collateral damage, however, is portfolio primacy. If BlackRock must act on a fund-specific basis, it cannot consider the aggregate effect of the emissions reduction on its institutional

100 For a discussion of fund-specific voting, see also Griffith & Lund, *Conflicted Mutual Fund Voting in Corporate Law*, *supra* note 59, at 1183-85 (2019).

portfolio as a whole. In our hypothetical, it means that many BlackRock funds will have to push against the Exxon emissions reduction, thus weakening the promise of portfolio primacy for climate risk mitigation. Furthermore, since BlackRock does not engage in fund-specific stewardship in practice, but rather acts according to general guidelines that apply to all its funds,[101] BlackRock will avoid excessively prescriptive interventions and will choose inaction more likely than action. Indeed, BlackRock has been supportive of environmental shareholder proposals that leave considerable discretion to corporate managers but has criticized other proposals for being "unduly prescriptive."[102] As a practical matter, it is very difficult to argue that an investment adviser violates its duty if it *does not* actively try to alter the business strategy of a portfolio company in a way that is beneficial to fund investors, while it is much less problematic to argue that an investment adviser violates its duty if it *does* actively try to alter the business strategy of a portfolio company in a way that is detrimental to fund investors. In fiduciary law, as in other legal domains, omissions are treated more leniently than acts.[103] Therefore, BlackRock and other fiduciaries are more likely to passively choose the status quo rather than actively try to pursue ambitious reforms.

Similarly, if Exxon D&Os must act on a company-specific basis, they cannot take into consideration the portfolio-wide interests of Exxon shareholders, but only the interests of Exxon shareholders as pertaining to Exxon itself. State corporate codes and case law often characterize D&Os' fiduciary duties as owed to the "corporation and its shareholders."[104] But

101 *See* Bebchuk & Hirst, *supra* note 14, at 2050-59 (arguing that the business model of index fund managers, such as BlackRock, creates incentives for underinvesting in stewardship).

102 BLACKROCK, 2022 CLIMATE-RELATED SHAREHOLDER PROPOSALS MORE PRESCRIPTIVE THAN 2021 (May 2022), https://www.blackrock.com/corporate/literature/publication/commentary-bis-approach-shareholder-proposals.pdf [https://perma.cc/R94G-7PSP]

103 *See supra* note 98, and accompanying text.

104 *See, e.g.*, CAL. CORP. CODE § 309 (West 2023); Nienaber v. Katz, 69 Ohio App. 153, 158 (1942)("[T]he relation between the officers and directors and their corporation and its stockholders is one of trust . . . ."); Schoon v. Smith, 953 A.2d 196, 206 (Del. 2008)("In discharging their management function, directors owe fiduciary duties of care and loyalty to the corporation and its shareholders.") (internal quotations omitted); Stockbridge v. Gemini Air Cargo, Inc., 611 S.E.2d 600, 605 (Va. 2005)("Directors have a fiduciary duty to manage the corporation's affairs with the utmost good faith in the best interests of all its shareholders and of the long-term health of the corporation itself."); Oldham v. McRoberts, 237 N.Y.S.2d 937, 951 (Sup. Ct. 1963), *modified,* 21 A.D.2d 231 (1964), *aff'd,* 15 N.Y.2d 891 (1965) ("[D]efendants breached their fiduciary duty, as directors and officers, to [the corporation] and its stockholders, thereby damaging [the corporation] by lessening the value of its assets."); TEX. BUS. ORGS. CODE ANN. § 21.401 (West 2013) ("In discharging the duties of director under this code or otherwise and in considering the best interests of the corporation, a director is entitled to consider the long-term and short-term interests of the corporation and the shareholders of the corporation . . . .").

