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C O R P O R A T E S O C I A L I S S U E S R E P O R T E R

Impartial Research on Companies and Shareholders Worldwide

August/September 2004

Most Mutual Funds Opposed All Social Proposals

A majority of the nation's 100 largest mutual funds opposed all social issue shareholder resolutions that came to votes in the first half of 2004, according to an analysis by IRRC. Another 15 percent voted against nearly all such proposals, while about 30 percent of the funds cast abstentions. None of the top 100 funds voted in favor of a majority of social issue proposals, IRRC found. (See table.)

This review looks at a new requirement—an Aug. 31 deadline set by the Securities and Exchange Commission for mutual fund companies to disclose their proxy votes at corporate annual meetings held between July 1, 2003, and June 30, 2004. A main impetus for the new disclosure rule has been to make fund managers demonstrate that they are voting their shares in the best interests of shareholders, rather than currying favor with companies with which they do other business (such as underwriting securities and managing employee pension plans) by opposing resolutions.

IRRC's review included the top 100 U.S. equity mutual funds, based on assets under management, and covered 28 investment management companies. The assets of the top 100

funds recently were valued at \$1.47 trillion, equal to 37 percent of all assets held in U.S. equity mutual funds, according to data from *Business Week* and the Investment Company Institute through June 2004.

The biggest disparity in voting

The Aug. 31 deadline for disclosure of proxy votes by mutual funds comes one year after the funds were required to disclose their proxy voting policies and procedures.

practices identified by IRRC was at the nation's two largest fund families. **Fidelity's** actively managed funds voted against all social issue proposals, while **Vanguard's** index funds abstained on 96 percent of all

such proposals. Each of these fund families has more than \$360 billion in assets and accounts for about one quarter of total assets held in the top 100 U.S. mutual funds. Only Fidelity's shares counted against the social issue proposals, however. Under SEC proxy rules, abstentions like those cast by Vanguard are not included in the final vote tally.

Splitting Votes

Further examination of Fidelity's votes reveals a split even within that fund family. While Fidelity's active funds have no stated proxy voting policy on social issue proposals (and in practice are voted against them), its index funds adhere to a policy set by Geode (Fidelity's index fund adviser) to abstain on all social issue proposals.

Two other fund families reviewed by IRRC also have striking differences in voting policies among the funds they manage. **AIM Investments** usually abstains on social issue proposals, while its **INVESCO** fund series has an avowed policy of supporting shareholder resolutions that seek basic labor protections, adoption of International Labor Organization principles and expanded reporting on equal employment oppor-

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Mutual Fund Family	Top 100 Assets (Millions)	Top 100 Funds (#)	Proxy Votes on Web Site	Voting Policies on Social Issues
Fidelity (Active Funds)	\$361,466.0	20	Yes ¹	Always votes AGAINST.
Fidelity (Index Funds)	28,813.1	2	Yes ¹	Always ABSTAINS
Vanguard	361,386.5	23	Yes ²	Always ABSTAINS (96%)
American Funds	284,529.8	9	Yes	Always votes AGAINST
T. Rowe Price	65,591.0	6	Yes ³	Usually votes AGAINST
Dodge & Cox	53,538.7	2	Yes	Always votes AGAINST
Franklin Templeton	32,805.3	4	No	Always votes AGAINST
Janus Funds	30,303.0	3	No	Usually votes AGAINST
Putnam	27,660.6	3	No	Always votes AGAINST
The Hartford	25,468.9	3	No	Votes FOR and AGAINST
American Century	20,601.9	1	Yes	Usually votes AGAINST
Oakmark	19,035.1	3	Yes	Always votes AGAINST
Davis Funds	18,609.2	2	Yes	Always votes AGAINST
Van Kampen	14,788.3	2	Yes	Usually votes AGAINST
Lord Abbett	13,635.7	1	Yes ⁴	Always votes AGAINST
Oppenheimer	12,160.8	2	No	Usually ABSTAINS
MFS	12,050.3	2	Yes	Always votes AGAINST
MFS Union Standard	—	—	Yes	Always votes FOR
Legg Mason	11,283.1	1	Yes	Always votes AGAINST
American Express	9,319.1	1	Yes	Always votes AGAINST
Longleaf Partners	8,518.6	1	Yes	Usually votes AGAINST
Columbia Funds	7,310.3	1	No	Usually votes AGAINST
Clipper Fund	6,985.6	1	No	Always votes AGAINST
Calamos Investments	6,723.2	1	No	Votes AGAINST or ABSTAINS
Harbor Fund	6,670.2	1	Yes	Always votes AGAINST
Selected Funds	6,328.1	1	Yes	Always votes AGAINST
Morgan Stanley	6,220.1	1	Yes	Usually votes AGAINST
AIM Investments	5,845.3	1	Yes ⁵	Usually ABSTAINS
INVESCO	—	—	No	Often votes FOR
Pioneer Funds	5,154.4	1	Yes ⁶	Usually ABSTAINS
DFA Investments	5,122.5	1	Yes	Always votes AGAINST

1. See "Investment Expertise" 2. See "About Vanguard" 3. See "Company Info & Press" 4. See "Proxy Voting Guidelines and Procedures" proxy votes not included. 5. Proxy votes not included. 6. Password protected – for subscribers only.

Source: Investor Responsibility Research Center and Business Week (for mutual fund rankings)

tunity issues. (None of the INVESCO funds is in the top 100 equity mutual funds, however.)

Similarly, **Massachusetts Financial Services** (MFS) routinely votes its mutual fund shares against all social issue proposals, except in the case of MFS Union Standard, a fund directed at union pension plans.

This fund (also not in the top 100) has a stated policy of supporting social issue proposals "on the premise that, in order to succeed over the long-term, companies need to treat employees, suppliers, and customers well; need to be environmentally responsible; and need to be responsive to the communities in which they operate."

The voting policy for MFS Union Standard is more consistent with guidelines established by social investing mutual funds, which have long advocated proxy voting disclosure by all mutual funds.

IRRC's review of the top 100 mutual funds found only one investment management company, **The Hart-**

Proxy Season

ford, that voted in favor of more than a handful of social issue shareholder proposals in 2004. About one quarter of the other mutual fund companies supported social issue resolutions on selected issues, such as annual reporting of political contributions, adoption of nondiscrimination policies for gays and lesbians, and more disclosure on climate change at some companies. In these instances, however, the funds typically were following the proxy voting recommendations of an outside provider.

Web Site Disclosure

The Aug. 31 deadline for disclosure of proxy votes by mutual funds comes one year after the funds were required to disclose their proxy voting policies and procedures in their Statements of Additional Information. (The SAI

is part of a fund's registration statement filed with the SEC.) IRRC's review of these guidelines last year found that while many mutual funds are willing to vote against management on certain corporate governance proposals (such as annual election of directors and cumulative voting), very few break from management's position on social issue proposals. (For background, see the August/September 2003 issue of *Corporate Social Issues Reporter*.)

Under the new disclosure rules, mutual funds must submit an "NPX" form with the SEC that lists votes on all management and shareholder proposals in companies held by the fund, including whether its shares were voted for or against management's position. The NPX form can be found on the SEC's Electronic Data Gath-

ering and Retrieval (Edgar) web site at www.sec.gov. However, because the filings often are listed by names other than those of the mutual funds themselves, the search on the web site often is time-consuming.

To save shareholders' time and effort, many mutual funds are now posting their proxy voting guidelines and votes on their own web sites. Of the 28 fund families reviewed by IRRC, 20 have information on their web sites about their voting guidelines—including 18 with links to their actual votes from July 2003 through June 2004. But even this search can be arduous, since many funds place the information in relatively obscure sections of their sites rather than as links from their home pages.

—Doug Cogan

Student Activists Press Proxy Voting

As college students around the country gear up for the start of a new academic year, wireless cards and cell phones are not the only things they are looking to upgrade; a number hope to promote socially responsible investing at their institutions. Leading the way are students at member schools of the Responsible Endowments Coalition, which was launched last spring by groups affiliated with 22 colleges and universities. With the coalition's ranks now nearing 30, it plans to hold its first conference in October. (For an earlier story, see the May issue of the *Corporate Social Issues Reporter*.)

The conference will be held in Philadelphia at the Wharton School of the University of Pennsylvania on October 16th and 17th, and will be sponsored by the Zicklin Center for Business Ethics. Ryan Burg, co-founder of the coalition and a Ph.D. candidate in business ethics at Wharton, told IRRC that the conference will focus on proxy voting, community investment and

conducting a SRI campaign in the university or college setting. "This is not a top-down, hierarchical organization," said Burg. "We want to have a town-hall style meeting of the student activists so we can make sure their concerns are what set the coalition's agenda." He noted that the conference will include background on SRI, introductions to particular issues, success stories and a panel on community investment.

Mark Orłowski, Williams graduate and another co-founder of the group, told IRRC that it has already lined up Lance Lindblom, President and CEO of the Nathan Cummings Foundation, a \$400 million leader in shareholder activism in the foundation world, as a keynote speaker. He noted that the conference will give participants the chance to see what other campuses are doing and should be a learning experience for both prospective members and campaign veterans.

