MIKE LIVERMORE: Hi, this is Mike Livermore, and with me today is Madison Condon, a professor at Boston University School of Law whose work focuses at the intersection of the environment and corporate governance. And this is an increasingly hot topic these days. Madison, thanks for joining me.

MADISON CONDON: Thanks so much for having me, Mike.

MIKE LIVERMORE: So in the environmental community, I feel like there are two camps, right? There are, on the one hand, pessimists who think that corporations are like these rapacious institutions that put profits above all other interests, and kind of destroy the planet in the process.

That's one group. And then there's another group who are more optimistic, and they look to corporations for leadership. And they're enthusiastic about things like environmental social governance, ESG, or sustainability commitments. And that's the other camp. And you hear from those folks as well.

So maybe just to get the conversation started, if you had to pick between one of these two camps, as someone who's an expert in this area, which camp-- where would you pitch your tent?

MADISON CONDON: I just think that's a really-- well, I mean, look. My heart genuinely is as an environmental professor and not a corporate professor, even though my scholarship is all corporate. So I think that in general, we have design policies and laws that make corporations in general bad.

I think that right now is really interesting, and lots of corporations are doing lots of different things for lots of different reasons. And there's-- some of them are moving in a good direction for their own reasons.

But yeah, maybe if you force me to pick a camp, I would be in the corporations are bad camp.

MIKE LIVERMORE: And of course, we all have our nuanced positions, and everything else. But so-- but you have written about some ways in which maybe there are reasons to be optimistic. Maybe we can explore some of that. And then you've reason to think we should be pessimistic, right? So it does kind of go both ways.

But one argument that's been circulated, and you've argued and others have as well in different contexts is, we have something kind of new in the world of corporate governance and the world of investor relations these days, which are these kind of megafunds like Vanguard and other funds like that, that kind of own the market and some very broad sense.

And they've become pretty active, at least that's my understanding as an outsider, is that at least some of these funds have become fairly active in kind of promoting particular types of agendas for corporate governance. And the idea is at least partially that these funds can kind of stand in for environmental interest, because they own so much of the market, they kind of internalize some of the costs.

So what is the role of these big funds these days? Are they playing an active role on corporate boards? What are the kinds of things that they tend to care about, and is environment in the mix, especially with respect to climate change? Or is that kind of a second tier priority? What is the landscape with these big entities now?

MADISON CONDON: Yeah, so I would say in the world of large investor shareholder activism, climate is, in fact, the number one priority. The thing that they spend the most resources. I think genuinely, both sort of PR out facing and also inside, trying to figure out what exactly their plan is in the climate and ESG space.

I mean, so what you're talking about is this universal owner theory, which is-- it's an old theory actually. It's sort of that as we notice these institutional investors accumulating more and more capital, the first idea-- the first concept of the universal owner arose around pension funds that were became sort of enormous in the '80s. The idea was, well, they own the whole market. They own a very large chunk of every publicly traded company.

Therefore, it doesn't really help them if Exxon pollutes a bunch of carbon into the air, because the climate damage is that will result from that pollution will actually really hurt the other portfolio. The rest of their income portfolio. You know, they're invested in real estate, they're invested in agribusiness. The whole economy will suffer from climate change, so it's not in these large diversified owners' interests, theoretically, to continue to allow the large oil and gas producers that they're invested in to go about their normal business.

So there was this theoretical idea that's been around for a while. And so the paper that you're referencing that I wrote about was sort of like this theoretical idea is actually happening, in some ways, right now. The biggest institutional investors-- BlackRock, Vanguard, and State Street in America, and a bunch of very large institutional investors in Europe-- have become very organized on the climate front, and have started to vote for and press for a bunch of different measures that actually have emissions reducing impacts.

And so I sort of theorize that their motivation for this was the externality internalizing motivation. That they are in fact behaving like universal owners.

MIKE LIVERMORE: So what are some of the-- if you happen to know off the top of your head-- what are some of the practices that they want to promote from a climate perspective in terms of when they're in their role as shareholders?

MADISON CONDON: So they have a few tools at their disposal. So at a very macro level, the way in corporate governance you talk about exit versus voice, do you sell the asset that you are displeased in, the way the directors of the corporation are running the company? Or do you intervene and use your shareholder pressure to either change the leadership or at least make it very clear what your preferences would be?

And this choice actually has a big-- it really matters and has particular relevance in the climate space, because there's a lot of debate over OK, well, if you just divest from an oil and gas company because you're upset about its emissions plan, its lack of plan to be compliant with the Paris Agreement, are you really helping to reduce emissions in any way? Are you really reducing their cost of capital?

And relatedly, if you just press oil and gas companies to sell off their assets to private equity or to state owned oil and gas companies, you're not really reducing emissions in the overall market. You're just getting it off of your own books. So I think that institutional investors are really beginning to recognize this-- I would call it in the environmental space leakage affect. The corporate governance people haven't totally caught up with the lingo, I think from the climate regulatory sphere.

