Vanguard Investment Stewardship Voting Insights

Vanguard

Climate shareholder proposal at BP

June 2023

Company: BP plc (BP)

Meeting date: April 27, 2023

Proposal: Item 25 (shareholder proposal)—Approve shareholder proposal on climate change targets

How the funds voted

At the annual meeting for BP plc, the U.K.-based energy company, the Vanguard-advised funds[1] did not support a shareholder proposal requesting that BP align its 2030 Scope 3 greenhouse gas (GHG) emission reduction aims, which are specific to the use of BP's energy products, with the goals of the Paris Agreement.[2]

Vanguard's principles and policies

On behalf of Vanguard-advised funds, we look for portfolio company boards to effectively oversee material risks, including material climate risks, and to disclose their approaches to oversight of these risks to shareholders. This allows stock prices to reflect the risks and opportunities associated with the company's strategy. We believe that boards have a responsibility to be aware of material risks and opportunities (including those associated with climate change) as they make informed, long-term decisions on behalf of company shareholders.

We believe that boards that are most effective in safeguarding long-term shareholder value from material climate-related risks demonstrate:

Relevant risk competence: Where climate matters are material to a company, we look for boards to be competent in relevant risks so that they can foster healthy debate, challenge management assumptions, and make informed decisions.

Robust oversight and mitigation of material climate risks: We look to understand boards' processes for overseeing and mitigating material risks on behalf of shareholders. Highly engaged and effective boards are well positioned to ensure that material risks, including material climate risks and opportunities, are considered in both short- and long-term planning.

Effective disclosure of material climate risks and attendant oversight practices: We look for companies to disclose to the market how their board oversees material climate risks and related climate strategies

1 Vanguard's Investment Stewardship program is responsible for proxy voting and engagement on behalf of the quantitative and index equity portfolios advised by Vanguard (together, "Vanguard-advised funds"). Vanguard's externally managed portfolios are managed by unaffiliated third-party investment advisors, and proxy voting and engagement for those portfolios are conducted by their respective advisors. As such, throughout this document, "we" and "the funds" are used to refer to Vanguard's Investment Stewardship program and Vanguard-advised funds, respectively.

2 The Paris Agreement sets a goal of holding the increase in global average temperature to well below 2°C above pre-industrial levels and pursuing efforts to limit the temperature increase to 1.5°C above pre-industrial levels. It does not prescribe a single pathway to reach those goals. Rather, it is a binding international treaty that requires all countries to commit to, communicate, and maintain national-level greenhouse gas budgets to achieve the global temperature goal. The Vanguard-advised funds do not dictate company strategy. As shareholders, the Vanguard-advised funds seek to understand whether and how companies and their boards are planning for resiliency against the backdrop of this stated policymaker goal. We believe that boards are responsible for determining risk mitigation approaches to maximize shareholder value in their companies and planning for an uncertain future. Where there are legally binding or government-designated budgets for different industry sectors associated with the agreement, we believe that companies should disclose how their targets and strategies are appropriate in the context of those factors.

in alignment with accepted investor-oriented frameworks such as the Task Force for Climate-related Financial Disclosures (TCFD).

At companies where climate matters present material risks, the funds may support shareholder proposals that seek reasonable and effective disclosure of Scope 1 and 2 emissions data and relevant categories of Scope 3 data. The funds may also support proposals that ask companies to pursue and disclose climate risk mitigation targets when material to a company's stated long-term strategy.

Analysis and voting rationale

Vanguard's Investment Stewardship team has maintained an ongoing dialogue and constructive engagement with BP leaders over several years. Our analysis of the climate-related proposal submitted for shareholder consideration at BP's 2023 annual meeting included engagements with members of the BP board and engagement with the proposal's proponent.

The proponent expressed a view that BP could lead and thrive in the energy transition by meeting the increasing demand for energy services while reducing GHG emissions to levels consistent with the global intergovernmental consensus specified by the Paris Agreement.

The proponent maintained that the company's current plans would not lead to net reductions in absolute emissions by 2030 and therefore could not be considered Paris Agreement-aligned targets. The proponent contended that companies such as BP should offer alternative energy products at scale that would lead to emission reductions during this decade. The proponent asked investors to support the proposal to encourage BP to advance the company's stated aims to align with the Paris Agreement goals.

Our engagement with BP leaders covered the board's governance and oversight practices of material risks to long-term shareholder value. We discussed the rationale for BP's February 2023 strategic update, in which the company announced it would be increasing investments in low-carbon energies and fossil fuels; these plans led BP to revise its decarbonization targets, which were announced in 2020. The company framed the strategic update as an adjustment to the company's plans in response to changes in the external environment and market dynamics, rather than a change in strategy. The board expressed confidence in the company's long-term strategic direction, operational performance, and financial framework, as well as its focus on execution and delivery.

