

Vanguard Investment Stewardship Insights

Voting insights: A proxy contest and shareholder proposals related to material risk oversight at ExxonMobil



May 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: ExxonMobil Corporation (Exxon)

Meeting date: May 26, 2021

Proposals: Items 1.1 through 1.12—Director Elections, Item 4—Require Independent Board Chair; Item 6—Issue Audited Report on Financial Impacts of IEA’s Net Zero 2050 Scenario; Item 8—Report on Political Contributions; Item 9—Report on Lobbying Payment and Policy; Item 10—Report on Corporate Climate Lobbying Aligned with Paris Agreement

How the funds voted

At the annual meeting for ExxonMobil, a U.S. integrated oil and gas company, the Vanguard funds voted on the dissident proxy card and supported two dissident director nominees to join Exxon’s board. The funds also supported two shareholder proposals related to lobbying. The funds did not support the remaining shareholder proposals, including one requiring an independent board chair, another seeking an audited scenario analysis, and one requesting more detail on Exxon’s political contributions.

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.

We carefully evaluate these board composition factors, among other considerations, as we analyze proxy contests. Our overall analysis focuses on

- the case for change at the target company,

- the quality of company and dissident nominees, and
- the quality of company governance.

In addition to constructing a well-composed board, the company should maintain a leadership structure and culture that enables the board to apply independent oversight of strategy and material risks and allows board members to appropriately challenge the management team. On behalf of the Vanguard funds, our Investment Stewardship team considers proposals requiring an independent chair case by case and is not prescriptive about which leadership structure best enables independent oversight.

Vanguard expects portfolio companies and their boards to be competent about material risks. With climate change, this includes an expectation of appropriate risk oversight, mitigation strategies and practices, and effective disclosure to the market of how the board oversees climate-related strategy and risk management. A highly engaged board will ensure that climate-related risks and opportunities are included in both short- and long-term planning.

Vanguard also believes that poor governance of corporate political activity, including lobbying, can manifest into financial, legal, and reputational risks that can affect long-term value for Vanguard funds. This is particularly true if there is a misalignment between corporate political activity and a company’s stated strategy, or lack of disclosure about the activity.

Analysis and voting rationale

Proxy contest

Vanguard’s Investment Stewardship team conducted nearly a dozen engagements with members of Exxon’s board and leadership team over the last year, with numerous discussions in the weeks ahead of the annual meeting. This follows roughly

a decade of engagement with Exxon on topics related to the board's composition, independence, and responsiveness to shareholder feedback. For several years, we have also annually discussed with members of Exxon's executive team the oversight of climate risks and the strategy for mitigating them. Beyond that, ahead of Exxon's annual meeting, we engaged multiple times with other shareholders and stakeholders to understand their perspectives, including with the proponent of the dissident slate, the hedge fund Engine No. 1. We also engaged directly with each of the proposed dissident director nominees to inform our analysis of their relevant skills and qualifications, as well as of the case for change at Exxon.

Several aspects of the dissident's case for change aligned with our team's observations at Exxon in recent years, including concerns about board dynamics and company performance. Industry analysts have raised questions about Exxon's overall strategy, including its approach to capital allocation amid increasing levels of debt, which has not preserved value nor driven operational efficiencies within the enterprise. In that context, we share concerns that Exxon's risk oversight process has not led to long-term value creation, with the company significantly underperforming peers and the market over all relevant short- and longer-term periods. We have further observed that an increasingly pressing need exists for Exxon to better align its climate strategy with (1) target setting in line with global peers and (2) its public policy efforts related to climate risks.

We believe that Exxon's insular culture may have contributed to these areas of underperformance in the past. Over the years, we have shared with Exxon our concerns about the lack of energy sector expertise in its boardroom and questions about board independence. And for years, we did not witness sufficient progress on either front. As a result, we started our analysis of the proxy contest focused on the potential benefits of change to the makeup of Exxon's board.

In determining the Vanguard funds' approach to the proxy contest, we grounded our assessment on how any changes to the board's composition would affect its ability to oversee risk and strategy and ultimately lead to outcomes in the best interest of long-term shareholders. We also considered how potential changes would position Exxon to succeed through the energy transition. In our assessment, two of the dissident director candidates appeared well-positioned to add both conventional oil and gas industry and transformational energy perspectives to Exxon's board. We determined that these perspectives would enhance the board's overall mix of skills and experience and benefit the company's efforts to assess strategic options and mitigate risks connected to the energy transition. For these reasons, the funds supported the nominations of Gregory Goff and Kaisa Hietala to Exxon's board.