And so instead, they are sort of starting to push for just sitting on assets. And Glencore, a coal company, has a climate rundown plan where they-- climate activists don't think it's sufficient, but they are sort of stated position is that they're not going to sell their assets off because they would be bought by private equity that would just pump them for emissions more in the short term.

MIKE LIVERMORE: So, one of the things that strikes me is-- there's so many, again, so many ways to take this. There's so many different nuances to this. But maybe just to the universal owner kind of side of this, does that create-- has that created conflicts with other shareholders?

So I'm imagining, say I own Exxon, or a coal company that you were mentioning, or whatever. And what I want to do is what most people want to do most of the time with most of their investments, which is make money. And I'm not a universal owner, I'm the opposite of universal owner. I'm a micro owner, right? I own-- I'm one little tiny piece of the world.

And so, when BlackRock or Vanguard or whoever wants to take steps, wants Exxon to take steps, so it actually reduce Exxon's profitability, but would increase the yield on other parts of Vanguard or BlackRock's holdings. That strikes me as-- from my perspective as an individual shareholder that doesn't just own the whole economy-- as a bad thing. And are those the kind of conflicts that-- has that conflict come up, and how has that been resolved or not resolved?

MADISON CONDON: Well, it's definitely a super interesting question in corporate law that a bunch of different people are thinking about from a lot of different angles right now. So but to be clear, BlackRock, Vanguard, and State Street never explicitly say, we are doing this thing at Chevron, for example, because we are motivated by portfolio impacts.

So for many corporate law reasons you-- a lot of these measures are cloaked in sort of like firm specific impacts. So I think one really good example to think through, because it just happened and caught a lot of people's attention, is the Engine Number One battle against Exxon that happened this spring. So Engine Number One is a super tiny-- well, it is a small hedge fund. It owned a very tiny interest in Exxon. Just, I think, 0.02% of the company.

And its strategy was a firm specific strategy. It was like Exxon has a bad business model, it's never-- its returns have been consistently failing. It's overspending on capital, it has totally refused to acknowledge that there could be a climate regulated future. Basically, its risk preparedness is terrible, we want to take over the company.

And they successfully replaced three directors on the board of Exxon. And they were only able to do that with their 0.0 ownership share by persuading the very large institutions to support them. BlackRock, Vanguard, and State Street.

So there's a really interesting paper that just got posted. SSRN, actually. It's by Ed Rock and Marcel Kahan at NYU. And they sort of-- they actually analyze the vote of who supported Engine Number One at the proxy fight, and who didn't, and who supported management. And it turns out that if you were overweighted in Exxon relative to the market-- so you were more concentrated in Exxon-- you were much less likely to support the Engine Number One sort of attack.

And then if you were underweight in Exxon, but overweight in the rest of the market, you were much more likely to support Engine Number One. So I think that that is a super interesting finding, and consistent frankly with the universal ownership theory.

MIKE LIVERMORE: Right. And then, and also with this tension between--

MADISON CONDON: Exactly, exactly. To bring it back home. That yes, maybe-- certainly-- if you only own Exxon, you're probably not interested in a measure that reduces Exxon's profits.

MIKE LIVERMORE: Right. Right, that makes sense. And so what do we think normatively about this, then? On the one hand, we think, as environmental types, we like the idea that a company like Exxon would start to shift its emphasis from fossil fuel extraction to other things, I guess. I mean, I'm not even sure what the business model looks like for these big fossil fuel companies. But that it would be somehow consistent with reducing greenhouse gases over the long term.

But on the other hand, it does seem vaguely weird that big actors like these major shareholders like BlackRock and Vanguard could kind of force one company, Exxon, to do things that are bad for it, because those things are good for other parts of the portfolio.

So for example, we wouldn't allow this in other contexts, right? Where, let's just say there were two companies that were competitors with each other, company A and B. And then a shareholder held both A and B and said, OK, well, we actually want A to just-- we want A and B to divide the market. So A's going to get the East Coast, B is going to get the West Coast, and that's going to increase our profits overall, rather than letting them compete with each other. That would clearly be impermissible. We wouldn't want that.

MADISON CONDON: Definitely. And that's the crux of the problem, is if we're going to allow this kind of activity. As a regulatory matter, as a policy matter, we think it's good that BlackRock is pressing for emissions reductions. How do you distinguish that from anti-competitive behavior, is one question. Because they can look pretty similar.

How do you know that United Airlines and American Airlines and Delta haven't all gotten together and say, we're going to reduce-- we're going to reduce our options and hike our rates, try to reduce our-- that's one way to reduce emissions, right? Reduce supply. But it's the exact same thing. How do you know they're doing it for the right reasons, when they're sort of exact same thing. That's a really hard question.

And then in a separate arena is this question in corporate law, where it's sort of like, corporate law and embraces this idea of shareholder primacy. And while I agree with you that in some ways it's weird that shareholders would press a company that they are invested in to hurt the company, to actually reduce its profits.

It's also weird that we could envision a future in which most, if not all, of Chevron's owners, for example our diversified owners. Like basically everyone. This is the direction that the market is headed. It's sort of also strange that just a single shareholder, who owns 0.0001 of this company can force that company to impose harm on the other 99.9% of shareholders. Like, that is also weird.