while this phrase has been sometimes interpreted in an *expansive* way, as suggesting that the interests of the corporation includes interests other than those of shareholders,[105] the analysis presented here indicates that the phrase "interests of the corporation and its shareholders" has also a *restrictive* meaning, which limits the interests of shareholders that are relevant for fiduciary purposes to the subset of interests that are directly related to the individual corporation. Shareholders inevitably possess a plurality of interests, including those arising from their entire investment portfolio. But, as we have seen, such a sprawling web of interests results in a tight knot of conflicts. Fiduciary law cannot cut this Gordian knot but can provide a framework for the peaceful coexistence of conflicting interests, by containing and compartmentalizing them along the formal boundaries of legal entities. In this sense, the "interests of the corporation and its shareholders" is only a subset of the interests of shareholders.[106]

In this light, the SEC decision to allow BlackRock shareholders to vote on the TSC Proposal can be read as a vindication of specialization. Under this view, the SEC decision is not a recognition that BlackRock can engage in aggressive portfolio tradeoffs for the benefit of society and the environment without violating its fiduciary duties. On the contrary, it is the acknowledgment that even if the TSC Proposal were implemented, portfolio primacy will yield to shareholder primacy, or will succumb to mere inaction, whenever there is a serious fiduciary conflict. Portfolio primacy does not really threaten the status quo; given the urgency of the climate crisis, we must look for other solutions.

CONCLUSION

This Essay has examined the fiduciary implications of portfolio primacy by using a hypothetical stewardship intervention in which BlackRock pushes Exxon to reduce its carbon emissions at the expense of Exxon's own share value. Disentangling the various fiduciary duties of BlackRock, BlackRock

105 *See supra* note 41.

106 *See also*, Kahan & Rock, *supra* note 10. Supporters of portfolio primacy disagree. In a class action filed against Meta Platforms in the Delaware Court of Chancery, plaintiffs argue that Meta's shareholders are "typically diversified" and therefore Meta D&Os have violated their fiduciary duties by making business decisions aimed at the financial success of Meta and ignoring the externalities produced in this way (which harm Meta's diversified shareholders). Verified Amended Complaint at 2, McRitchie v. Zuckerberg, No. 2022-0890 (Del. Ch. Feb. 9, 2023), (No. 2022-0890), 2023 WL 1861619 ("If the decisions that maximize the Company's long-term cash flows also imperil the rule of law or public health, the portfolios of its diversified stockholders are likely to be financially harmed by those decisions. As fiduciaries at a corporation with a business model that depends upon maintenance of a powerful global network, the directors and officers of the Company cannot willfully blind themselves to this reality: where there is great power there is great responsibility.").

D&Os, and Exxon D&Os reveals that portfolio primacy creates a fiduciary deadlock: a situation in which different fiduciary relationships come into conflict with one another. I have argued that the only possible solution to the deadlock, which I have called "interest specialization," renders portfolio primacy ineffective.

One possible objection to this Essay's approach is that the formal legal structure of fiduciary law might have a relatively weak impact on the actual behavior of investment and corporate managers. In the asset management industry, fiduciary conflicts are ubiquitous, and yet asset managers continue to operate;[107] therefore, one might argue, BlackRock might well engage in aggressive portfolio-based stewardship, if it so wished. The crucial question, according to this "legal irrelevance" thesis, is not whether BlackRock may or may not legally push Exxon to cut its carbon emissions, but whether it has economic incentives to do so.

A proper assessment of the promise and practical impact of portfolio primacy must certainly include a careful analysis of asset managers' economic incentives. I attempt such an analysis in a companion article.[108] However, ignoring the structure of fiduciary law would be a serious mistake. In addition to being an issue of interest in itself for legal scholars and practitioners, fiduciary duties are a matter of concern for asset managers too. As attested by Larry Fink's words in the epigraph, BlackRock's whole environmental stewardship narrative is explicitly grounded in fiduciary duties.[109] In fact, fiduciary conflicts are a threat not only to BlackRock's environmental rhetoric but also to its business model, which is based on selling different financial products to clients with different goals: systematically favoring some clients over others or favoring the asset manager's own profits over client returns would be extremely bad for business.[110]