"The coalition's role is to help any school with SRI issues at whatever

stage they happen to be at," said Orłowski. Both he and Burg emphasized that the group is not a single-issue organization. "The coalition does not advocate specific policies for specific schools. Some issues work well in some schools and not in others," said Burg. "Our mission is to educate and empower," added Orłowski. The membership is currently focused on proxy voting, letter writing, transparency of voting records, community investment, and, to a lesser extent, divestment.

In the 1970s and 1980s, much of the education community was involved with social investment questions. Proxy voting committees consisting of students, administrators, teachers and alumni were common, and schools often published their votes on the record. In addition, at least a half dozen schools proposed shareholder resolutions on issues such as the signing of the Sullivan principles for fair employment in South Africa, though reaching con-

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Cintas Drops Suit, Endorses Monitoring Proposal

In September, **Cintas** dropped its controversial defamation lawsuit against Tim Smith, director of socially responsible investing at Walden Asset Management. As part of the settlement, Smith acknowledged in a letter to Cintas CEO Scott Farmer that his statement at the company's 2003 annual meeting that a Haitian contractor Cintas used was a "poster child for sweatshops" was not an "accurate profile of working conditions at this plant or of Cintas's commitment to and compliance with its code of conduct and supplier monitoring program."

No monetary damages were attached to the settlement, and both parties described the agreement in conciliatory language.

In what Cintas executives described to IRRC as a "separate development," Cintas's board opted to endorse a shareholder proposal filed by the New York City Employees' Retirement System, the New York City Teachers' Retirement System and the General Board of Pension and Health Benefits of the United Methodist Church, asking the company to "report to shareholders by April 2005 on the adherence of Cintas's suppliers to the company's code of conduct for vendors." Notably, Smith's had made his since retracted sweatshop comments last year in conjunction with a shareholder resolution calling on the company to report how it monitors conditions at its suppliers worldwide.

The Lawsuit

During settlement negotiations, Cintas provided Walden with information regarding audits performed at the Haitian plant cited by Smith in his speech, Haitian American Apparel. In particular, Cintas gave Walden access to audit reports conducted by California Safety Compli-

ance Corp., also known as Cal Safety, and International Compliance Group at the facility on May 20, 2003, and Oct. 28 and 29, as well as a videotape of a follow-up visit to the factory by Cintas personnel in November 2003. "In short, based upon these materials," Smith wrote in his letter to Farmer, "I would not have described this facility as a sweatshop, and I regret any harm that may have been caused to Cintas by the reporting of my remarks outside the shareholder meeting at which they were delivered."

Smith went on to say in the letter that, "audit reports and the videotape indicate that the factory is a spacious and well-lit facility with adequate ventilation, potable water, and sanitary bathroom facilities." He also said that the audits reveal that employees are paid at least the minimum wage and time-and-a-half for overtime hours. He noted that problems uncovered in a May 2003 audit, including concerns about methods for recording employees' time worked and inaccurate overtime calculations appeared to be resolved, as the videotape showed that the factory installed time clocks to deal with these concerns. Cintas declined to give IRRC access to these materials. Cintas previously declined to give IRRC information on its supplier in Haiti for an earlier article, although it has emphatically denied the allegations raised by Smith all along.

Overall, Smith applauded Cintas's code and monitoring program, but he added that audits need "to strive for continuous improvement" and include surprise visits and confidential employee interviews. Smith ended that he and the staff at Walden would "welcome the opportunity to share our views on these subjects" with Cintas.

Sarah Kelly, compliance manager and trust counsel with Boston Trust

and Investment Management, Walden's parent company, told IRRC, "We're glad we've been able to reach an amicable settlement with Cintas through an exchange of information." She added, "The copies of independent audit reports that Cintas shared with us allowed Tim to be able to apologize for the tone of his comments at the annual meeting, as they did not reflect the true conditions at Cintas's vendor in Haiti." She noted that Walden also shared the information that was the basis for Smith's speech with Cintas. She said that Walden was "pleased to find out" that Cintas was in fact conducting independent audits of its suppliers, a practice she describes as "important," and noted that the settlement would not alter Walden's plans to continue to press companies on the supplier compliance issue. Smith declined to be interviewed for this article.

The allegedly inaccurate information Smith used for his speech to shareholders last year came from a report released by the Union of Needletrades, Industrial and Textile Employees (Unite), now part of the newly merged Unite-Here. The report contained a list of allegations about forced overtime, wrongful firings and unacceptable health and safety conditions. Smith explains in his letter to Farmer that Walden does not have the capability to conduct this type of research, the principal reason it relies on this type of reporting.

At the time the report was released, Unite and the International Brotherhood of Teamsters had formed a partnership to organize workers at Cintas. Under the partnership, drivers who deliver Cintas's products organize with the Teamsters and support the organizing efforts of production workers in Cintas's laundries, who are organizing with Unite. The unions continue to say Cintas has a record of abusing workers and break-

ing laws at its own facilities, from failure to pay minimum wages and overtime pay to discrimination. The unions' organizing campaign continues. Cintas has maintained that the union drive clearly shows that Unite had dubious motives in releasing its report on the supplier in Haiti.

For an article IRRC published when the suit was filed in February this year, Ahmer Qadeer of Unite told IRRC that Cintas's lawsuit was "totally frivolous" and that its charge that Smith lied was "fraudulent" in itself. Qadeer insisted that all of the information presented by Smith was true, and that Unite had the evidence, including worker testimonials and customs documents, to back it up. Qadeer had suspected at the time that Cintas was suing Smith and Boston Trust in an indirect attack on Unite and its unionization drive. He declined to comment for this article. (See the February 2004 issue of *Corporate Social Issues Reporter* for the full article on the filing of the lawsuit and the allegations surrounding Cintas's supplier in Haiti.)

When the lawsuit was first filed in January, it alarmed filers of shareholder proposals, which feared it would cause a chilling effect on shareholder activism and dialogue with between shareholders and companies. Socially responsible investors IRRC spoke with, including the Interfaith Center on Corporate Responsibility and its affiliates, seemed to be pleased and in part relieved a deal was struck between the parties.

As for using information from unions in the future, David Schilling, director of the Interfaith Center's contract supplier program, told IRRC that "unions often have contact with workers and organizations on the ground that can get perspective on what's going on that we won't get from other sources," so this type of information is still "important" and needs to be taken "seriously." Schilling explains

that while auditing firms have a certain expertise, especially in analyzing payroll information, they do not always effectively interview workers to get at more qualitative problems like discrimination and violations of organizing rights.

Change of Heart?

Ironically, Smith in the end won the report he sought with the proposal he introduced at Cintas's annual meeting last year. In what appeared to be a change of heart, Cintas's board this month decided to endorse a shareholder proposal from New York City and the United Methodist Church on reporting on vendor compliance. In Cintas's proxy statement, the board says that starting with the end of its 2005 fiscal year, Cintas will report on the implementation of its code annually. The first report, the board says, will provide:

- "A summary of the number of apparel suppliers encompassed within Cintas's code of conduct and audit program.
- "The number of on-site audits conducted as part of the program for fiscal year 2005, and a description of the elements contained within the audit process.
- "A summary of the audits' findings, with notes regarding corrective actions requested by Cintas and the outcome of the suppliers' efforts.
- "A summary of any relationships that Cintas has chosen to terminate because of its code of conduct and audit program."

The first report will be made available to shareholders on Cintas's website, no later than Aug. 31, 2005. Cintas also disclosed in its proxy statement its code of conduct and details on its audit program, which it says includes a "119-point annual audit of our major contractors and suppliers...by independent, third-party auditing firms that are highly

experienced in the specific operations of the apparel industry, and fully practiced in the standards and guidelines outlined by organizations such as FLA [Fair Labor Association], WRAP [Worldwide Responsible Apparel Production] and SA 8000 [Social Accountability International's audit program]." Cintas also emphasized that it strictly enforces its code, terminating contracts with vendors that refuse audits, have egregious violations or refuse to implement corrective action plans.

In response to questions about the reason for the change in position, Wade Gates, spokesperson for Cintas, told IRRC that "the decision to recommend approval of the resolution in this year's proxy is not a change of position for the board; rather, it is an extension of the commitments made last year." He added that Cintas's audits "contain sensitive and confidential information from our suppliers, and we believe that we have developed a format in which we can provide the transparency we want for the program while protecting our suppliers' confidential information."

Pat Doherty from New York City's Comptroller's Office said he is looking forward to working with the company on the forthcoming report. Schilling similarly told IRRC that the Interfaith Center and its member, the United Methodist Church, are looking forward to talks with Cintas on the report's content. He says that he would like more information on the resources Cintas is dedicating to monitoring, especially training, the problems Cintas's audit program is unearthing and how the company is grappling with them. He added that while a report like Gap's most recent supplier compliance report (see May 2004 *Reporter*) would be ideal, he doesn't expect Cintas to match its breadth or depth in its first attempt.