MIKE LIVERMORE: There's something weird about that too, yeah. I don't know if it's a paradox, but it's a kind of a dilemma that's created by this new model.

It places corporate law and even just our ideas, including our ethical and normative ideas about within the realm of business ethics kind of grew up in the era of kind of prior to these big, diversified funds, where you might be diversified, but you weren't-- the governance of any particular firm wasn't really affected by the fact that some of the shareholders were diversified and cared about the effects on firm B's performance of firm A's decisions in their capacity as firm A's shareholders, right?

And so it really does raise a lot of interesting questions. It seems like we're really just getting started thinking about these things in the corporate governance area.

MADISON CONDON: I think that's totally right. I think that's really right. And the other thing that I point out in the paper is, given that we acknowledge that they have these incentives, these portfolio based incentives, what theory are we using to support our embrace of shareholder primacy? Why do we then continue to say corporations have to maximize profits? Because part of the theories-- the academic theories and the theories that the courts have embraced-- all underlie things that are sort of no longer true if you acknowledge that universal ownership is true.

So one of the basic theories for why we have shareholder primacy is this residual claimant idea. This sort of idea that after bankruptcy is happened, and all the different stakeholders are paid out, the shareholders are the ones who get whatever is left over in the corporation. And therefore, they have like the best incentive to maximize the corporation's profits, and to oversee the management of the corporation is doing a good job to maximize profits.

That's a pretty foundational idea in terms of why we should have shareholder primacy that's just not true, if all the shareholders are universal owners. And so I think we need to-- I would like the field in general to think about which theories we're going to use to move forward.

MIKE LIVERMORE: Yeah. No, it's really interesting. So let me offer a hypo, just to try to understand and make sense of this whole brave new world that we're in. So let's imagine that the three big universal owner type funds, or some group, let's say some consortium of these big entities got together and said, you know what, there's a company out there, XYZ. And XYZ is terrible for our portfolio.

We don't own any XYZ right now, let's just say. Or we own some small-- we own just a tiny bit of it in our bigger portfolios, because it's just a small part of the market and we hold diversified portfolios. So we have a little XYZ.

And XYZ creates way more loss for the rest of our portfolio than it creates benefit for us in our capacity as owners of XYZ. Let's just-- you can imagine this. XYZ generates some unregulated toxin that is terrible for agriculture, industry, and real estate, or whatever else. It's just a bad actor out there that's doing bad stuff. It's making money, but it's causing a lot of-- so many externalities that they overwhelm the positive benefit that XYZ generates.

It's unregulated for some reason. They're blackmailing the president or something. Somehow they have escaped from the regulatory regime, and tort law isn't going to work for whatever reason. So our more standard ways in the legal system of addressing a problem like that are off the table.

MADISON CONDON: Not a completely unrealistic typo.

MIKE LIVERMORE: Can we think of any real-world analogies? And then, so the company is going say, all right, let's do this. Let's buy up 51% of the shares of the company, kind of hostile takeover style, and shut it down. That's what we're going to do, we're just going to-- we're going to shut it down.

We're not going to liquidate it. We're not going to sell it. We're literally just going to-- whatever, just not run it anymore, right? Not run the factory. Just close the factory, stop the pollution, walk away, and carry it as a loss and not even-- it's on our balance sheet, we still own it, but it's not running.

Again, that strikes me as a perfectly logical kind of thing for them to think, to do in this hypo, but also strikes me as deeply weird that we would have funds going out there and doing this kind of thing.

MADISON CONDON: Totally weird. I mean, so what you're describing is not-- it's basically the same mechanism as a government buyout, except the government is broken, and somehow, for some reason in this hypo, the institutional investors are doing it. I guess it makes me want to clarify one point that I think is sort of important when thinking about all this stuff, is that all of these large institutional investors, basically their main product and where most of their money is housed is in these big, quote unquote, "passive funds."

So they are really limited in their ability to do sort of what you just described, which is target a specific company and buy it all up. If they were to do stuff like that, they would be regulated in a very different way, and they would their whole product stuff would be a very different way.

It just makes me want to mention that-- so a lot of the-- so this is generally like a post 2008 phenomenon, the fact that Vanguard, State Street, and BlackRock are so enormous. This embrace of index funds and industry index investing and ESG investing has-- there's been a massive outflow from actively managed funds into passively managed funds, which are quite concentrated.

So it's part of the explanation for why they're so huge. But a deeper and more far away ago historical explanation for why this is happening is, a bunch of policy reasons-- decisions that we made in the '80s to have the way people save for retirement is through the stock market. And through these index funds.

So instead of having a pension that your employer manages for you, and then pays out to you through your retirement, such that like the risk of a market loss is on your employer. We switched it to be that your employer gives you a bunch of money instead each year, from part of your paycheck. And then the risk is on-- and then you invest that, and then the risk is on you if the market collapses.

So Leo Strine, he's an ex Supreme Court justice of Delaware, he has this idea of forced capitalists. That a lot of people own Exxon who don't even know they own Exxon, and frankly don't have a lot of different options for owning Exxon. If your paycheck is just positive in just some retirement fund, it's really hard to sell a certain company or buy a certain company. You basically are forced to own like big chunks of the market.

