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# Sustainability
## Risk Monitor


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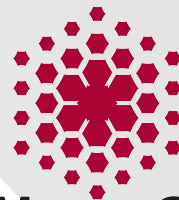


RiskMetrics Group
The Center for the Financial Community

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SHAREHOLDER ACTIVISM

2010 U.S. Proxy Season

# Internet Resolutions Return With Narrower Focus on Freedom

*By Carolyn Mathiasen*

Some of the new vocabulary and social issues introduced by the explosion of Internet use are on display in shareholder resolutions pending for the 2010 proxy season. The majority of those proposals focus on concern about the ability of Internet Service Providers (ISPs) to control access to information in the United States by prioritizing content on the Web. Avoiding that practice has become known as "net neutrality."

This is the second year that shareholders have proposed resolutions to U.S. carriers about domestic manipulation of the Internet. Last year, proponents affiliated with Open MIC (the Open Media and Information Companies Initiative) sponsored a batch of two-pronged resolutions asking ISPs to report on their policies for protecting user privacy and for allowing freedom of expression on the Internet.

*The shareholder resolutions focusing on net neutrality come at the same time that the Federal Communications Commission is launching a rulemaking on the issue, which would formalize and expand more general principles it embraced in 2005.*

The 2009 Open MIC campaign fell afoul of the Securities and Exchange Commission's rule that allows companies to omit resolutions deemed to impinge on "ordinary business" issues that should be under the purview of management. (The proposals, however, did come to votes at two companies that chose not to challenge them.) The SEC's "no-action letters" sanctioning the omissions defined ordinary business in the case of those resolutions as dealing with "procedures for protecting user information." Now proponents are trying again, with more narrowly tailored resolutions focusing only on Internet freedom. Open MIC, a project of the Tides Foundation, is again providing support for the campaign.

## 2010 Resolutions

**New York City-led proposals:** The New York City pension funds, one of the proponents that had lost a batch of resolutions on Internet privacy and freedom to adverse SEC staff decisions last year, is sponsoring a new resolution, now filed at **Comcast**, **EarthLink**, **Qwest**, and **Sprint Nextel**. The resolved clause asks each company for a report on the merits of "publicly adopting a set of guiding principles for the company to promote a free and open Internet."

The resolution suggests that the proposed guiding principles take into consideration the tenets of the Global Network Initiative principles, the Universal Declaration of Human Rights, and the Internet principles adopted by the Federal Communications Commission in 2005. (For more on relevant FCC action, see below.) In discussing the need for such principles, the resolution asserts that while new Internet technologies provide ISPs with "powerful tools and exciting business opportunities," they can also inhibit an open Internet. As an example, it points to content-filtering technology used to block pirated content, which it says also "will inevitably interfere with, and suppress, completely legal forms of speech and expression." It notes that repressive regimes also practice content filtering, which it says raises "challenging questions for the Company."

**New Trillium proposals:** Trillium Asset Management has a different new resolution on net neutrality at **AT&T** and **Verizon**, asking the companies to issue a report discussing how they "could address the challenges presented by the free and open Internet" in the context of corporate social responsibility, reputation, and the impact of corporate policies on customers, communities, and society.

The "whereas" clauses note that ISPs such as AT&T and Verizon "forge rules that shape, enable, and limit Internet use." They cite FCC Chairman Julius Genachowski's assertion that a free and open Internet will have a critical role in solving the "great challenges [we face] as a nation right now, including health care, education, energy, and public safety." Like the New York City resolutions, the proposals point to FCC consideration of rules on net neutrality issues. The resolution to AT&T notes that a senior vice president in October asked AT&T managers to campaign against FCC regulation of the Internet, and the resolution at Verizon asserts that its CEO "told an industry convention it would be a 'mistake, pure and simple' for the FCC to impose a burdensome regime of regulation on the Internet."

**A resubmission at CenturyTel:** While last year's proposal on Internet freedom and privacy was omitted on ordinary business grounds at the companies that challenged it, it came to votes at two companies that did not — CenturyTel, where it received 30.5 percent support and **EarthLink**, where the vote was 9.2 percent. Trillium Asset Management has now re-filed

the proposal at CenturyTel, again asking for a report on "the effects of the company's Internet management practices in the context of the significant public policy concerns regarding the public's expectations of privacy and freedom of expression on the Internet."

*Now proponents are trying again, with more narrowly tailored resolutions focusing only on Internet freedom. Open MIC, a project of the Tides Foundation, is again providing support for the campaign.*

A "whereas" clause points to a particular concern that the proponents have with CenturyTel: its partnerships with an online advertising company, NebuAd. The resolution asserts that the partnerships allowed targeted advertising based on which Web sites the customers visited and that they were required to "opt-out of a program in which many were not aware they were enrolled."