—Peter DeSimone

Fair Labor Association Issues Second Report

The Fair Labor Association (FLA) issued its second annual public report in August with noticeable changes. In addition to covering more companies—25 in all, up from six in the first report—the new report provides summary statistics on each company's supply chain and the results from monitoring visits to their suppliers, enabling readers to easily compare companies. The report also marks the first time **Nike** has reported on its supply chain since being named in a fraud suit filed by California resident Marc Kasky. The monies Nike paid to settle the case funded part of the changes to the FLA's monitoring methods and reporting format.

Answering Criticism

The new reporting design and monitoring procedures answer most of the criticisms the FLA received following the release of its first report. Staunch opponents of the FLA, including the National Labor Committee, had said the first report's omission of factory names and the inability to compare brands called into question the FLA's credibility. (See the June/July 2003 issue of IRRC's *Corporate Social Issues Reporter* for feedback on the FLA's first report.) While the new report also does not reveal factory names or addresses, it does review results for individual companies. It also shares information on the FLA's new approaches to dealing with the thorny issue of freedom of association, an issue for which the FLA received harsh criticisms for its monitoring and remediation procedures. The changes appear to have silenced the FLA's previous critics, at least for now, with none offering public rebukes of the new report.

Still, the new format might pose challenges to the FLA and its members. As with **Gap's** public report

earlier this year on its suppliers, the FLA's assessment paints a bleak picture of major brands' supply chains, with most factories reporting multiple code violations. In fact, the FLA's monitors found more violations in the second year than the first. If improvements are not reported in year three, serious doubts might be raised about the effectiveness of the FLA and its members in fixing violations and moving factories toward sustained compliance.

While acknowledging that all of the factories audited by the FLA's third-party monitors had problems, the FLA's leadership sounded an upbeat note. "The Fair Labor Association is making good on what it promised following its groundbreaking first report," said Auret van Heerden, FLA president and chief executive officer. "FLA's second annual public report draws upon more rigorous and comprehensive monitoring and verification, more independent monitoring, more company reports and special features. Although there is still much more work to be done, we are pleased and proud of the increased level of company participation, accountability and transparency—and improved conditions for factory workers."

Results

The report contains profiles for 10 FLA participating companies—**adidas-Salomon**, Eddie Bauer, GEAR for Sports, **Liz Claiborne**, **Reebok**, **Nordstrom**, Nike, Patagonia, **Phillips-Van Heusen** and Zephyr-Graf-X, as well as 15 university licensees. In 2003, the FLA conducted independent monitoring visits to 110 facilities in 20 countries, representing approximately 5 percent of each company's applicable factory base in high-risk regions. In all, 10 FLA-accredited monitoring groups spent more than 1,056 person days monitoring, averaging 9.6 person

days per monitoring visit.

The greatest number of audits—35, or 32 percent—took place in East Asia, defined as China, Hong Kong and Macau. The regional breakdown of FLA monitoring visits roughly reflects the distribution of factories contracted by FLA affiliated companies, with the notable exceptions of two regions—Europe, Africa and the Middle East, which received fewer visits proportionately, and Southeast Asia, which received more attention than the raw numbers warranted. This discrepancy, the FLA says, is due to the weighting system it uses to select facilities for audits, which gives factories in higher-risk countries a preference for selection. While each company has a different sourcing strategy, the report showed that most FLA companies have increased the number of factories that they contract in China, and to a lesser extent East and Southeast Asia, with the number of factories in Latin and North America falling. These developments might reflect the upcoming phaseout of the Multi-Fiber Agreement quota system on Jan. 1, 2005, which many analysts believe will lead to increased sourcing in China.

The FLA reported 1,671 violations—about 15 per factory—in year two, up more than 120 percent from the nearly 7 instances of noncompliance per factory in year one. The FLA believes that the increase is most likely due to the FLA's new focus on selecting high-risk facilities for monitoring, and on improving the quality of monitors and their familiarity with the FLA's requirements.

The FLA's monitors categorized violations as follows:

- The largest category of violations noted in the report—accounting for 46 percent of those the monitors found—involved **health and safety**, up from 26 percent in year one. Most

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violations centered on insufficient postings of evacuation procedures and inadequate safety equipment.

- The next most problematic area was **wages and benefits**, accounting for 16 percent of the violations found, up from 14 percent in year one. Among the most commonly reported problems were failure to pay workers' legal benefits and inadequate systems to record workers' time.
- Another 8 percent of the violations related to **hours of work**, down from 15 percent in year one.
- Seven percent of the problems monitors reported concerned incomplete **code awareness**. To fulfill this obligation, factories must: post a code that makes standards clear; demonstrate both worker and management awareness of the code; and have a system to report noncompliance. FLA companies are required to provide workers with a channel through which they can communicate grievances to brand representatives.
- **Harassment and abuse** accounted for 5 percent of the reported violations, down from 8 percent in year one. Almost 20 percent of these cases involved verbal abuse of workers by supervisors. Sexual harassment was reported in only three factories, but this low number, the FLA says, seems to reflect underreporting attributable to the difficulty for workers to report and monitors to detect violations.
- **Overtime compensation**

problems—where factories did not pay workers the 150 percent, 200 percent or 300 percent of minimum wages for overtime work required by local laws—accounted for 5 percent of the overall violations.

- **Freedom of association** accounted for 4 percent of the violations. Of these 70 reported instances of noncompliance, 34 percent were classified as restrictions on workers' right to establish and join organizations of their own choosing without previous authorization. In many cases, local laws restricted workers' rights in this area; monitors recorded all factories in China, where freedom of association is prohibited, as not in compliance with this standard.
- **Forced labor** accounted for 3 percent of the violations found, compared with 5 percent in year one. Nearly half of the 46 cases were found in South Asia, and all related to personnel or recordkeeping practices. For example, 46 percent related to insufficient hiring and employment records. In other cases, workers were hired as daily workers, which enabled factories to avoid providing various benefits and protections to which full-time workers are entitled, or factories limited workers' freedom of movement by withholding the workers' identification cards. Monitors also noted cases where recruitment fees restricted workers' movements.
- Of the 26 violations of **child labor** reported—2 percent of the

overall code violations reported this year—none actually involved children working in factories, according to the FLA. Most related to incomplete or fraudulent age documentation.

- **Non discrimination** accounted for 2 percent of the overall violations, down from 4 percent in year one. Almost half of the nondiscrimination violations detected took place in Southeast Asia, with most relating to pregnancy testing and status.

The FLA believes that monitors found higher rates of violations in health, safety, wage and benefit issues because these are easier to detect through visual inspection, reviewing documents and using testing equipment. Detecting discrimination or constraints on freedom of association typically is more difficult, since it requires extensive interviews and follow-up investigations. The findings, the FLA says, also might reflect monitors' relative strengths in noticing abuses.

The second report includes progress reports on the participating companies' labor compliance programs, the FLA's full evaluation of Reebok—the first labor compliance program the FLA has accredited, and blow-by-blow findings from unannounced external monitoring visits to factories. It also features case studies of third-party complaints the FLA received during 2003, highlighting three cases involving factories supplying Nike, Lands' End and Liz Claiborne. The full report can be viewed on the FLA's website, www.fairlabor.org.

—Peter DeSimone

Wal-Mart Moves to Counter Critics

One are the images of a yellow happy face wearing a red cape, or the “roll-back man,” slashing prices at Wal-Mart stores in television commercials. Instead, happy associates smile brightly into the camera between the tall aisles of birthday cards and thank-you notes, talking proudly of their accomplishments at the retail giant. The new ads show working-class families, many of them members of ethnic minorities and women, finding and developing their lifetime careers at Wal-Mart. These are the faces of Wal-Mart’s new campaign to remake its public image, one that has seen a barrage of criticisms and controversies in recent years.

Challenges and Criticisms

Accusations against Wal-Mart, the nation’s fastest-growing and largest employer, have been plentiful and varied. Most have targeted the company’s labor practices, alleging violations of wage and hour laws and workers’ right to organize, as well as sex discrimination and exploitation of undocumented workers. Wal-Mart currently faces more than 30 lawsuits—some have reported up to 44 employment actions across 31 states—seeking class action status. In the most prominent case, a federal judge approved class action status for a sex discrimination lawsuit against Wal-Mart in June 2004, creating the largest workplace bias lawsuit in U.S. history. The judge, Martin J. Jenkins, wrote that the case was “historic in nature, dwarfing other employment discrimination cases that came before it.” (For more on the June decision, see the June-July issue of the *Corporate Social Issues Reporter*.)

The sex discrimination lawsuit, initially filed in June 2001 by seven female employees, alleges systematic discrimination against female work-

ers in Wal-Mart stores and its Sam’s Clubs nationwide. It charges Wal-Mart with sex discrimination in pay, promotion, training and job assignments and with retaliating against women employees who complained about the alleged discrimination. The suit also charges the company with creating a sexually demeaning atmosphere. The suit is seeking to cover up to 1.6 million former and current female workers. Wal-Mart has responded to the June ruling, saying that it does not prove the merits of the case and that the company will appeal.