And I just think that's worth mentioning when you're thinking about the other sort of weirdness of allowing that one cranky pro Exxon investor to force the other investors to eat these externalities. It's just a weird system we have.

MIKE LIVERMORE: Right, because this is-- in a way, this is how we deal with retirement in the country. And of course, I guess if someone wanted to be a stickler about this they could say, look, that person could just have invested in bonds or something like that. Just in government bills or something. But the returns on those obviously are so low that it's kind of not a realistic scenario.

MADISON CONDON: Yeah, and like, can you put bonds in 401(k)s? Maybe I'm confused, but there's a bunch of tax reasons that we funnel people into very specific products, too.

MIKE LIVERMORE: We have to talk to some of our tax friends about that.

MADISON CONDON: Yeah, I'm starting to like that. Yeah, I'm beginning to talk about things I don't know.

MIKE LIVERMORE: But just back to this idea of shutting down the bad company. You know, what makes me think of that is, and it's a very important point that you raise, it's worth emphasizing that these big funds are limited in what they can do, right? They can't just go out there and act like private equity funds and buy things up and shut them down, or whatever. They're passive investors.

They have seats on boards. They don't necessarily have seats on boards themselves, I guess, but they vote shares, there are directors that these-- that appeal to the interests of these kinds of large institutional investors, and so on. So they have some share or some influence over the management of these companies via the board of directors and their ability to vote these shares.

But they're not taking over companies and managing themselves. Which I think raises another interesting dilemma, and one that you mentioned earlier, which is given the limits of what these investors can do, and the fact that we have parts at least of our corporate law allow the cranky investor as you say to press the issue of kind of maximizing profits.

So if the independent directors are the ones that were most amenable to the interests of the universal owner types were to push efforts at the company, and management was to kind of go tow the line and adopt policies that severely reduce their profits, they would probably face litigation from those cranky shareholders that are saying that you can't do that. You have an obligation to me to maximize profit.

So maybe we can just explain for folks who aren't familiar with what that litigation would look like. And then I think this will then get us into the question of this kind of exit versus voice issue, and some of those things. So but just in the technical details, what does that mean for the cranky investor? Why does that cranky investor have any power whatsoever?

MADISON CONDON: Well, this is a really interesting question. So the cranky investor could bring-- they would bring a fiduciary duty claim against the directors of the board, saying violated your fiduciary duties to me because you're beholden to these other institutional investors.

So it would hinge on like a few things. So one thing, it would hinge on is, are these institutional investors-- you know, they individually own like a few percent to maybe 10% even of a company, but they don't own more than 50%. So the only way to actually change the leadership of the board to be more beholden to them is to have a 50% coalition.

So one question would be, are they behaving like a controlling shareholder? Meaning, have they-- is there collusion such that this extra set of scrutiny that we're going to provide, that Delaware provides for fiduciary duty analysis, would they apply to-- would BlackRock qualify as a controlling shareholder? That's one question.

Right now, it's not like they have like a voting agreement between these entities. It's just like individually each in their own interests. They do cooperate a lot, they do have climate action 100+ is this sort of convening institution that really provides them with a lot of resources, and coordinates them when working with these companies. I think that certainly this cranky shareholder that we're hypothesizing would allege that Climate Action 100+ sort of acts as a facilitating group to constitute a controlling shareholder. So that's one question.

One big point is that we have in Delaware law the business judgment rule, which means that the courts are pretty reluctant to-- they're reluctant to analyze whether a business decision was a good business decision or not. They're sort of like, that's not our expertise, we're not MBAs, we're judges. That's for the board and the management to decide.

So as long as the directors can put forward a plausible, firm specific rationale, and they can say we're not disloyal, we didn't get any benefit from this decision, we just think it's good for the company, then the courts would likely just apply the business judgment rule and say this was a business decision. You don't get any farther in this process.

MIKE LIVERMORE: Right. So just the reason we're talking about Delaware so much, for folks, is that that's where most of the companies that we're talking about have their corporate headquarters, and that's the law that is going to apply. It's a quirk of the US legal system that Delaware decides how--

MADISON CONDON: How the world runs.

MIKE LIVERMORE: Exactly. How our corporations are run. So yeah, so the business judgment rule. Courts are not-- or the Delaware court anyway, isn't particularly inclined to interfere in judgments that are plausibly essentially profit maximizing. But if Exxon were to say, we're adopting the Bill McKibben, keep it in the ground.

MADISON CONDON: Explicitly for our diversified shareholders. That would be a problem.

MIKE LIVERMORE: Exactly. Or if they were even to say, oh, because we think it's profit maximizing even though it obviously is destroying all the value of our company, the court might say, all right, look, that's not really plausible anymore, right? And so the cranky shareholder rule that all of these steps, whatever the corporations are doing here, have to be plausibly related to the profit maximization of the firm, basically, within some band of the discretion given by the business judgment rule.