## Regulating Net Neutrality

The concept behind net neutrality assures users access to all lawful Internet content, applications, and services without interference from ISPs in any way, including affecting speed of transmission.

**FCC deliberations:** The shareholder resolutions focusing on net neutrality come at the same time that the FCC is launching a rulemaking on the issue, which would formalize and expand more general principles it embraced in 2005.

President Obama spoke out in support of net neutrality during his presidential campaign, and his new FCC Chairman, Genachowski, picked net neutrality as the subject of his first major public address, at the Brookings Institution Sept. 21, 2009. At that time, Genachowski said: "Broadband providers cannot discriminate against particular Internet content or applications. This means they cannot block or degrade lawful traffic over their networks, or pick winners by favoring some content or applications over others in the connection to subscribers' homes. Nor can they disfavor an Internet service just because it competes with a similar service offered by that broadband provider. The Internet must continue to allow users to decide what content and applications succeed."

The speech foreshadowed a formal proposal on the issue, which the five-member commission voted unanimously Oct. 22 to put out for comment. Although the vote was unanimous, the two Republican members, while agreeing to proceed with the rulemaking, did not support the content.

An FCC news release the same day said the main points of the proposal stipulated that a provider of broadband Internet service:

1. Would not be allowed to prevent any of its users from sending or receiving the lawful content of the user's choice over the Internet;
2. Would not be allowed to prevent any of its users from running the lawful applications or using the lawful services of the user's choice;
3. Would not be allowed to prevent any of its users from connecting to and using on its network the user's choice of lawful devices that do not harm the network;
4. Would not be allowed to deprive any of its users of the user's entitlement to competition among network providers, application providers, service providers and content providers;
5. Would be required to treat lawful content, applications and services in a nondiscriminatory manner; and
6. Would be required to disclose such information concerning network management and other practices as is reasonably required for users and content, application, and service providers to enjoy the protections specified in this rule-making.

Interested parties have until Jan. 14, 2010, to offer comments; replies to the comments are due March 5, after which the commission will refine the proposal.

The proposal made clear that "reasonable network management practices" would be permitted, including reducing congestion, giving priority to communications by public safety agencies and preventing unauthorized transmission of copyrighted works.

Nevertheless, ISPs have protested that the rules would prevent them from dealing with congestion, especially because they say the proliferation of services such as video sharing that require large amounts of bandwidth demand active management of networks. Other opponents of the proposal, including Sen. Kay Bailey Hutchison (a Texas Republican), have protested that the rules would "stifle investment incentives" and keep ISPs from developing innovative technologies.

But supporters of new rules say that they are necessary because, without them, carriers would be able to charge companies more to carry certain types of Internet traffic or could provide service that moves more quickly to advertised links than non-advertised links. Without the rules, they say, if the proposed **Comcast-NBC** consolidation goes through, Comcast would be able to provide preferential bandwidth to NBC Web content.

**Proposed legislation:** Rep. Edward Markey (a Massachusetts Democrat) has introduced a bill (HR 3458) that would write into law many of the provisions in the rulemaking. The bill, the "Internet Freedom Preservation Act," asserts in the preamble that legal and marketplace changes permit "telecommunications network operators to control who can and who cannot offer content, services, and applications over the Internet" and it says that "Internet access service providers have an economic interest to discriminate in favor of their own services, content and applications and against other providers."

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Markey's bill, which is co-sponsored by Rep. Anna Eshoo ( a California Democrat) would amend the Communications Act of 1934 to forbid ISPs from blocking Internet access, charging for Internet content or services beyond end-user charges, preventing users from attaching lawful devices, or prioritizing traffic of one service provider over another. When the FCC voted to move ahead with its own consideration of net neutrality rules in October, Markey called them an "excellent complement" to his proposal. Hearings haven't been scheduled.

**Censorship questions:** The net neutrality issue ties into concerns about more blatant Internet censorship abroad, which President Obama criticized during his November trip to China. At a conference at the University of Nebraska that month, Andrew McLaughlin, White House deputy chief technology officer, made the case that any U.S. failure to require net neutrality domestically makes it easier for repressive governments to limit Internet access by their own citizens.