During our meeting, we sought to better understand how the board and management team were thinking about changes in demand and in the regulatory environment, and the board's role in oversight of those matters. We discussed board skills and boardroom dynamics related to decision-making, appropriate debate, and diversity of perspectives in deliberations. We discussed how the board was involved in BP's scenario analysis and planning process, including how it is considering expert insights regarding the resilience of oil and gas projects under a scenario of a 1.5°C limit to global warming. We also discussed whether BP had considered pursuing some form of external validation of the alignment of its strategy with the Paris Agreement goals to provide further assurance to shareholders that the company's plans and targets align with its stated commitment to the Paris Agreement goals. We were also interested in understanding the board's response to shareholder feedback received in 2021 and 2022 on climate-related proposals, and to the 2023 shareholder proposal on Scope 3 emissions targets, including the reasons the board decided to recommend shareholders vote against it.

Members of BP's board explained that the board was not looking at any single scenario given the complexities of the energy transition and the multiple possible pathways to reach net zero. BP leaders reiterated their belief that when taken in its totality, BP's strategy is consistent with the Paris Agreement. The board acknowledged differing views and opinions on the pace of BP's energy transition. However, in the board's assessment, the shareholder proposal encroached on the board's role and responsibility of oversight of company strategy, and it cautioned shareholders against limiting management's flexibility by focusing on one aspect of that strategy. The board considered the proposal to be disruptive and a threat to long-term value creation and therefore not in the best interest of the company and its shareholders.

Vanguard's Investment Stewardship team analyzes shareholder proposals on a case-by-case basis based on the Vanguard-advised funds' proxy voting policies, taking into consideration public disclosures and insights gained during engagement. In this case, we determined that the proposal was addressing a material risk for the company but concluded that the requested action implicated a change in company strategy. The funds do not seek to direct company strategy. Therefore, the Vanguard-advised funds did not support the shareholder proposal. The proposal received approximately 17% support from shareholders.

The Vanguard-advised funds voted in support of the re-election of all directors, including the board chair, who was re-elected with 90% support, down from 97% in 2022. Before the annual meeting, some shareholders had publicly announced their intention to vote against the board chair's re-election because of concerns with BP's revised emissions targets. We considered the board's risk oversight process adequate and, as such, did not find that a vote against directors was warranted.

We will continue to engage with BP leaders to inform our understanding of the board's governance and oversight processes and how the company is being managed to deliver long-term shareholder value in an evolving market.

What we look for from companies on this matter

We look for boards to have appropriate competencies to oversee material risks, including material climate risks, and to adopt robust risk management and mitigation practices, including thoroughly explaining their approach to setting emissions reduction targets. Where climate change presents a material risk to long-term shareholder value, companies should provide effective, coherent, and comprehensive disclosures to the market on their climate-related strategies. We look for companies to provide quantitative disclosure of their performance metrics and progress against the company's own established strategies and targets; we also look for qualitative disclosures of governance and risk management processes.

We analyze and vote on all shareholder proposals on a case-by-case basis. When evaluating proposals, we weigh whether a specific risk is material to the company, whether it addresses a governance decision or encroaches on operational or strategic actions, and whether the company already meets the request. We look to see a clear link between the proposal's enactment and the company's long-term value. The Vanguard-advised funds may support a proposal at one company but not a similar proposal at another company with different circumstances.

Vanguard publishes Investment Stewardship Policy and Voting Insights to promote good corporate governance practices and to provide public companies and investors with our perspectives on important governance topics and key votes. This is part of our growing effort to enhance disclosure of Vanguard's investment stewardship voting and engagement activities. We aim to provide additional clarity on Vanguard's stance on governance matters beyond what a policy document or a single vote can do. Insights should be viewed in conjunction with the most recent region- and country-specific voting policies.

The funds for which Vanguard acts as investment advisor (Vanguard-advised funds) retain the authority to vote proxies that the funds receive. To facilitate the funds' proxy voting, the boards of the Vanguard-advised funds have adopted Proxy Voting Procedures and Policies that reflect the fund boards' instructions governing proxy voting. The boards of the funds that are advised by managers not affiliated with Vanguard (external managers) have delegated the authority to vote proxies related to the funds' portfolio securities to their respective investment advisor(s). Each external manager votes such proxies in accordance with its own proxy voting policies and procedures, which are reviewed and approved by the fund board annually. The Vanguard Group, Inc., has not been delegated proxy voting authority on behalf of the Vanguard-advised funds.

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