

Vanguard Investment Stewardship Insights

Voting Insights: Emissions reduction targets and climate lobbying at Phillips 66



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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: Phillips 66

Meeting date: May 12, 2021

Proposals: Item 5 – Adopt GHG Emissions Reduction Targets;
Item 6 – Report on Climate Lobbying



How the funds voted

At the annual meeting for Phillips 66, a U.S.-based energy company, the Vanguard funds voted in support of a shareholder proposal requesting that the company set emission reduction targets inclusive of greenhouse gas (GHG) emissions for all of its operations and energy products. The funds voted against a proposal requesting a report on climate-related lobbying activities.

Vanguard's principles and policies

Vanguard expects portfolio companies and their boards to be competent about relevant and material risks. In the case of climate change risk, this includes an expectation to implement appropriate risk oversight and mitigation practices and to effectively disclose to the market how boards oversee climate-related strategy and risk management. A highly engaged board will ensure that climate-related risks and opportunities influence short- and long-term planning. Vanguard encourages companies to set clear and meaningful climate-related goals related to their overall strategy.

At companies where climate matters present material risks, the funds are likely to support shareholder proposals that seek reasonable and effective disclosure of greenhouse gas emissions or other climate-related metrics. The funds may also support proposals that ask companies to pursue climate risk mitigation targets such as those aligned to the goals of the Paris Agreement.

Vanguard believes that poor governance of lobbying activities coupled with misalignment to a company's stated strategy or lack of transparency about the activities could manifest into financial, legal, and reputational risks that can affect long-term value for Vanguard funds.

Analysis and voting rationale

We have engaged with Phillips 66 board members several times over the past few years. The focus of our discussions has ranged from board composition and executive compensation to climate change risk and climate-related shareholder proposals. This year, we discussed two shareholder proposals with company leaders to better understand their approach to setting GHG targets and how they assess the relationship between their lobbying activities and their strategy for addressing the risks associated with climate change.

With respect to setting emissions reduction targets, the company mentioned a desire to ensure that its set targets are supported with operational rigor. The company explained that its culture and processes are structured around individual business units and vary from facility to facility. Phillips 66 believes that setting company-wide targets without carefully understanding and mitigating the risks of that strategy throughout the organization would lack cohesion with the goals that individual business segments are working toward internally.

We understand the challenges that Phillips 66 would need to overcome to align each business unit's strategy with a company-wide target, and we have been directionally supportive of the progress the company has made. But we also believe it could be doing more to protect shareholder value.

Where climate change is a material risk, Vanguard expects companies to set meaningful goals and disclose them clearly, as that transparency enables thorough analysis, productive

dialogue, and accurate security pricing benefiting a range of company stakeholders. We believe a request to set company-wide targets inclusive of Scope 1, 2, and 3 emissions would not only bring Phillips 66 more in line with industry peers but also would provide investors with material and decision-useful information on the company's climate strategy. Therefore, the Vanguard funds supported the emissions reduction shareholder proposal.

With respect to the shareholder proposal seeking a report on the alignment of climate lobbying activities at Phillips 66 with the Paris Agreement goals, in our assessment the company has opportunities to increase disclosure on its direct and indirect lobbying activities. We have provided feedback to the board that we expect continued progress on oversight of lobbying-related activities and disclosures.

As detailed above, we believe that Phillips 66 has work to do to advance its strategy for addressing the risks associated with climate change. However, in our assessment, this shareholder proposal is misdirected in that it seeks to change the company's strategy through a report on the company's lobbying activity.

If the company had a stated climate strategy that was more clearly supportive of the Paris Agreement and had set goals that reflected this position, we would expect its political activity and lobbying to align with that approach. In our analysis, that is not the case. Because of the current misalignment between the proposal's requests and the company's current climate strategy, the Vanguard funds voted against the proposal on climate lobbying.

What we expect from companies on this matter

On behalf of the Vanguard funds, we expect boards to provide proper oversight of risk and strategy. Where climate change risk is material to a company, we expect boards to be climate competent, to mitigate risk through setting appropriate targets, and to effectively disclose their climate strategy and progress in publicly available materials. Shareholders benefit from disclosure that can provide insight into how a board oversees material risks and how a company mitigates both the physical and transitional risks associated with climate change.

We expect boards to oversee corporate political activity throughout their enterprise and to communicate their firm's philosophy and policies to investors. We look for companies to disclose the oversight policies and structures in place to ensure their political activities' alignment with their philosophy and long-term strategy.