*The Washington Post* on Nov. 25 quoted McLaughlin as saying, "If it bothers you that the China government does it, it should bother you when your cable company does it." The article also quoted AT&T lobbyist Jim Cicconi as responding that it was "ill-considered and inflammatory to connect censorship in China to the practices of American ISPs, whom he said do not threaten free speech." Internet censorship in countries like China has been an issue in a handful of shareholder resolutions for the last few years. A perennially high-scoring proposal at **Cisco Systems** from Boston Common Asset Management asking for a report on steps the company could take to ensure that its products aren't used to enable censorship seems likely to be submitted again for the company's fall 2010 annual meeting.

## Raising the Online Advertising Issue

Net neutrality isn't the only Internet-related issue pending for consideration this year. As You Sow and Ethical Funds have a new proposal asking **Google** to adopt "a set of principles for online advertising that goes beyond current company statements and addresses the collection of sensitive information about health, finances, ethnicity, race, sexual orientation, and political activity for the purposes of behavioral advertising."

The resolution notes that online advertising networks are increasingly using behavioral advertising — the tracking of consumers as they perform Internet searches —to develop consumer profiles for more targeted advertising. It asserts that Google's behavioral advertising "has become the focus of intensive scrutiny and concern" and that the Federal Trade Commission and other groups are now reviewing online advertising practices. While the resolved clause doesn't ask for a new policy, the resolution says the proponents "believe the company should give serious consideration to adopting a policy of seeking prior consent of users."

It's not clear whether shareholders will get to weigh in on this particular issue. The SEC staff always has considered advertising to be an ordinary business question, so if Google decides to challenge the proposal the staff would be going against precedent if it advised the company to include it in its proxy statement. Still, the staff has a tradition of changing with the times — deciding in earlier decades, for example, that nuclear power and tobacco had come to raise fundamental questions that transcended ordinary business decisions – and issues of online advertising could reach that point as well.

SHAREHOLDER ACTIVISM

2010 U.S. Proxy Season

# Energy Issues To Give New Dimensions to Water Resolutions

*By Carolyn Mathiasen*

The 2010 proxy season will feature new resolutions on three energy issues that have important ramifications for water quality and scarcity — coal combustion waste, hydraulic fracturing, and water consumption by electric utilities. Green Century Funds is coordinating the effort, which involves a variety of filers.

Elements of the new proposals reflect the effect of the U.S. Securities and Exchange Commission's October policy shift, announced in Staff Legal Bulletin E, which gave proponents new leeway to broach the issue of business financial risk without having their resolutions invite "no action" letters. (For more, see the October issue of the Sustainability Risk Monitor.)

## Coal Combustion Waste

Three resolutions raise questions about the risks of coal combustion waste (CCW) to the water supply, a new issue for proxy voters. All are sponsored by Green Century; they are directed to **First Energy**, **Southern Co.**, and **Xcel Energy**, three companies that produce significant amounts of CCW.

The proposals ask each company's board to issue by August 2010 "a report on the company's efforts, above and beyond current compliance, to reduce environmental and health hazards associated with coal combustion waste, and how those efforts may reduce legal, reputational and other risks to the company's finances and operations."

*Three resolutions raise questions about the risks of coal combustion waste to the water supply, a new issue for proxy voters.*

Waste produced from burning coal contains various toxins, including arsenic, mercury, and lead, which are associated with serious health problems. The National Resources Defense Council estimates that U.S. coal-fired power plants produce 130 million tons of CCW a year, much of which is placed in landfills or specially created artificial ponds. The CCW to be deposited in ponds is mixed with water to enable it to be piped from coal-burning plants. Environmental activists are concerned that the vast majority of ponds lack liners to prevent the contaminated water from reaching water supplies. An estimated 40 percent of landfills that take CCW also aren't lined, and CCW mixed with rainwater in the fills can also leach into the water table.

In addition, CCW is sometimes dried for certain uses, including plaster, concrete, and drywall, which the proponents assert poses environmental concerns as well, among them the possibility that mercury from coal fly ash may be released into the air.

Ironically, the ramifications of CCW have become more serious as advances in air pollution controls with the installation of scrubbers have created more toxic residues in the waste. CCW emerged as a high-profile environmental issue in December 2008 after a 1.1 billion-gallon toxic sludge spill at the Tennessee Valley Authority, which has dramatized the potential scale of liability. The Environmental Protection Agency has reportedly found evidence of water pollution caused by CCW at more than 60 sites. It is now working on a draft regulation to tighten controls over CCW, which may classify it as a hazardous substance.