Furthermore, fiduciary liability is much more likely to constrain a visible and large-scale effort such as the one that portfolio primacy advocates than the subtle everyday conflicts that the "legal irrelevance" thesis takes as emblematic examples of the law's inefficacy. Finally, the macroscopic conflicts discussed here might very well result in a regulatory backlash, whether in the form of more aggressive enforcement or even in a change of the regulatory

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107 For a discussion of the pervasive fiduciary conflicts in financial conglomerates and the weak response of fiduciary law, see generally Andrew F. Tuch, *The Weakening of Fiduciary Law*, *in* RESEARCH HANDBOOK ON FIDUCIARY LAW 354 (D. G. Smith & Andrew S. Gold eds., 2018).

108 Tallarita, *The Limits of Portfolio Primacy*, *supra* note 10.

109 Fink, supra note 1.

110 *See* BlackRock, Inc., 2022 Proxy Statement, *supra* note 5, at 98 ("By asking the Company to adopt stewardship practices designed to curtail corporate activities that externalize social and environmental costs . . . even if such curtailment could decrease returns at the externalizing company, the proposal is asking BlackRock to take actions potentially at odds with some clients' stated investment objectives and our fiduciary duties." (quotation omitted)).

landscape; such an outcome is certainly feared by industry players and therefore is a particularly strong incentive against portfolio primacy. In conclusion, a fiduciary law analysis is a crucial part of the overall assessment of portfolio primacy.

Similar arguments apply to the fiduciary duties of corporate managers. While it is true that corporate D&Os enjoy broad judicial deference,[111] the decision by corporate managers to engage deliberately and systematically in a value-decreasing strategy for the private benefit of some influential shareholders would be such a glaring violation of fiduciary duty that we should expect plaintiff lawyers and courts to take notice and react.

Would it be possible to rethink the structure of fiduciary law by allowing and incentivizing portfolio-level decisions? Given the economic structure of fiduciary law, a socially oriented fiduciary loyalty seems an overambitious goal, but it is certainly worthy of careful study.

I believe, however, that a much more promising use of legislative power would be to impose external constraints on the interests of beneficiaries. If, for example, carbon emissions were taxed at the cost that they impose on society on a global scale, private actors would internalize the social cost of their decisions and the interests of investors would naturally converge toward the social goal.[112] Similarly, if the legislator capped the level of carbon emissions, such an external constraint would limit the discretion of the fiduciaries.

Both a redesign of fiduciary law and aggressive environmental policy are ambitious strategies, which face many political hurdles.[113] The analysis of their advantages, disadvantages, and legal and economic limits is beyond the scope of this Essay. But they both presuppose an ambitious policy intervention that would reshape the way fiduciary loyalty operates. Given the urgency of the climate crisis, we should seriously question our ability to rely on private ordering within the current structure of fiduciary law and we should rather focus our efforts on trying to pursue ambitious regulatory solutions.

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111 *See, e.g.*, Marc I. Steinberg, *To Call a Donkey a Racehorse – The Fiduciary Duty Misnomer in Corporate and Securities Law*, 48 J. CORP. L. 1 (2022) (arguing that the application of fiduciary duty in the corporate law setting is so weak that it is a mistake to call the duty of corporate directors a fiduciary duty).

112 *See generally* A. Lans Bovenberg & Lawrence H. Goulder, *Environmental Taxation and Regulation*, *in* 3 HANDBOOK OF PUBLIC ECONOMICS 1471 (Alan J. Auerbach & Martin Feldstein eds., 2002).

113 For a discussion of the political obstacles to ambitious environmental regulation, see generally MICHAEL P. VANDENBERGH & JONATHAN M. GILLIGAN, BEYOND POLITICS: THE PRIVATE GOVERNANCE RESPONSE TO CLIMATE CHANGE (2017).