Another type of lawsuit, generally called an “off-the-clock” class action, refers to the allegations that Wal-Mart’s store managers asked employees to clock out and then to clean the stores, or made them work through their breaks and lunch hours. A suit in California represents about 230,000 current and former Wal-Mart employees, and there are similar suits in other states, including Indiana, Minnesota and North Carolina.

Yet a different type of legal case involves employment of undocumented workers. In October 2003, federal agents raided 61 Wal-Mart stores in 21 states and arrested 250 night-shift janitors who were undocumented immigrants. The arrested workers were technically employees of Wal-Mart’s contractors, and Wal-Mart has denied any charges of wrongdoing. Federal authorities told *The Washington Post* in November 2003, however, that wiretapped recordings indicated that Wal-Mart executives had full knowledge of the matter. A New Jersey lawyer filed a civil suit on behalf of nine Mexican immigrants against Wal-Mart shortly after the raid, accusing the company of having violated the Fair Labor Standards Act and the Racketeer Influenced Corrupt Organizations Act,

along with other charges. The suit asserted that Wal-Mart and its contractors deliberately hired illegal immigrants to keep the maintenance costs down, and alleged that the companies had underpaid and overworked the undocumented employees.

Whether Wal-Mart executives knew about the illegal workers is still under federal investigation, almost a year after the initial raid. But according to *The Wall Street Journal* last month, Wal-Mart is talking with the plaintiffs’ lawyer to settle the lawsuit. The settlement could cost the company several million dollars, according to press reports.

Additional lawsuits are still possible. Terry Collingsworth, the executive director at International Labor Rights Fund—an organization dedicated to taking legal actions against corporations for their labor and human rights violations around the world—recently told IRRC, “We are exploring concrete options against Wal-Mart on behalf of workers in developing countries who are toiling in Wal-Mart sweatshops around the world.”

In one move to counter some charges, Wal-Mart announced that, starting September 2004, it is instituting a pre-hiring background check for all store positions. “By adding another level of security to hiring practices, our associates can be assured that we are strengthening our efforts to try to intercept anyone who might otherwise damage that integrity,” said Sue Oliver, senior vice president of People for Wal-Mart’s Stores Division, in a press release.

Hidden Costs?

The controversies over Wal-Mart’s labor practices have caused some to question whether Wal-Mart stores are a net benefit to the communities in which they locate. One recent study claims that the retailer imposes hid-

den significant costs on the taxpayers, in that, because of the low pay scales, its employees are more likely to rely on various public services. In a report published in July at the University of California, Berkeley, Arindrajit Dube and Ken Jacobs say that Wal-Mart workers on public assistance programs in California annually cost approximately \$86 million, \$32 million in health-related services and \$54 million in other assistance.

The report, *Hidden Cost of Wal-Mart Jobs: Use of Safety Net Programs by Wal-Mart Workers in California*, says that Wal-Mart employees in California earn an average wage of \$9.70 per hour compared with \$14.01 for general employees in the large retail sector. Wal-Mart employees are about 40 percent more likely to be using state-sponsored health programs, the researchers claimed, adding, "If other large California retailers adopted Wal-Mart's wage and benefits standards, it would cost taxpayers an additional \$410 million a year in public assistance to employees."

Wal-Mart responded to the Berkeley study, countering that "annual wages for Wal-Mart associates are significantly greater than those paid by other non-union retailers, and virtually identical to those of unionized grocery workers." "More than 90 percent of Wal-Mart associates are covered by health insurance, approximately 50 percent through the company's medical insurance plan," it added. The company also claimed pro-labor bias at the university's Center for Labor Research, which published the report. "It's disingenuous of the Labor Center's researcher to tout their study as a fair, balanced assessment of Wal-Mart's impact on California taxpayers," Wal-Mart representative Cynthia Lin said in a statement on Aug. 9. "Information shows the Labor Center, dubbed a 'union think tank,' has strong ties to organized labor, which has long tar-

geted Wal-Mart." She said that the researchers obtained their data from Kenneth Drogin, an expert hired by plaintiffs in the sex discrimination class action lawsuit against Wal-Mart.

Facing Opposition

Residents in a number of communities have protested Wal-Mart's plans to enter their neighborhoods, voting against its development plans. In Inglewood, Calif., 60 percent of voters shot down plans for a Wal-Mart superstore to enter the city in April this year, despite the company's vigorous campaign—involving television commercials and free donuts—to gather support for its development.

A similar debate among the members of the Chicago City Council in May resulted in the approval of a zoning change that gave the green light to one new superstore but rejection of another needed to allow a second. Some of Chicago's community leaders have expressed concern that Wal-Mart pays substandard wages and benefits and that it hurts small businesses. As a result, two Chicago aldermen have introduced proposals to set minimum wage and benefits for large retailers such as Wal-Mart to enter the city. On Sept. 1, The Associated Press reported that Wal-Mart had put the second Chicago project on hold, even though a company spokesman said that Wal-Mart remains "committed" to the project. "But it would be unwise for us to move forward at this time," he added.

Another challenge to Wal-Mart, in Tega Cay, S.C., has seen the local residents organizing into a group called "Us Against the WAL." According to a local paper, *The Herald*, in July 2004, opponents claim that Wal-Mart "would diminish the area's quality of life by eliminating small retailers, not giving back to local groups, potentially lowering property values in some of York County's most pricey neighborhoods and by increasing traffic and crime." In response, a

Wal-Mart representative told *The Herald* that these complaints are largely unfair or inaccurate. "Wal-Mart has been running into increased difficulty getting supercenters open," he acknowledged. "A lot of it is a misconception, though."

For a company whose plans include an expansion by 50 million square feet of store space just in 2004, the pressure is increasing. Sarah Clark, a Wal-Mart representative, told the *Sacramento Bee* on July 25 that the company is taking a more proactive approach to public relations these days, trying to explain "who we are as opposed to allowing others to define who we are." The public relations campaign, she said, is not in response to a specific accusation but based on a 2002 public survey, conducted at Wal-Mart's behest, which suggested that the company was developing a negative reputation.

Telling Wal-Mart's Story

In his annual letter to the shareholders, Wal-Mart's president and chief executive officer Lee Scott said, "As the largest, perhaps most visible, company in the world, we are being held to an increasingly higher standards of behavior. ...In the past, we were judged mainly by our accomplishments. Today, Wal-Mart is increasingly defined by our actions as an employer, corporate citizen and business partner." He added, "We must always do the right things in the right way, but we can also be more aggressive about telling our story."

Scott reiterated these thoughts at the company's June 4 annual meeting in Fayetteville, Ark., along with announcements of some changes in the company's policies, according to *The Washington Post* on June 5. The changes, *The Post* noted, included raising wages for some workers and promising to reduce executive bonuses by 7.5 percent this year and 15 percent next year should the company fail to promote women and minorities for management positions in

proportion to their applications. The changes also included alerting workers if managers changed any information on employee timecards, as well as plans to introduce technology designed to ensure a worker's breaks and lunch hours.

A couple of months later, Wal-Mart's good will extended to the news media. On Aug. 5, the company announced a \$500,000 scholarship program for minority college students studying journalism, in an effort, according to a press release, "to increase the level of diversity in newsrooms around the country." Wal-Mart's vice president of corporate communications, Mona Williams, added, "Like all of us, journalists are shaped by their own culture and past experiences, and this helps determine how they see the world. Currently there simply are not enough news reporters, editors and producers whose thinking reflects their experiences growing up as minorities in this country." Williams told *The New York Times* on Aug. 16, "We've really been in the spotlight and I think that's made us especially sensitive to the need for balanced coverage." She added, "It doesn't matter if the subject is Wal-Mart or something else. You just aren't going to have that unless different perspectives are represented."

In addition to the journalism scholarship, Wal-Mart has this year become a sponsor of National Public Radio and has started underwriting a popular talk show, "Tavis Smiley," on a public television station in California. Williams told *The New York Times* that the company sought the demographic that NPR listeners represented, to "reach community lead-

ers and help them understand the value that we bring to their areas." According to an NPR representative, the station's audience consists of "intelligent and well-educated people" who "tend to be business leaders and tend to be engaged in the civic process." A recent survey indicated, she added, that 56 percent of NPR listeners shop at Wal-Mart, compared to 66 percent of the general population. Williams told *The Times*, "We want those folks to know that having a Wal-Mart in their town is a good thing."

Shareholder Actions

Shareholder resolutions attempting to influence Wal-Mart's social policies have been filed for many years, most often by religious investors affiliated with the Interfaith Center on Corporate Responsibility. In 2004, a shareholder resolution asked Wal-Mart to report on its equal employment opportunity policies, and another asked it to issue a sustainability report on its economic, environmental and social practices and performance. Votes at Wal-Mart historically have been low because 38 percent of the stock is owned by the founder's family, but they have spiked upward in recent years, as shown in the following table.

Vidette Bullock Mixon of General Board of Pensions of the United Methodist Church, the primary filer of the 2004 sustainability reporting resolution, recently told IRRC that before the 2004 annual meeting in June, she

sensed the company was "evaluating" its relationships with stakeholders. After the meeting, she believes, the company appears to have decided that it would have to "deal with" its stakeholders, and to have realized the "necessity of doing a better job at reporting on its labor and other social issues."