That puts a pretty substantial-- I guess one could argue about how much that limits what the companies can and can't do, or what the shareholders can and can't require or push Exxon to do. But certainly, shutting down the company, or for example, if Exxon wants to get out of the oil business and it doesn't sell its leases, it just holds onto its leases, it would be very hard to justify that under the business judgment rule.

So given that, what do we have in terms of what steps can be taken? Because ultimately, Exxon is in the fossil fuel business. its whole business model is fossil fuel extraction, and refining, delivering. That's what it does. So what's a greener Exxon look like? Is it just-- what does that look like? How do you-- how do you envision a greener version of that?

MADISON CONDON: Well, I think that one point to be made, if we're going to talk about Exxon in particular, and I think actually basically many of the oil and gas companies that are US based, is that there's plenty of firm specific reasons to think that the leadership of Exxon has been bad. And there's plenty of reasons that better firm specific leadership, actually delivering more returns to shareholders, would also reduce emissions.

That's sort of like low hanging fruit, like double materiality. You just have to put people on the board of Exxon who can possibly envision a world in which climate regulation is possible. Which I think you should do as a business, as a business matter, frankly, if you're a shareholder that's interested in not totally losing money if the world goes in one direction.

That's one thing. Another thing that is very specific but I think actually is a good fulcrum, and a really important fulcrum, is that shareholders have been really agitating for fossil companies to stop messing with the political process. So to really cut out their dark money spending, so that-- basically what I mean by dark money is, it's really hard for shareholders right now to figure out exactly what the corporations that they are invested in are-- who they're spending money on, and for what causes.

Mostly because they can give the money to a third party either industry coalition, or chamber of commerce, or National Association of Manufacturers, or whatever. And then that organization can then fund a bunch of like, lobbying against, for example, the Washington State carbon tax.

So there's been a bunch of successful, 65% support, for example, shareholder proposals, which is, give us a report about how your lobbying is aligned with the Climate Agreement. And that's actually like a hook, because you can't lie in materials that you give to your shareholders, because you will be sued. And no one really wants to put out a report about how much money they've spent on fighting the Washington State carbon tax.

So it actually has sort of like a spending decreasing measure. Again, it's not the same as having Exxon sit on its oil fields. But I think it's not insignificant.

MIKE LIVERMORE: That's something that's worth pursuing. And again, I think, just to make sure that folks understand, we're talking about decisions that are plausibly within the business judgment rule. And so look, someone can argue of course, well, it's perfectly profit maximizing for Exxon to spend some money on fighting these policy proposals. And that's expected of profit maximizing firms, et cetera, et cetera.

But we're not really arguing one way or the other. Or it doesn't sound like you're arguing one way or the other about what is in fact profit maximizing from the perspective of an individual shareholder of Exxon. The question is, what is realistically going to be allowed by the Delaware court, as plausibly justified for it's profit maximizing perspective.

MADISON CONDON: It's extremely unlikely that a Delaware court would say, no Exxon, you have to spend lobbying money. They just wouldn't do that.

MIKE LIVERMORE: Yeah, that's right, that's right. It's just-- yeah, exactly. So then this kind of gets us to this divestment question, and the exit versus voice. So it sounds like on the broader question of divestment-- correct me if I'm wrong-- that you're more on the voice side.

It sounds like you think there's enough that can be done as a shareholder within the constrictions of existing law-- the confines of existing law-- that would actually be useful and promote kind of good behavior and more sustainable practices. So that it's worth actually remaining invested in these companies, rather than divesting altogether.

MADISON CONDON: I actually don't think that's true. I mean, I don't think that there's a one size fits all policy. I think that, particularly for these large passives, there's just-- they're not going to divest. So I think that, as a matter of public-- so for example, I think as a matter of public pressure, like, I think you can acknowledge that BlackRock can't straight up divest, but you can acknowledge that they have control over, like the indexes that they license.

So if those indexes-- so right now, these products are a little bit a mess in terms of funds that are labeled climate friendly that are, in fact, not climate friendly. And I think that pressing the institutional investors to press the index providers to be better about thinking about what is or is not ESG, and to be more transparent about that, I think that's another really important move.

But in terms of divestment, so there's been a lot of reporting that cost of capital for dirty businesses is going up. And certainly the industry is complaining that this is because of the divestment movement. The counter to that is like, no, it's just traditional investing. It's a bad time to be in fossils right now. The future looks bleak.

I sort think that they're like a little bit the same thing. There's-- like, what is and is not ESG has become like extremely porous. Sometimes, ESG seems to mean just any time you're thinking about climate change at all, even if it's just for like a purely bottom line reason, that's labeled ESG.

MIKE LIVERMORE: Yeah, I mean this is a complicated thing, too, just in terms of what is the-- this kind of transparency issue around ESG. But just to put a fine point on the divestment question, so you were saying that look, the reality is these big institutionals, like Vanguard and BlackRock, are not going to divest from fossils. And so they might as well be using their positions to promote the better policies.

But there are folks out there who could divest, and have divested. So like the universities are obviously the big example of this. And they control nothing like BlackRock, but they have some money that they control. And so then, you think maybe it is a good idea-- so even though-- so these universities have a choice.

