

Vanguard Investment Stewardship Insights

Voting insight: Shareholder proposal seeks science-based emissions targets at Costco

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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: Costco Wholesale Corporation (Costco)

Meeting date: January 20, 2022

Proposal: Item 5 (shareholder proposal)—Report on greenhouse gas emissions reduction targets

How the funds voted

At the annual meeting for Costco, a U.S.-based chain that operates members-only warehouse outlets, the Vanguard funds supported a shareholder proposal requesting that the board adopt short-, medium-, and long-term science-based greenhouse gas emissions reduction targets, inclusive of its full value chain, in order to achieve net zero emissions by 2050 and to effectuate appropriate reductions prior to 2030. The proposal passed with 70% support.

Vanguard's principles and policies

Vanguard expects companies and their boards to exhibit three key elements of sound climate risk governance:

- **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.

- **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).

At companies where climate matters present material risks, the funds are likely to support shareholder proposals that seek reasonable and effective disclosure of Scope 1, 2, and 3 greenhouse gas emissions. Costco's Scope 1 emissions largely entail the emissions generated by its warehouse stores. Its Scope 2 emissions are generated, in part, by the electricity needed to operate those stores. And its Scope 3 emissions are indirect emissions primarily generated by the company's 25,000 global suppliers.

The funds may also support proposals that ask companies to pursue climate risk mitigation targets. The goals set forth in the Paris Agreement have become a widely accepted standard for countries and companies aiming to address climate change. Vanguard encourages companies to set and disclose targets that align with these goals.

Analysis and voting rationale

Engagements are an important component of our proposal review process. These discussions allow us to better understand a company's climate risk mitigation efforts in the context of its growth strategy.

When appropriate, we engage with both the proponent of the shareholder proposal and company leaders to understand both viewpoints.

Our engagement with Costco included an independent director and several senior executives. Company leaders outlined the work that Costco is doing to mitigate Scope 1 and 2 emissions, and the company has indicated that details will be published by December 2022.

We identified gaps in the company's disclosures about Scope 3 emissions, which are likely its largest source of emissions per Costco's previous disclosures on this topic. In our engagement, we sought clarification on a timeline for disclosures about Scope 3 emissions. We view such emissions as material if these sources generate more than 40% of a company's total emissions. We observe that several of Costco's peers are further along on their climate journeys, including on Scope 3 disclosures and targets, suggesting that those peers provide better oversight and mitigation of material risks.

Costco leaders outlined the steps they were taking to survey and benchmark their supplier network to determine the maturity of individual climate mitigation strategies. They outlined a plan for near-term emissions reductions for 2035, which is five years later than what the shareholder proposal requested.

The proponent, in our conversation, provided context on their dialogue with Costco over many years. In this instance, they felt the proposal would clarify the company's commitments and how the targets it sets align with the Paris Agreement goals.

The proponent also pointed to the material risks Costco faces given its limited progress on this issue. Competitors such as Walmart, Best Buy, and Target already measure value chain emissions and are pursuing science-based targets that align with the Paris Agreement goals. Costco's own filings acknowledge that environmental, social, and governance (ESG) issues could lead to its losing market share and diminish its reputation with customers.

Our independent analysis determined that the proposal was addressing a material risk, and that the proposal language gave Costco's management flexibility in implementation and appropriate

discretion. We determined that the proposed actions would add clarity for shareholders on Costco's exposure to and mitigation plans for climate risk throughout its business. They would also help the market understand the resiliency of Costco's business in a low-carbon world.

The proposal requested near-term emissions reductions for 2030. We believe that timeline is reasonable and does not encroach on management's ability to execute its strategic plans.

Because the proposal addressed a gap in disclosures related to a material risk and gave management flexibility on implementation over a reasonable time period, the Vanguard funds supported the proposal. A majority of shareholders also voted for it.

What we expect from companies on this issue

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 provide effective oversight of 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 team's thinking, and appropriately oversee business strategy and material risks.

Where climate change is a 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 related to the expected energy transition. We encourage companies to disclose material risks, including climate-related risks, and their mitigation strategies. As we have previously communicated, robust climate risk mitigation measures include setting targets aligned with the goals of the Paris Agreement or applicable subsequent agreements and disclosing how the company will deliver shareholder value considering climate risk.