Mixon said representatives from the United Methodist Church and the Interfaith Center met with Wal-Mart officials in August to discuss the company's supply chain management issues—and on adopting auditing and vendor standards in particular—and described the meeting as "constructive." While Wal-Mart officials have admitted that some of its store managers in the past may have made questionable decisions, she said they are reluctant to ascribe these failures to inadequate company policies. In her view, in contrast, there are "bound to be problems" for a large company such as Wal-Mart, and that it is important to focus on better training, education, monitoring and reporting of its policies and performance. Preparing a sustainability report, she said, would help the company to "fill in the gaps" and install proactive measures. Mixon said the Methodist Church pension board may not file the sustainability reporting resolution at Wal-Mart next year, depending on the outcome of its next meeting with company officials—planned for October.

—by Sol Kwon

Primary Proponent	Resolution	Year	Vote (% support)
Sisters of Charity of St. Elizabeth	Report on steps to break glass ceiling	1999	4.8
		2000	5.0
	Report on EEO	2002	11.3
		2003	13.0
		2004	16.1
General Board of Pensions / United Methodist Church	Issue sustainability report	2004	14.2

Disney, McDonald's Supplier Project Claims Progress

A group of faith-based and socially responsible institutional investors in late August announced long-awaited progress—but scant details—on a project that seeks to boost rates of compliance with labor rights standards among **Disney's** and **McDonald's** suppliers. As a result, fieldwork is getting underway on the creation and testing of systems intended to keep factories in line with company codes.

Mutual Concerns

The project grew out of mutual concerns discussed during a dialogue that has spanned nearly five years among the investor coalition and the two companies about ways to foster sustainable improvements in factory conditions. The investor groups participating in the project are the As You Sow Foundation, the Center for Reflection, Education and Action, the Connecticut State Treasurer's Office (fiduciary for the Connecticut Retirement Plans and Trust Funds), Domini Social Investments, the General Board of Pensions and Health Benefits of the United Methodist Church, the Interfaith Center on Corporate Responsibility and the Missionary Oblates of Mary Immaculate.

Disney and McDonald's have touted their confidential meetings with the investor groups to critics over the extended period, some of whom have questioned whether Disney and McDonald's were simply using the groups at the table for cover from further scrutiny. Talks with Disney started in 1999, while dialogue with McDonald's began in 2000.

Since the beginning of talks, none of the investors participating have filed shareholder proposals at Disney or McDonald's, but neither company has escaped shareholder scrutiny altogether. Harrington Investments

has challenged Disney annually on doing business in China, asking it to adopt the China principles since 2002; it missed the resubmission threshold for next year.

In addition, New York City presented a resolution at Disney's annual meeting this year that asked the company to review the labor standards of its suppliers' operations in China, which won 29 percent support. New York City also filed a proposal at McDonald's in 2003 asking the company to report using the Global Reporting Initiative's guidelines, but withdrew it after McDonald's agreed to add elements to its annual sustainability report. Patrick Doherty, a representative of the New York City Comptroller's Office, says his office has adopted a wait-and-see attitude with regard to the new developments. He says that New York City filed at Disney this year because of continued concerns about its operations in China. "We are looking forward to seeing what the company is proposing to do on this project," he told IRRC.

The groups working with the companies say that in addition to the August announcement they have made other progress with both companies over the years that warranted continuing the dialogue without the threat of shareholder proposals. As for the timing of this most recent announcement, David Schilling, director of the Interfaith Center's contract supplier program, told IRRC that the groups decided it was appropriate to issue a press release since the project's field work has now begun and the companies have made a firm commitment to the project and reporting on results. He added that the groups hope that "this project will make a significant positive contribution to international labor standards compliance."

The Problem

Disney's consumer products division at any given time contracts directly, and indirectly through licensees, with as many as 10,000 manufacturing facilities in 50 countries. McDonald's, similarly, hires suppliers in China to manufacture toys for its Happy Meals for children in addition to purchasing food, packaging and other materials from farms and other third parties. For many years, Disney and McDonald's have had strict standards in their codes of conduct for their licensees and manufacturers, which address key labor rights issues including the prohibition of forced and child labor and the setting of requirements in such areas as health and safety, working hours, compensation and compliance with applicable laws. In addition, both companies have been active in undertaking educational, monitoring and remediation efforts to promote compliance with these codes at the factories where their products are sourced throughout the world.

However, while the codes look strong on paper, high rates of factory terminations and recurring violations at many facilities have caused both companies problems. In 2000, a Hong Kong newspaper alleged underage children worked at a factory in Shenzhen, China, making toys distributed with McDonald's Happy Meals. McDonald's suppliers in China and Vietnam have since been the target of allegations from a number of groups, including the newly merged union, Unite-Here. Likewise, Disney has been dogged by reports from the National Labor Committee and the Hong Kong Christian Industrial Committee that its suppliers pay poverty wages, violate local laws and harbor conditions that endanger workers' health and safety.

Mark Spears, director of corpo-

rate compliance at Disney, acknowledges that one of the principal reasons Disney decided to participate in the project is that it recognizes “that after a fairly exhaustive effort to improve factory conditions, the standard approaches to monitoring are not creating the desired results.” He says that Disney and all of the participants hope this project will produce sustained compliance and incremental improvements in factories going forward.

The Project

The collaborative project announced in August has been launched to strengthen the effectiveness of the companies’ compliance programs with the aim of achieving “sustained compliance.” Schilling told IRRC that, in essence, the groups define sustained compliance as a situation where problems identified in a company’s supply chain are “corrected and stay corrected.” In support of this goal, the collaborative project will create and test internal systems within factories to promote such compliance over time, including enhancing training and education for management, supervisors and workers and implementing positive compliance incentives, such as additional business. The project will also attempt to develop better methods of encouraging remediation in facilities that demonstrate significant compliance issues to minimize circumstances in which factory termination is the only business alternative.

The project partners will work with local nongovernmental organizations and governmental authorities, as well as individual factories, to identify effective implementation practices that can be applied across industries, geographic regions and socio-economic and regulatory systems. The participants anticipate completion of

the project within the next 18 months and plan to report periodically on project progress and results.

The groups declined to release further details of the project or a schedule for further updates. Schilling explained that the participants recognize that public transparency is essential; however, they all agree “the project will fail if it is conducted in public.”

Conrad McKerron, director of the corporate social responsibility program at As You Sow, added that the investor groups decided it was worth giving up some transparency in the beginning for the tremendous research opportunity of working directly with the brands on improving compliance and gaining greater transparency in the long term. “We would not have spent this much time and effort if we didn’t feel there was a sincere effort on the part of the brands to drive to proceed with this project,” he says. Disney’s Spears explains that the need for keeping a tight lid on the project’s progress at this point arises because the participants want to ensure that key commitments, including cooperation from governments, are in place and working before reporting so as not to jeopardize the project’s success by exposing it to premature scrutiny.

Overall, McKerron says that he hopes the process serves to educate those companies on the fence that are unwilling at this point to spend money on supply chain compliance or report on results. He says he will measure success on this project by two benchmarks—the quality of reporting Disney and McDonald’s end up producing and the degree of sustained compliance the groups are able to achieve in the factories. “We’ve been beating the independent monitoring mantra for years,

so it was time that we engaged companies directly to see what works best so that we can make better recommendations to companies when we challenge them,” he says.

Other Progress

In addition to the project announced in August, As You Sow and other groups involved in the Disney dialogue say that it has produced several positive changes at Disney. One is that Disney agreed to conduct a sweeping review of its contract supply system, auditing for the first time all of its supplier factories, and computerizing its audit tracking system. Disney also changed its policy to terminate contractors who fail a third audit. The investors also say that their dialogue has motivated Disney to reduce the number of suppliers it uses, improving Disney’s ability to monitor conditions at its now smaller number of facilities. They also applaud Disney for recently posting some basic information about its compliance program on its public website, marking the first time Disney has disclosed this type of information outside of its proxy statement.

In the case of McDonald’s, the groups withdrew a shareholder resolution there in 2000 after the company agreed to write a report on vendor standards compliance. The report, the groups admit, was not forthcoming on most of the relevant issues surrounding supplier compliance but subsequent dialogue led to more progress, they say, and the resolution was not re-filed. The groups note that McDonald’s published a more detailed vendor standards compliance report in 2001 and an even more in depth report this year, which is now available on the McDonald’s website.

—Peter DeSimone

Companies Ambiguous on Board Diversity

The SEC's assumption that new proxy disclosure rules on the board nomination process would yield information on the importance corporations place on diversity appears to have been off the mark. An IRRC review of 2004 proxy statements of the Fortune 100 found that only a handful specifically told shareholders they took into consideration the diversity of their board by race and sex when evaluating new board nominees. Nearly 30 companies made no mention of diversity. And while the majority of the Fortune 100 made reference to diversity, they left open to interpretation whether they were referring to diversity by race and sex or other factors, such as professional experience.