Through our direct engagement with the lead independent director and other Exxon board members, we gained insight into recent progress the company has made and the future steps it is committed to taking regarding board composition. We were encouraged by recent signs of increased board independence and positive steps regarding new board members' applicable skills and diverse backgrounds.

Exxon has committed publicly to a thorough search for candidates who fill gaps on the board within the year, and we look forward to reviewing the outcome of that search. At present, we believe Exxon will benefit from having enough flexibility to successfully navigate recent additions to its board alongside conducting this search following this year's annual meeting. To that end, the Vanguard funds did not support Alexander Karsner and Anders Runevad on the dissident slate.

Independent chair proposal

Our engagement with Exxon's independent directors significantly improved in recent months. Its lead independent director made himself and other independent directors available for multiple discussions with our Investment Stewardship team without Exxon's management present—a marked shift from engagement practices in prior years.

Through these engagements, we observed the benefits of Exxon's recently enhanced lead independent director role. We also saw improvements to Exxon's board dynamics and the independent perspectives that each director provides. Exxon directors gave us specific examples of changes that directly resulted from the board's independent oversight, as well as examples of how the board independently challenges management. To address shareholder concerns about the lack of relevant energy and climate experience, Exxon has publicly committed to add, within 12 months, two new directors who possess those skill sets. We view this as a positive step in response to shareholder feedback.

Through our discussions with the lead independent director and other board members, we gained greater insight into the independent leadership the board is providing. We appreciate the benefits that a stable board leadership structure will provide as Exxon emerges from a proxy contest and continues to incorporate newer perspectives in the boardroom. As a result, the Vanguard funds did not support a proposal to require an independent board chair at Exxon this year. The funds will continue to monitor the efficacy of Exxon's leadership structure. We look forward to continued engagement with the current and incoming independent directors and expect continued progress toward independent oversight of material risks, strategy, company culture, and board dynamics.

Additional shareholder proposals

The Vanguard funds did not support a shareholder proposal requesting an audited report of the financial impacts of the International Energy Agency (IEA)'s Net Zero 2050 Scenario. Our research found that Exxon's current reporting includes more than 70 scenarios from reputable sources, including the IEA and the Intergovernmental Panel on Climate Change (IPCC). The company indicated that its relevant subject matter experts were reviewing the IEA's Net Zero 2050 Roadmap that was released in mid-May 2021 and were considering including the IEA's scenario in their next Energy and Carbon Summary. Given the recency of the IEA's scenario release, Exxon's current scenario analysis disclosure, and the company's stated plans to review the scenario and roadmap, we concluded that this shareholder proposal did not warrant the Vanguard funds' support at this time.

The funds did not support a shareholder proposal calling for a report on political contributions. In our assessment, Exxon's recent enhancements to its disclosure on this topic give investors adequate insight into the company's political contributions and its board's oversight of this risk.

The Vanguard funds voted in support of two shareholder proposals, one calling for a report on lobbying payments and policies and the other for a climate lobbying report aligned with the Paris Agreement goals. Exxon has acknowledged that its lobbying efforts present a material risk. Although the company discloses details about its lobbying activities, its disclosure does not clearly explain how the company's lobbying efforts align with its strategy and publicly stated positions. For example, Exxon's existing disclosures do not explain how its lobbying efforts are tied to its publicly stated support of the Paris Agreement goals. We believe that investors would benefit from enhanced disclosure that clearly outlines Exxon's lobbying activities, board oversight of those activities, alignment of lobbying efforts with company strategy and publicly stated positions, and risk mitigation efforts stemming from any misalignment. In our engagements, Exxon leaders were receptive to our feedback on these matters, and we will continue to monitor Exxon's progress on and disclosures about them over the coming year.

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 decisions about a company's leadership, strategy, and risks to long-term value.

If a board lacks the appropriate composition to independently oversee areas of material risk and company strategy, we expect the company to conduct a thorough search to identify qualified directors who will bring the necessary skill set into the boardroom. Similarly, we expect boards to be climate competent. Particularly for companies where climate change is a material risk to the business, we expect boards to reflect the necessary skill set to independently oversee a company's risk and strategy related to the energy transition, and to be effectively composed in such a way that independent directors can challenge management on areas related to climate strategy and climate risk mitigation in both the short and longer term.

Furthermore, we expect boards to oversee corporate political activity across their enterprise and to communicate the company's philosophy and policies to investors. We look for companies to disclose the oversight policies and structures in place to ensure that the political activity aligns with the company's philosophy and long-term strategy.