They can maintain their positions on these as shareholders and then align themselves with folks like BlackRock or others who are even more aggressive in promoting these kind of policies. Or they could divest. And how should they think about how to make that choice?

MADISON CONDON: Well, I think if you think that the rest of the institutional investors are going to start taking a portfolio primacy approach, or a universal owner approach, you might not want to be invested in that company anymore. You could help them, but you also might, as sort of an investment proposition if the stock's going to go down, not be invested in that company anymore.

If you have those active choices, and at some point there is this-- the divestment movement and debate has been around a long time, and the pushback against it has always been divestment doesn't do anything, there's always going to be someone else to step in and take your place. There's always going to be vice funds that are willing to take the profit of the other people who find that less savory of an investment.

But at some point, the line runs out. At some point, the divestment movement becomes big enough it obviously starts to affect capital. And I think that we're beginning to see a tipping point right now, with it actually getting harder to get fundraising for capital projects in the fossil space.

MIKE LIVERMORE: Right. So let's talk a little bit about the greenwashing point that you've been making. We've been circling around it a little bit. So environmental social governance funds have become a pretty big deal. I think probably a lot of people are invested one way or the other in these kinds of funds. But there's a question of what that actually means.

So how confident should I be when I buy a fund that is labeled as climate friendly, that I'm actually only invested in companies that are doing good things for the environment?

MADISON CONDON: You know, that's a really good question, and there should be way more transparency and way more research on this topic. So far, it's just sort of anecdotal. Vanguard got in trouble. They had a fossil free fund that had Kinder Morgan and a couple others, maybe Occidental in it. So fossil fuel companies in the explicitly labeled fossil free fund.

So that seems clearly like a problem. But then becomes, so you ask the question from an investor perspective, but maybe I'll also answer it a little bit from the regulator perspective. It's a question of what are you expecting when you buy a low carbon fund? Like you, Mike. Like what is your definition of low carbon? That's a really interesting question from a securities regulation perspective when you're trying to say, no, Vanguard, this product that you're offering is or is not low carbon, actually.

Which scenario have you picked? When do you think that all fossils have to stop being produced? You can look at what the European Union is going through right now, and they're sort of-- they have this process to label every investment as green or not green, and it's erupted all of these fights over, is natural grass-- is natural gas green? It's certainly less bad than coal and oil. I wouldn't call it green.

But there's all of these borderline questions, and so it's like, do you as an investor know enough about what is green or not green to police your decisions? Do the people making the indexes know enough about what they're doing to label things green or not green? Do the regulators know enough?

So that's a really interesting question. I think that there's going to-- I think we're just really at the beginning of seeing it all play out, about it seems pretty easy to regulate fossil free or not. When people start to make claims about this fund is Paris compliant or not, et cetera. There's so many questions about what that means.

Does it mean that like all the companies in the portfolio have some sort of net zero commitment? It might mean that, but then there's so many questions about, well, has that been audited? Is that realistic at all, like when the company made this net zero claim, like did it impact its financial sheet in any way? Did it change capital allocation in any way?

These are all questions, because plenty of companies right now are making some pretty ambitious claims, and it's very clear that it hasn't trickled down to the people who are sort of making the day to day decisions about what buildings to buy, what suppliers to contract with. So it's a real mess, I will say.

MIKE LIVERMORE: So when you have these funds, do they have a definition-- I mean when they say we're the green fund X, or socially responsible fund Y, is there like a sheet? A term sheet, or something that explains what is actually meant by that? Or is it just like, a name for the fund? How does that just operationally work?

MADISON CONDON: So you can look into the term sheets. Usually you can see the methodology that's employed. Often it will be like an underweighting, overweighting methodology. The problem with that is that that in itself is pretty opaque, because oftentimes they're using ESG scores, which they've bought from a third party ESG provider. So like MSCI, or Sustainalytics, or S&P, they all have ESG scores that they compile themselves and then sell.

Which they themselves don't have a ton of transparency about what actually went into this ESG score. How are you balancing all the different factors? Is the data that you use to make the ESG score real data, or did you-- where did you get it from? Has it been audited at all?

So if you're an interested investor that's actually trying to figure out the emissions footprint of your portfolio, it's extremely challenging.

MIKE LIVERMORE: Right, so there are these third party providers that, it strikes me that that would be a kind of an obvious thing that would happen in the market. And they're of questionable I mean, are they not trustworthy? What's the story with these third party actors? Because I can imagine, just in other domains where this kind of thing has come up, people wanted to buy-- they want to buy coffee that isn't exploitive. So they get fair trade certified.

Or, you want humanely raised meat, so you have some certification for that, and you look for that in the grocery store. Or you care about sustainably sourced paper products, and so there is different entities out there who were each vying to become the accepted standard for sustainable forestry practices. So, is this just another manifestation of that? Are there NGOs in this space who do a particularly good job, and it's just a matter of kind of separating the wheat from the chaff? Or is this kind of a fundamentally more complicated problem than what we've seen in the past?