The passed-over opportunity to provide more insight into corporate thinking on board diversity comes at a time when hoped-for gains in the percentage of women and members of racial minorities holding corporate board seats have failed to materialize. IRRC's research shows that women and members of racial minorities gained virtually no ground on boards during this last annual meeting season.

New Requirements

The new disclosure requirements were put in place by the SEC Nov. 19, 2003. They were by far the less controversial part of a two-part proposal designed to open up the board nomination process and increase director accountability as a result of the corporate financial scandals. (The other part of the proposal, which would enable large security holders to nominate a few board members under limited circumstances, has never made it to the full SEC for a vote and is now unlikely to at least until after the U.S. presidential elec-

tion.) (For background on both proposals, see the December 2003 *Corporate Social Issues Reporter*.)

The SEC disclosure rule, which took effect Jan. 1, requires companies to report to shareholders on the board nomination process in their annual proxy statements. Companies must now describe how they identify and evaluate board candidates, which provides an opportunity to state whether they take into consideration the diversity of their boards by race and sex. Companies also must list their minimum qualifications for board candidates, creating yet another opportunity for them to report if they are seeking diversity by race and sex. The SEC had rejected a recommendation from social investment firms and other groups to require companies to reveal the extent to which they take race and gender into consideration in nominating candidates. The SEC said that it had adequately addressed this issue by requiring companies to disclose their criteria for considering board candidates, adding that it did not think it appropriate to identify any specific criteria that a company must address. Most commentators supported the rule and there was little squawking at the time of its approval.

Other provisions of the rule require companies to report whether they consider director candidates put forth by shareholders and, if so, their procedure for doing so. This requirement makes it easier for shareholders to plug into the nomination process. Companies also must now report if they hire an outside search firm, which reveals whether a board is relying on its own network of contacts or aggressively expanding its search. An all-white male board that relies only on its own contacts, for example, raises a red flag for board diversity advocates.

Disappointment

Board diversity advocates say that while they are disappointed by this first year of disclosure, they expect it to improve. Nikki Daruwala of the Calvert Group Ltd., the lead proponent of board diversity shareholder resolutions in 2004, told IRRC that "We weren't thrilled with the initial results, but it's a start. Companies move slowly, but this is one of the issues where patience will pay off." Daruwala said she's seen corporations move faster on board diversity than on many other social issues," pointing to the withdrawal of six of Calvert's 10 board diversity resolutions filed in 2004. In each case, companies agreed to immediately adopt proposed language on diversity, and **American Power Conversion** added a woman to its board following several years of receiving resolutions. Calvert, which is satisfied only when a company agrees to make explicit reference to diversity by race and gender, has proposed model charter language on board diversity for corporate nominating committees. It includes reference to race, gender, culture, thought and geography, and also recommends that a board reflect a range of viewpoints, backgrounds, skills, experience and expertise.

"We'd like to see companies institutionalize the process of identifying a diverse slate of board candidates and flesh out what they specifically mean by diversity," Daruwala told IRRC. "Through the collective efforts of Calvert, the state of Connecticut and other institutional investors, we plan to keep companies on their toes and move the needle further on this issue." Daruwala also stressed that it's important that corporations not only include a commitment to diversity in their proxy statement or nominating charter, but that they act upon that commitment.

IRRC Findings

IRRC reviewed the 2004 proxy statements of the publicly traded companies among the Fortune 100 for any reference to diversity in the required discussion of minimum board nominee qualifications and the board evaluation process. Of the 88 corporate proxy statements available in early September, only six companies specifically stated they took into consideration the diversity of their board by race and sex when considering board nominees. These companies were **Coca-Cola**, **Pfizer**, **J.P. Morgan Chase**, **Johnson & Johnson**, **Procter & Gamble** and **Time Warner**. Another 28 companies made no mention of diversity in their discussion of the board nomination process.

More than half of the 88 companies reviewed—47—made a reference to diversity, but did not further define the term. Numerous companies included diversity among a list of one-word qualifications, such as age, skills, independence and integrity. Others indicated they were looking for diversity of background, experience or perspective—which may or may not overlap with diversity by race and sex. Still other companies, however, seemed to indicate they were looking for diversity of professional experience in areas such as business, finance, government, education, technology and public interest. Of these 47 companies:

- 23 simply listed diversity or diversified membership
- 5 listed diversity of background
- 3 listed diversity of perspective
- 2 listed diversity of experience
- 11 listed a combination of diversity of background, perspective or experience
- 3 listed diversity of professional background

Another seven companies associated diversity with other characteristics, including three that could be inferred to take into account race and gender.

ConAgra reported that it considered “diversity, including the extent to which the candidate reflects the composition of company shareholders and other constituencies.” Similarly, **Wells Fargo** said that when evaluating a candidate for nomination as a first-time director, it considers “the current composition of the board in light of the diverse communities and geographies served by the company.” **Walt Disney** said that it evaluates “the extent to which the prospective nominee helps the board reflect the diversity of the company’s shareholders, employees, customers, guests and communities.”

Kroger reported that one of the criteria it used to evaluate board candidates was an “ability to understand the perspectives of the company’s customers, taking into consideration the diversity of the company’s customers including regional and geographic differences.” **Intel** reported that its assessment of board candidates includes “issues of diversity in numerous factors such as age; understanding of and achievements in manufacturing, technology, finance and marketing; and international experience and culture.”

Notably, two companies—**McKesson** and **Dow Chemical**—noted that a board candidate must have a commitment to diversity (and in Dow Chemical’s case, a commitment to ethnic, racial and gender diversity), although neither made a reference to the diversity of its own board. Seemingly, an all-white male board expressing a commitment to diversity would meet their criteria. Both companies have women and minorities on their boards, however. McKesson’s 10-member board includes three women and one ethnic minority member, and Dow Chemical’s 14-member board includes two women and two ethnic minority members.

Three companies made a point of telling shareholders that their board candidate selection was race- and gen-

der-neutral. **Morgan Stanley** and **Medco Health Solutions** reported that they selected board candidates regardless of race and sex; both also noted that they sought board candidates from diverse professional backgrounds. **Wal-Mart** said it is committed to a diversified membership, but added that it does not discriminate on the basis of race or sex.

No Gains this Year

The new SEC disclosure requirements had been approved two weeks after the SEC signed off on related new rules to enhance the independence of boards of companies listed on the New York Stock Exchange and Nasdaq Stock Market. (For more see the November 2003 issue of the *Corporate Social Issues Reporter*.) Companies listed on the exchanges must now have a majority of independent board members. NYSE companies also must now have nominating, compensation and audit committees comprised solely of independent directors; and Nasdaq has tightened its independence requirements related to those board functions. Proponents of board diversity had high hopes that those new independence requirements would result in more women and people of color joining boards.

The percentage of board seats in the S&P Super 1,500 held by women remains at around 11 percent in 2004, however, and the percentage held by members of ethnic minorities is less than 10 percent. Women, more than members of racial minorities, seem to be capitalizing on the trend toward independence; of the directors added to S&P Super 1500 boards in 2003-2004, 15 percent have been women, slightly ahead of women’s 11 percent representation overall on their boards. For members of ethnic minorities, though, a countervailing trend is in evidence: only 7 percent of the recent directorships have been awarded to ethnic minority members, according to IRRC data. (These percentages were the same for women

Presbyterians Assess Israel-Related Investments

The issue of investment in U.S. companies that may provide support for Israeli expansion has now surfaced in a broad new policy adopted by the Presbyterian Church (U.S.A.). Earlier this year the subject came up in a shareholder resolution sponsored by Mercy Investment Program asking **Caterpillar** to report on whether its sales of bulldozers to the Israel Defense Forces comport with the company's code of conduct.

The church's annual General Assembly in June and July adopted the new policy by a 431 to 62 vote. It calls on the denomination to examine its investments in companies whose actions further the Israeli occupation of Palestinian territories and to begin steps that may include dialogue with involved companies, shareholder resolutions or, as a last resort, divestment.

In the coming months, the assembly's moderator Rick Ufford-Chase wrote in a letter posted on PC (USA)'s website, the Mission Responsibility Through Investment Committee will begin a process with the following steps:

1. "assessing the impact of corporate involvement in providing direct or indirect support to unjust practices or programs in the region,"
2. devising a list of corporations with whom PC (USA) may choose to engage,
3. dialogue with representatives of these corporations, "normally involving not only MRTI but also representatives of the presbytery in which the corporate headquarters is located,"
4. shareholder resolutions, in the event that discussions do not result in "a change of corporate practice," and
5. "If necessary, a recommendation to withdraw church funds from these corporations."

MRTI will discuss next steps in November, focusing on firms, Ufford-Chase said, "whose business in Israel is found to be directly or indirectly causing harm or suffering to innocent people, Palestinian or Israeli."

