Vanguard Investment Stewardship Insights

Voting insight: Shareholder proposal at Valero requesting disclosure of emissions reduction targets

June 2022

Company: Valero Energy Corporation (Valero)

Meeting date: April 28, 2022

Proposal: Item 4—Disclose climate action plan and GHG emissions reduction targets

How the funds voted

At the annual meeting for Valero, a U.S.- based independent refiner with ethanol and renewable diesel businesses, the Vanguard funds did not support a shareholder proposal requesting that the company disclose near- and long-term greenhouse gas (GHG) emissions reduction targets aligned with the Paris Agreement's goal of limiting the global average temperature rise to 1.5 degrees Celsius, and a plan to achieve them inclusive of the company's full range of emissions.[1]

Vanguard's principles and policies

Boards are responsible for overseeing a company's long-term strategy and any material risks to shareholder value. As part of our Investment Stewardship team's activities, we regularly assess how well a board of directors understands the company's strategy and the board's own role in identifying, mitigating, and disclosing material risks that may affect long-term shareholder value. Climate change is one such risk to our investors' portfolios.

Where risks are material, we look for companies to demonstrate three key elements of sound climate change risk management:

Oversight: A climate-competent board that demonstrates awareness of climate risks and fosters healthy debate on climate topics, challenges management assumptions, and makes thoughtful and informed decisions regarding these risks.

Mitigation: Robust risk oversight and mitigation measures, including setting targets aligned with the goals of the Paris Agreement and an expected net zero transition and integrating climate risk considerations into strategic business planning and capital allocation decisions.[2]

Disclosure: Effective and comprehensive disclosures, both qualitative and quantitative, to show progress over time, preferably written in accordance with the framework of the Task Force on Climate-related Financial Disclosures (TCFD).

The Vanguard funds do not seek to direct company strategy or operations. At companies where climate matters present material risks, the funds may determine that it is in the interest of long-term shareholders to support shareholder proposals that seek reasonable and effective disclosure of greenhouse gas emissions. Similarly, the funds may support proposals that ask companies to establish appropriate climate risk mitigation targets in keeping with the company's strategy.

Analysis and voting rationale

When evaluating a shareholder proposal related to climate change risks, engagements serve as a critical input to our decision-making process. These conversations enable us to better understand the company's perspectives related to the proposal, its climate risk mitigation strategy, the board's oversight of climate-related risks, and how the proposal's requests could affect the company's stated strategy.

During our engagement with Valero, company executives explained their strategy to generate shareholder value under low-carbon-economy scenarios, including their plan to address the company's Scope 1 and 2 emissions. Valero has publicly disclosed a near-term target to reduce or offset 63% of their global refining Scope 1 and 2 GHG emissions by 2025 and a medium-term target to reduce or offset global refining Scope 1 and 2 emissions by 100% by 2035. Company leaders explained that their near-term target had a defined pathway supported by projects that had already gained board approval. They further explained that their plan to achieve their 2035 target would rely in part on projects and technologies that were still under development.

Up to 90% of Valero's emissions footprint consists of Scope 3 GHG emissions. As noted by the proponent who submitted the proposal, the company does not disclose Scope 3 emissions data. During our engagement with company leaders, we encouraged increased disclosure given the apparent materiality of Scope 3 emissions to Valero. Executives provided their perspective on the complexity and limitations of inventorying Scope 3 emissions at this time and shared the rationale for their intensity-focused approach to emissions and deliberate approach to target-setting. The company expressed concern that setting a Scope 3 net-zero-by-2050 target would imply a reduction in their business because of the nature of the refining business model.

Valero provides TCFD reporting and has disclosed that it is updating the report with more scenario analysis. As a part of that process, the company is also evaluating the potential for additional GHG emissions reduction targets.

During our engagement, we also discussed the relevancy of the Science Based Targets initiative (SBTi) cited in the proponent's supporting statement. We recognized that SBTi had paused development of guidance for the sector and that it is not currently accepting targets for validation from companies in the oil and gas sector. Valero had indicated in its proxy, and provided confirmation to us, that it employs a third-party external audit of its emissions disclosures.

Following our engagement and independent review, we determined that although a lack of Scope 3 disclosure lags Valero's peers, the proposal's requests were not reasonable given the company's stated strategy, the impact a Scope 3 reduction target would have on the business, and a lack of accepted framework for setting Scope 3 targets for the sector. Thus the Vanguard funds did not support this shareholder proposal.

What we look for from companies on this matter

As stewards of our clients' investments, we look for boards to represent the interest of all shareholders while prioritizing oversight of financially material risks through the lens of shareholder returns. We encourage boards to create long-term shareholder value through effective and informed oversight of company strategy and risks. We further look for boards to challenge management and regularly re-evaluate risk mitigation practices while seeking diverse opinions and perspectives to appropriately oversee company strategy and risks.

When GHG emissions are a material risk to a company's performance and strategy, we look for boards' climate literacy to enable independent oversight of the energy transition, company strategy, and material risks. We encourage public disclosure explaining all the aforementioned areas. Specifically relating to shareholder proposals on GHG emissions reduction target-setting, we hold that boards should have appropriate latitude to determine which risk mitigation strategies maximize long-term shareholder value, and absent industry-wide accepted frameworks for target-setting, we believe that the board should be able to make such decisions. Relevant to the energy transition, we acknowledge that the pathway may not be linear, but we encourage boards to effectively oversee this dynamic transition.

1 Vanguard's Investment Stewardship team is responsible for engagement with portfolio companies and proxy voting at the direction of the boards of our internally managed global equity holdings, including Vanguard index funds. Investment stewardship activities, including proxy voting, for Vanguard's externally managed active funds are supported by those funds' external advisors.

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 funds do not dictate company strategy. As shareholders, the Vanguard 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 companies should disclose how their targets and strategies are appropriate in the context of those factors.

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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