Vanguard Investment Stewardship Insights

Voting Insights: Director election and climate-related proposal at AGL Energy

September 2021

Vanguard publishes Investment Stewardship Insights to promote good governance practices and to provide investors and public companies with our perspectives on important governance topics and issues that come up for shareholder votes.

Company: AGL Energy Limited (AGL)

Meeting date: 22 September 2021

Proposals: Item 3a—Elect Director; Item 6b—Shareholder resolution on Paris Goals and Targets

How the funds voted

At the annual meeting for AGL, Australia's largest utility company, the Vanguard funds held the board accountable for governance concerns about material climate risk oversight by voting against the only director up for reelection. The funds supported an advisory shareholder resolution asking AGL to set emission reduction targets aligned with the Paris Agreement goals as part of its demerger plans. AGL had previously announced its intention to split into two companies in 2022.

Vanguard's principles and policies

Good governance starts with a company's board of directors, and an effective board should be both independent and diverse in terms of personal characteristics, skills, experience, and opinions. Company boards that are appropriately capable, diverse, and experienced are equipped to make better decisions, and good results are more likely to follow.

Vanguard's Investment Stewardship team regularly assesses how well a board of directors oversees the company's strategy and the board's own role in identifying, mitigating, and disclosing material risks that may affect long-term shareholder value. The transition to alternative energy sources taking place in global energy and electricity markets because of climate change is one such material risk. It also presents strategic opportunities.

When the Investment Stewardship team identifies material governance failures, the Vanguard funds may take accountability measures such as withholding support for directors' reelection and/or supporting shareholder proposals that seek to address gaps in a company's disclosures.

Analysis and voting rationale

AGL is the largest single carbon emitter in Australia, primarily because the bulk of its electricity generation comes from coal-fired power plants. Market expectations for companies to plan for an energy transition have become increasingly clear over the last several years, as has the materiality of the related risks to shareholder value. Investors and activist groups in Australia have repeatedly asked companies, including AGL, to develop and disclose plans for reducing emissions.

Vanguard's Investment Stewardship team has maintained an open dialogue with AGL's board members over multiple years. Our recent discussions focused on the board's oversight of the company's energy transition plan and deteriorating stock performance, as well as the company's announced plan to execute a demerger to create separate companies: one that contains the coal generation assets and another that contains the retail business and new energy solutions.

Our research and analysis, and our engagements with AGL's directors, left us with significant concerns regarding the board's oversight of and responsiveness to the material risks on climate change.

While we recognize the company is in a challenging situation because the Australian electricity market relies heavily on coal for generation, we believe the board had opportunities to act sooner to put in place an adequate strategic and risk management plan for its energy transition.

We observed that the board failed to appreciate rapidly changing market trends and expectations, the impact of new technologies and disruption on its business, and the damage to its reputation. In previous engagements, we queried board members on the company's decarbonization roadmap and shared our perspective that the disclosures the company was providing did not give the market an appropriate understanding of the alignment of the company's strategy with the goals of the Paris Agreement. Our analysis this year did not identify substantial improvements to those disclosures.

These issues and other factors have contributed to a significant loss of shareholder value. According to Bloomberg, as of 15 September 2021, AGL's total shareholder return had decreased 49.5% over the last five years, compared with a 15.4% increase in total shareholder return for the ASX 200 Utilities Sector Index and an 85% increase in total shareholder return for the ASX 100 index.[1]

The board has acknowledged its shortcomings in public statements and in our engagement. The Vanguard funds voted to withhold support for the only director up for reelection—the Australian market employs a staggered board election process—as an accountability measure for our concerns with the board's collective risk and strategy oversight in the past and as a signal that we expect stronger risk oversight practices.

The Vanguard funds also supported a resolution asking AGL to set and disclose Paris Agreement-aligned targets along with the forthcoming demerger scheme documents, and details of capital expenditure and remuneration arrangements to support achievement of the targets.

The company has stated that it intends to have a greater focus on its energy transition, provide further details of its decarbonization plans and targets as part of the demerger documents, and introduce a Say on Climate vote. We welcome these commitments. However, we would have expected a more timely and comprehensive response to the shareholder feedback the company has received over multiple years.

Since AGL's decarbonization and energy transition path is currently not aligned with the Paris Agreement goals, we remain concerned that delays in disclosing such a roadmap are likely to lead to further erosion of shareholder value.

What we expect from companies on these matters

On behalf of the Vanguard funds, we expect boards to represent the interests of all shareholders and to make independent, thoughtful decisions about a company's strategy and risks to long-term value creation.

We expect boards to regularly and critically reevaluate their assumptions, seek diverse perspectives that challenge a company's leadership thinking, and appropriately oversee business strategy and material risks.

Where climate change is a significant material risk to a company's business strategy, we expect the board to be climate-competent and reflect the necessary skills to independently oversee its company's risks and strategy on the energy transition. As we have previously communicated, robust climate risk mitigation measures include setting targets aligned with the goals of the Paris Agreement.

1 Past performance is no guarantee of future returns. The performance of an index is not an exact representation of any particular investment, as you cannot invest directly in an index.