At the assembly, representatives also called for an end to Israel's construction of a barrier between its land and Palestinian land in the West Bank, denounced "Christian Zionism" (a theology that encourages support for Israel in part because Israel features prominently in events prophesied in the book of Revelations) and voted to "examine and strengthen the relationship between Christians and Jews." Accounts of the resolution in the secular press focused on the divestment option, despite the fact that it is mentioned only as a last resort. In a *Los Angeles Times* op-ed piece, Alan Dershowitz blasted the denomination for voting "to divest from only one country in the world"—not "North Korea, Libya, Russia, Sudan, Cuba or Belarus," but "Israel, the only democracy in the Middle East and America's most reliable ally in a troubled part of the world."

In response to criticism such as this, the assembly's stated clerk, Clifton Kirkpatrick, issued a statement noting that "the assembly's action calls for a selective divestment, and not a blanket economic boycott." Kirkpatrick specifically disavowed comparisons to apartheid-era South Africa, saying that while such a comparison "may be presumed by some...the assembly has not asserted any moral equivalency between the two." He also said that the denomination was "not singling out Israel and Palestine alone for observation and critique," noting that PC (USA) "has spoken specifically about issues of justice related to North and South Korea, Rwanda, Taiwan, Central American states, and many others, including the United States."

"Israelis have a right to live in their country free from fear of terrorism that can strike innocent people anywhere, at any time," moderator Ufford-Chase said in a statement regarding the policy. "Palestinians have a right to live free from the horrors of a military occupation."

—Jan Fetter-Degges

and minorities new to the board in 2002-2003.)

Evolving Responses

Shareholders have been filing resolutions on board diversity since the early 1990s. While some corporations initially rejected the notion that their businesses would benefit from having women and members of racial minorities on their boards, most now

acknowledge that diversity on their boards would be advantageous. The disagreement has shifted to whether corporations with all-white male boards should take concerted, proactive steps to diversify their boards or whether diversity will occur over time without any special efforts.

Investor support for board diversity resolutions dropped sharply in 2004 after achieving the highest av-

erage vote of any category of social policy shareholder proposals from 1999 to 2002. In 2003, average support rose even higher, to more than 25 percent, but proposals asking companies to pledge not to discriminate against employees on the basis of their sexual orientation were the top vote-getters, averaging 36 percent support.

In 2004, the average support for
(continued on p. 20)

AEP Analyzes Costs of Climate Change Control

American Electric Power released a groundbreaking report on Aug. 31 that analyzes the potential costs of controlling power plant emissions of carbon dioxide that contribute to global warming. The 120-page report came at the request of the State of Connecticut and other shareholder proponents concerned about AEP's heavy reliance on coal to generate electricity.

Board-Level Review

AEP—the nation's largest electric utility and biggest emitter of carbon dioxide—is poised to invest \$5 billion in pollution control equipment at its coal-fired power plants through 2020 to comply with the Clean Air Act. Future controls on carbon dioxide emissions could compromise some of these investments, which are aimed at conventional pollutants like sulfur dioxide, nitrogen oxides and mercury, but not at greenhouse gases like carbon dioxide.

Last spring, the State of Connecticut filed a shareholder resolution with AEP asking its board of directors to "assess how the company is responding to rising regulatory, competitive and public pressure to significantly reduce carbon dioxide and other greenhouse gas emissions." The proponents withdrew the resolution after AEP agreed to have a special subcommittee of its board prepare such an assessment.

During the spring and summer of 2004, three independent directors of AEP's board coordinated the company's assessment, which is now posted on AEP's web site at www.aep.com. Robert Fri, a visiting scholar with Resources for the Future, led the review process. Also serving on the special board subcommittee were Donald Carlton, chair of AEP's Audit Committee, and John

DesBarres, chair of AEP's Human Resources Committee. AEP's full board reviewed a draft of the report in July 2004.

"Bob Fri and his committee are to be commended on a report that takes a comprehensive approach to a complex strategic planning issue," Connecticut State Treasurer Denise Nappier told IRRC. "Because of the multifaceted and evolving nature of the issues, the report does not have all the answers, but certainly suggests a framework for addressing critical questions as they arise."

Senate Bills Evaluated

In drafting the report, AEP's board subcommittee confined the policy analysis to "plausible" legislative greenhouse gas scenarios and proposed multi-emission regulations, such as the McCain-Lieberman Amendment that came to a vote in the U.S. Senate last fall. That bill (which was defeated by a vote of 55-43) has been reintroduced, along with alternative multi-pollutant legislation sponsored by Sen. Tom Carper (D-Del.). The possible financial effects of both bills on AEP are examined in the new report.

Four other utilities—**Cinergy**, **Reliant**, **Southern** and **TXU**—are expected to complete similar reviews later this fall and early next spring. Like AEP, they had received global warming shareholder proposals in 2004, but got them withdrawn in exchange for conducting such analyses. (For more details on these withdrawals, see the March 2004 issue of *Corporate Social Issues Reporter*.)

Adding gravity to these reports is a recent lawsuit filed by attorneys general from eight states and New York City alleging that the nation's largest coal-burning utilities are creating a "public nuisance" by emitting vast quantities of carbon dioxide into the atmosphere. AEP, Cinergy, Southern

and **Xcel Energy** (as well as the publicly owned Tennessee Valley Authority) are named in the suit, which was filed in the Federal District Court of Manhattan in late July. Citing possible damage to urban infrastructure and potentially huge increases in public health costs from global warming, the suit seeks a court order to require these companies to reduce their power plant emissions of carbon dioxide by at least 3 percent per year for 10 years.

For its part, AEP concludes that it is well positioned to deal with future carbon emission constraints through emissions trading and greater use of biomass, wind power and a new generation of cleaner-burning coal plants. However, AEP's policy analysis focuses mainly on the two Senate bills—the McCain-Lieberman bill and the Carper bill—which seek to cap future emissions at 2000 levels (i.e., offsetting any growth in future emissions). AEP's report does not consider any scenarios in which the United States would target deeper cuts in carbon dioxide emissions before 2020.

AEP does caution in its report that cutting emissions below 2000 levels could strand some of the utility's investments in its large coal-fired generating fleet. "Of course, it is quite possible that the McCain-Lieberman reduction requirement could be tightened in the future (e.g., in the post 2020 period)," the report warns. "This could lead to dramatically higher costs to the company and potentially create a need to recover some of the remaining unamortized portion of the environmental control investments for currently regulated emissions at some AEP power plants."

Despite this admission, the most stringent control scenario evaluated in AEP's report is one that seeks to stabilize U.S. carbon dioxide emissions at 2000 levels by 2010. By contrast, the Kyoto Protocol, an interna-

tional agreement from which the United States has withdrawn, aims to cut industrialized nations' carbon dioxide emissions 5 percent below 1990 levels by 2012. The Kyoto Protocol will enter into force if and when Russia makes good on a recent pledge to ratify the agreement.

\$1.5 Billion at Risk

From a shareholder's perspective, the key finding of AEP's new report is that proposals to stabilize carbon dioxide emissions in the United States may put at risk \$1.5 billion of the \$5.0 billion that the utility plans to invest in pollution control equipment through 2020.

AEP believes that \$3.5 billion of investments in pollution control equipment at its low-cost coal-fired units through 2010 are secure under any plausible emissions control scenario. However, proposed legislation could "materially alter the amount and manner" of the additional \$1.5 billion that AEP plans to spend between 2010 and 2020.

AEP remains confident that it is on the right course, however. As company spokesman Bruce Braine explained to IRRC, "While proposed legislation could materially affect the additional \$1.5 billion spent after 2010, our decisions regarding the exact type and nature of these investments need not be made for several years. So at this point in time there is no risk of stranded investment."

Moreover, the likelihood that AEP will not be able to fully amortize its investments in scrubbers and selective catalytic reduction equipment—affecting 50 to 60 percent of its coal-fired generating capacity through 2010—is "exceedingly low," Braine stressed. Even with such new investments in pollution control technology, AEP's retrofitted power plants "will continue to be among the cheapest and lowest emitting coal-fired sources in the U.S.," he said.

"In fact, it would take a program that would require shutdown of more than 50 to 75 percent of the coal-fired

generation in the nation before 2025" to strand any of AEP's scheduled pollution control expenditures through 2010, Braine estimated. He views such a control program as "politically unlikely to say the least!"

The State of Connecticut has not commented on the specific policy proposals analyzed in the AEP report. More important, in Treasurer Nappier's view, is the report's underlying forecast that "mandatory reductions of greenhouse gas emissions are likely in the next decade." Nappier told IRRC: "We concur [with this prediction], and therefore look forward to continuing discussions with AEP as the company implements its strategic plan to fully address the impending regulations."

Nappier is one of the founders of the Investor Network on Climate Risk (INCR), a group of state and city treasurers, labor pension fund leaders and foundation trustees that is seeking greater oversight and scrutiny of the investment implications of climate change. Ceres, a coalition of investor, environmental, labor and public interest groups, is serving as the Secretariat for the INCR.

Commenting on AEP's new report, Nappier told IRRC: "It is the hope and expectation of institutional investors that others in the industry will follow AEP's lead in carefully and seriously considering the potential financial risks posed by climate change and the changing regulatory environment—and sharing that assessment with shareholders." Such disclosure is a key recommendation of a new *Investor Guide to Climate Risk*, commissioned by the INCR and written by IRRC. The online guide is available at www.incr.com and www.irrc.com.