MADISON CONDON: It's definitely not an NGO thing. I mean, if anything, the NGOs are the ones who are sort of trying really hard to point out the greenwashing when they can find it. But they're not the ones providing the ESG information. It's sort of like the traditional index providers, or like traditional financial analysts that have expanded into the ESG space. And the ones that have come to dominate, I just said, are MSCI and Sustainalytics.

And there's been a bunch of mergers and consolidations as this industry has become very huge rapidly in the past couple of years. There's a bunch of problems. It's not like any one organization is particularly nefarious, although maybe the oil and gas companies are. But the data that they're using is only as good-- the products that they're selling to the investors or to the index providers is only as good as like the data that they get.

And a lot of the data that they get right now is like voluntarily provided by corporations, either to CDP or otherwise. And none of that is audited or assured. Or if it is, it's not getting the level of assurance that we would expect from a financial statement. It's getting like a different type of lower level assurance.

All of this I think is a very big problem, given how much a thing like your emissions can be a statistic. Like. Your emissions can really be an input into a bunch of different investor's decision makings in how to allocate capital.

MIKE LIVERMORE: So part of the question, I wonder, is just how much demand there is for the truth of the matter on these questions, versus how much do people just want to see oh, ESG and the title of the fund. Do people actually care that much about the behind the scenes process? And if so, why doesn't an actor like the Sierra Club or Environmental Defense Fund or whoever actually get into the business of providing reliable estimates of the kind of ESG characteristics of some of these funds?

MADISON CONDON: Because it really relies on a bunch of data that's internal to the company. You can do third party estimates, and that is growing, to be sure. One thing in particular that's growing is sort of remote sensing of methane emissions, or remote sensing in general of deforestation, or various emissions. So that's happening, and private providers are definitely moving into that space. So sort of like snooping on companies for their environmental damage.

It's still pretty small, though. And at root, a lot of this data has to come from the companies themselves. They have the data, they should give it to the investors. And I mean, just to be clear, I think that that is going to happen imminently. The Securities and Exchange Commission is working on proposed rules that should come out, I think soon. Maybe in the next month, I think early next year, which will be mandatory climate risk disclosure rules in which what I expect would require mandatory disclosure of certain categories of emissions. At least for certain industries.

MIKE LIVERMORE: And do we do this with any other ESG characteristics? Obviously the SEC requires disclosure of all kinds of data about companies, all kinds of information. Their balance sheet, and obviously their exposure to risk, and et cetera, et cetera. Is this-- is the climate related disclosures that are on the horizon, are those akin to other kind of socially relevant disclosures? Or would it be something quite new?

MADISON CONDON: So they're simultaneously considering, or working on, I should say, proposed rules for disclosure in the realm of human capital management, which is basically like HR slash diversity, or human resources treatment, broadly defined.

So that I think counts. I'll just say a defense of the climate disclosure rules, this is where I get frustrated with the definition of ESG. I don't think there's anything that special about the climate risks, other than everyone has a weird block about them, and decides to treat them differently. It's obviously relevant to investors. Like, if you've told all of the world that you are going to reduce emissions by a certain date, normal investors would like to know what that means.

And on your balance sheet, are you going to start investing in X and Y, or are you going to transfer this, or what is the plan? That's just a basic financial-- I think obviously that should be a thing that companies need to do a better job of disclosing to their investors. And similarly, normal investors should be worried about are corporations, factories, and flood plains, like, are they prepared for the internet to go out at a certain category of storm? There's a bunch of super relevant financial risks that are being ignored by the market, and these just seem like, clearly material.

So not special in some sort of way, you know? So you framed it as sort of like, are there other disclosures in which we ask for social disclosures. And I'll say the one I can think of which no longer exists is the conflict mineral disclosures in which companies were sort of supposed to-- there's a post Dodd Fran-- there's a Dodd Frank [? era ?] regulation that finally got rolled out, which was disclosure of payments if you work in the conflict minerals space outside of the US territory. But it no longer exists because it got killed by the Congressional Review Act.

So that to me is a purely social disclosure. You know, tangentially related to the bottom line. I don't think that that's what the climate disclosure rules are. I think that they are bread and butter materiality investor concerns.

MIKE LIVERMORE: So are they covered by existing rules, then? And it's just the rules need to be applied more vigorously--

MADISON CONDON: Yes, that's in part--

MIKE LIVERMORE: and this is a clarification?

MADISON CONDON: I mean, I think it's a big failure of enforcement. So there was a 2010 guidance about how, if climate risks are material they should be disclosed. That should capture like a lot more than what the market is currently delivering to investors. It just hasn't, and the SEC hasn't been an enforcement priority under the last administration.

So I think there's easily an argument that a lot of these disclosures are already required. But there's also so much confusion in this space, and it is admittedly like a very rapidly moving and new field. And so I think that new regulatory guidance is absolutely necessary.

MIKE LIVERMORE: So just to take a step back. Obviously, we've been talking a lot about the financial industry, and investment, and how kind of financial markets respond to these risks, and so on. And one question I'd be curious how you think about this is, obviously, there are a lot of the risks associated with climate really don't touch on the market, or touch on the market very, very little.