New Generation from Coal

In addition to discussing the potential financial implications of carbon constraints on its generating system, AEP's new report also stresses the need to move beyond its aging fleet of

coal-fired plants toward a new generation of cleaner-burning coal plants that use integrated gasification combined cycle (IGCC) technology. In conjunction with the release of the report, AEP announced plans to install up to 1,000 megawatts of IGCC generating capacity by 2010, at a cost of \$1.3 to \$1.6 billion. IGCC technology has been demonstrated in pilot projects over the last 10 years, but never before introduced on such a large, commercial scale.

While IGCC plants cost up to 20 percent more to build than conventional coal-fired plants, they produce fewer emissions of carbon dioxide and other pollutants that, over the long term, could justify their added upfront expense. IGCC plants also have the benefit of being able to capture carbon dioxide for injection into the ground at a substantially lower cost than conventional "scrubbing" methods.

The long-term viability of underground carbon injection has yet to be proven, however. AEP and the power industry are actively engaged in research and development initiatives in this area. (For more on IGCC technology and underground carbon storage, see the December 2003 issue of *Corporate Social Issues Reporter*.)

In its report, AEP projects that it could achieve up to 0.8 million metric tonnes (MMT) of annual savings in carbon dioxide emissions through carbon capture and storage from new IGCC plants by 2020. However, such sequestration would increase the estimated generating costs of IGCC plants by some 30 percent.

Still undetermined is whether utility regulators would allow AEP to recover the additional costs of IGCC power generation and carbon capture and storage. According to Dan Bakal, director of electric power programs for Ceres, AEP's report "shows that the company is facing a great deal of regulatory uncertainty, especially on global warming." Bakal believes that such "uncertainty is going to inhibit the investments it wants to make in clean

technologies, like IGCC power plants.”

Fortunately, AEP’s report identifies several other ways that the company can curb its carbon dioxide emissions through 2020. AEP estimates that it would achieve up to 2 MMT of annual savings through additional investments in wind power. (AEP already is an industry leader in wind power development.) Another 2.8 MMT of annual savings would result from biomass co-firing of some of its coal-fired power plants.

AEP also believes it could achieve approximately 4 MMT of additional savings through installation of more gas-fired power plants or purchased emissions credits and offsets, depending on assumptions made in AEP’s planning model. AEP believes such a multi-pronged approach should enable it to keep its carbon dioxide emissions stable at 2000 levels through at least 2020.

Costs of Controls

Altogether, AEP’s report evaluates three scenarios to control U.S. greenhouse gas emissions, including one that involves litigation and “piecemeal implementation” rather than comprehensive federal legislation. The most ambitious of the scenarios, in terms of setting targets and timetables, is the Climate Stewardship Act, sponsored by Sens. John McCain (R-Ariz.) and Joe Lieberman (D-Conn.). As amended on the Senate floor last fall, this bill seeks to cap most industrial carbon dioxide emissions at 2000 levels by 2010. However, it does not establish a timetable for deeper cuts.

According to AEP’s analysis, such emission stabilization measures would require AEP to reduce or offset 9.6 MMT of carbon dioxide emissions by 2020, at a net present value cost of \$500 million to \$900 million. (This cost is in addition to the \$2.6 billion in net present value that AEP plans to spend to reduce conventional coal

plant emissions.) The net effect of the McCain-Lieberman bill would be to reduce AEP’s planned coal-plant retrofit expenditures by \$400 million to \$900 million after 2010, while increasing its investment in new gas-fired, IGCC and renewable power generation by \$700 million to \$1.4 billion through 2020.

Alternative clean air legislation proposed by Sen. Tom Carper (D-Del.) would cost AEP substantially more—anywhere from \$3 billion to \$6.4 billion in net present value—according to AEP’s recent analysis. Carper’s bill, known as the Clear Planning Act of 2003, would impose higher costs on AEP in part because it focuses solely on power plant emissions rather than a broader set of industrial sources. More important, the Carper bill would allocate carbon dioxide allowances on the basis of total power generation, rather than a utility’s historical carbon emission rates. Such an allocation scheme favors utilities that are less dependent on coal than AEP. Coal currently accounts for about two-thirds of AEP’s power generation.

The allocation scheme drafted under the Carper bill effectively would give AEP only 120 MMT of annual carbon dioxide emission allowances after 2012, compared to 167 MMT of actual emissions by the utility in 2001. AEP would have to make up the 28 percent difference by purchasing carbon emission credits, which it estimates could range in price from \$5 to \$20 per ton between 2015 and 2020. All told, AEP estimates that it would have to spend far more to achieve net carbon stabilization under the Carper bill than it expects to spend to reduce conventional air pollutants under the Clean Air Act through 2020.

Report Limitations

With its new report, AEP has pre-

pared the most in-depth, publicly available utility analysis to assess the financial costs of possible carbon emissions constraints. By focusing on “plausible” near-term proposals to stabilize carbon dioxide emissions over the next 15 to 20 years, the report covers a useful time frame from the standpoint of investment recovery.

Yet in relation to the Kyoto Protocol and the shareholder proposal submitted in 2004, AEP’s report falls short in one key respect—by failing to go beyond carbon stabilization scenarios to consider goals to “significantly reduce” these emissions. AEP’s analysis of the Carper bill provides a glimpse of the financial stakes that might be involved in achieving substantial emissions reductions. Not considered in the report is another bill introduced by Sen. James Jeffords (I-Vt.) in 2001 that proposes to cut utilities’ carbon dioxide emissions 21 percent below 2000 levels by 2008.

As spokesman Bruce Braine explained to IRRC, “Our Board of Directors looked at those proposals which are real and have at least some plausibility of being enacted and taking effect over the next five to 15 years. Because the focus of our report to our shareholders is financial, we limited the time frame to the pre-2020 period, since it is the period with the greatest relevance with respect to stranded costs.”

Eventually, carbon dioxide emissions must be cut by some 60 to 80 percent to halt the buildup of this heat-trapping gas in the atmosphere. AEP stresses that such major reductions must be achieved worldwide, involving developing countries like China and India. Moreover, such reductions likely would have to extend over the next 50 to 100 years, which is well beyond the time frame considered in the AEP study.

— Doug Cogan

Proxy Season

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sensus on sponsorship among the different educational constituencies proved tricky. But with the end of the apartheid era in 1994, many of those proxy committees were disbanded, and those that continued to vote became leery of reporting on the record. In recent years, only Harvard and the University of Wisconsin have allowed their names to be used in IRRC's annual study of institutional voting.

In the last few years, with increased campus concern about sweatshops, global warming and other issues, student pressure for their institutions to become more active on social investing issues has been rising. To date, Swarthmore is the only school that has actually filed or co-filed a shareholder proposal in the post-apartheid era (to prevent workplace discrimination against gay employees), but

Burg said "four or five schools are at the point where they could easily file a resolution now," and predicts that 10 more will be in such a position within the next three years.

Orlowski noted that the two biggest obstacles for students starting campaigns are getting information on their school's endowments and convincing decision makers, both administrators and trustees, of the importance and potential of proxy voting. The coalition hopes to reduce this barrier significantly, once its website is further developed, by posting SRI-related documents from its member schools.

Burg predicted that environmental issues and workers' right to unionize will be two of the areas shareholder activism will focus on in the coming year. At the conference he expects coalition members will also want to dis-

cuss the UnFarallon campaign, which seeks to stop colleges and universities from doing business with Farallon Capital Management, a large hedge fund that detractors claim engages in unethical business practices. However, "the core of the movement is shareholder activism, and you need to be an owner to participate," he said. Burg noted that SRI is a rare opportunity for student activists because "it allows them to work within the agenda of major corporations that form the fabric of society." He was especially enthusiastic about proxy voting, calling it "a powerful tool to generate discussion amongst shareholders" and "one of the few mechanisms of direct influence to affect change in companies."

For more information on the Responsible Endowments Coalition, visit www.sriendowments.org.

—Ben Shell

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the five board diversity proposals that came to votes fell to around 7 percent. One factor was that shareholders negotiated withdrawals at some companies that had gotten high votes in past years. In addition, the vote tallies seem to have been swung by investors that do not have their own voting guidelines but rely on outside proxy advisory services; one of these firms—Institutional Shareholder Services (ISS)—reversed direction and opposed the proposals this year. It

said the Calvert proposals were too specific in recommending that Calvert's charter language be adopted. It also found the resolutions less compelling in light of company compliance with the new independence and disclosure requirements.

Calvert and other social investment firms have had discussions with ISS to protest. They have argued that the intent of the board diversity resolutions—to have companies make a greater effort to seek out women and people of color as board candidates—

remains unchanged. Daruwala says Calvert plans to propose similar resolutions to around a dozen companies in 2005 that will again reference the model charter language. Daruwala told IRRC that corporations prefer specific proposed language, as borne out by the high number of withdrawals in 2004. The 2005 resolutions will propose that a diverse slate of candidates be included in every search for board nominees and that boards look in nontraditional places for nominees.

—Susan Williams