So flooding in Bangladesh, which is going to cause a really substantial amount of human suffering. Obviously one can argue that could be destabilizing, and there could be some kind of political consequences, but there's also just going to be things that are going to cause human suffering of people who do not have a lot of money, and do not participate in financial markets. And are essentially at the very fringes or almost entirely excluded from the global economy. They operate within a local economy that's mostly cut off from the rest of the global economy.

So there are clearly, even if BlackRock can act in a way to maximize the interests-- its own interests or the interests of the people that own its funds in a very kind of portfolio oriented way, there are lots of effects of climate change that are outside the portfolio. Effects on species, obviously.

So what does that mean for it? Is that an important limitation on what we can accomplish through this type of corporate governance, ESG type of mechanism, or is there-- are there reasons to be less concerned about that, and to feel as though if we actually just get the financial markets operating properly, then we will be making efficient investments in climate change or in climate change reduction, or not investing in fossil fuels or whatever else?

MADISON CONDON: Yeah, I mean you're totally right. I make this point in the externalities paper, as well. The ideal level of emissions reduction for BlackRock from a cost benefit perspective is less than the preferred global level of emissions reduction. So BlackRock can handle-- so there's a trade off that BlackRock has to make. How much profit am I going to sacrifice from oil and gas, and in return receive sort of reduced emissions to my portfolio.

The comfortable temperature for BlackRock is higher than the comfortable temperature for the world. The world would choose to stop producing oil earlier, and to keep the temperature lower. Yeah, I mean, that's bad. So I think that's important to point out. So I talk about this in the paper, but it's also important-- my paper has been read as advocating for BlackRock as like, the savior of the world. And that's just like very much not the position of the paper.

The paper tries to be pretty descriptive, because I think a lot of what the work is doing in the article is just sort of pointing out what is going on, and what the incentives are, and just arguing that it's already happening. But yeah, the short answer is yes, BlackRock has different incentives than the global governance or even the citizens of America.

So the question is what to do about that. What does that mean? Does that mean that you have concerns about BlackRock acting as a pseudo regulator? And I think your concern might be that would displace government. Like, what if we rely on BlackRock to solve our problems instead of the government, I think is one concern. There's like a crowding out effect.

I think that's really legitimate. I mean, I think our current government is pretty broken. So I don't think that BlackRock is like a great solution in any way. I think it's in response, partially in response, to a broken government.

MIKE LIVERMORE: I mean, in a way it's just illustrative of how out of whack our policies are, if they're not even maximizing value for an entity like BlackRock or Vanguard, right? They're not even-- I mean, what does that mean? They're not--

MADISON CONDON: You mean, like even politically and powerfully [? entities? ?] Is that what you mean?

MIKE LIVERMORE: Yeah, exactly. If we're not maximizing the-- essentially what we're talking about is the returns to financial markets in the United States, right? If we're not maximizing that, then what are we maximizing with our policies? Like, whose interest are we actually promoting, if it's not the owners of our economy? And it's certainly not, in this instance, it's not the interest of regular folks.

MADISON CONDON: Well, I will say that Rex Tillerson was the Secretary of State. So I just think-- I think of government capture as a very big obvious part of the story here.

MIKE LIVERMORE: But it's-- just to be clear, to put a fine point on it, it's not captured by the owners. And it's not owners versus non owners, it's not management versus labor. It's not rich people versus people who don't have a bunch of money. We're actually saying that the US policy is not promoting the interests of rich people as well as it could, which is pretty amazing.

MADISON CONDON: Yeah, it is interesting. It depends-- I mean, to be fair, definitely it's rich people who own the stock market. That's definitely true. There's definitely a bunch of other rich people whose interests it would be to keep maximizing fossil fuels.

MIKE LIVERMORE: Right, that's right. But it's just like, if you take kind of--

MADISON CONDON: I agree with you.

MIKE LIVERMORE: The ownership class in a very general sense, it's not maximizing their interests, and that's fascinating. That seems to be a very strange state of affairs, a pretty pathetic state of affairs. Not that we should be maximizing the interest in the ownership class. But these are the-- I

MADISON CONDON: I don't know if the benefits of the ownership class is my main goal.

MIKE LIVERMORE: But I guess what I mean by that is, if we're not going to maximize the benefits of the ownership class, it would presumably be so that we could promote the interests of non owners and people who don't have a lot of money. Workers, and all of that. But that's not what we're talking about here. We're talking about promoting the interests of some subset of wealthy people at the expense of everybody else, including the ownership class in general. Which is a pretty pathetic place to find ourselves.

MADISON CONDON: Yep. That's where we are.

MIKE LIVERMORE: OK. Well--

MADISON CONDON: On that note.

MIKE LIVERMORE: On that note, nevertheless, there's a lot of exciting stuff happening in the space. Some good, some bad. And it's great that there are smart people who are paying attention to this, and can keep all of us updated and alert to developments in these sectors.

So thanks very much for your work on these issues, and for taking the time to chat with me today.

MADISON CONDON: Thanks so much, Mike. It's been really fun.