Discussing their choice of resolution targets, the proponents say coal combustion accounts for 53.5 percent of generation capacity at FirstEnergy, 68 percent at Southern, and 49 percent at Xcel. In a briefing paper shared with RiskMetrics, they said "shareholders want assurance that our company is (1) poised to adapt to regulatory changes that may include a forced transition out of wet storage and (2) taking the necessary measures to avoid potential financial liabilities imposed by structural failures (i.e. spills, leakages) or unintended consequences of dry re-use."

## Hydraulic Fracturing

The environmental implications of the recent explosion in the use of hydraulic fracturing — the process in which water, sand, and a mix of chemicals are blasted into tight layers of shale to extract natural gas — are the issue in resolutions that have been announced for seven companies. Miller/Howard Investments has filed at **El Paso Energy** and **Energen,** and Green Century is filing at **EOG**, **ExxonMobil**, **Williams**, and **Ultra Petroleum**. As You Sow has joined as a filer at Ultra, and three religious groups are co-filing at EOG. The sixth resolution is pending at **Cabot Oil & Gas**, where the filer has asked not to be identified at this time.

The resolved clauses of all seven resolutions are basically the same, asking for a report by September 2010 summarizing "(1) the environmental impact of fracturing operations; (2) potential policies for the company to adopt, above and beyond regulatory requirements, to reduce or eliminatehazards to air,

water, and soil quality from fracturing." The supporting statements say the proponents would like the report to include discussion of "less toxic fracturing fluids, recycling or re-use of waste fluids, and other structural or procedural strategies to reduce fracturing hazards."

*NorthStar Asset Management is continuing for a third year a campaign to get companies to adhere to the United Nations declaration that asserts that 'the human right to water entitles everyone to sufficient, safe, acceptable, physically accessible and affordable water.' This year it is sponsoring resolutions to four companies, asking them to 'create a comprehensive policy articulating our company's respect for and commitment to the human right to water.'*

As this "fracking" has become more widespread, environmentalists have been increasingly concerned that the wastewater produced by the process can both cause contamination at the ground level and also overload the waste treatment plants to which it is shipped. They are also concerned that chemicals mixed with sand and water to aid the fracturing process can harm the water supply — an especially tricky issue because companies aren't required to disclose which chemicals they use in fracking mixes. (These issues are discussed in detail in the lead story in the November issue of the Sustainability Risk Monitor.)

In the resolutions, the proponents assert that "we believe uneven regulatory controls and reported contamination incidents compel companies to protect their long-term financial interests by taking measures beyond regulatory requirements to reduce environmental hazards."

**The Halliburton angle: Halliburton** has been prominently cited in the debate over fracking chemicals because it is one of their major producers. No resolution on the issue is pending there this year, but one shareholder, Trillium Asset Management, wrote the company in early October inquiring, as the company put it in its response, "about Halliburton's management of risk related to its hydraulic fracturing operations." The company on Oct. 26 provided a three-page response from Christian Garcia, vice president for investor relations. Among other things, Garcia told Trillium that Halliburton voluntarily is in the process of developing a new Chemical Scoring Index that is designed to allow it to compare the Health, Safety, and Environmental impact of all its chemical formulations as a numerical score. The index is intended to enable operators to select formulations that have the lowest score for their application, and Halliburton expressed the hope that will become an industrywide standard.

On the specific issue of water quality, Garcia reported that Halliburton is "actively engaged in developing new technologies to facilitate the recycling of fluids that are flowed back out of natural gas wells, resulting in the reduction of the amount of flowback fluids that needs to be disposed of and the amount of fresh water used during hydraulic fracturing operations." Like other corporations being prodded on the fracking issue, Halliburton said it "believes that existing state oil and gas regulatory programs — combined with existing federal programs regarding chemical disclosure — are more than sufficient to ensure that any risks associated with hydraulic fracturing are properly and effectively managed."

**ExxonMobil's involvement:** The prescience of shareholder activists in deciding to tackle fracking earlier this year was reflected in the Dec. 14 announcement that ExxonMobil had agreed to buy **XTO Energy** for USD 41 billion in an all-stock offer. XTO, the nation's second-largest gas producer, was a key player in the development of the Marcellus Shale in Texas that set off the hydrofracking boom earlier in this decade, and it has developed strong technical knowledge in producing gas from shale. In discussing the XTO deal, *The New York Times* Dec. 14 called it "the latest and most significant signal that large companies are moving to make major investments in American shale fields."

## Utilities' Water Use

Green Century also is sponsoring a resolution on the issue of water consumption by electric utilities. That proposal is pending only at **NiSource** for the 2010 spring proxy season, but the proponents say it could become a model for a broader campaign.

The resolution asks that an independent board committee report by Sept. 1, 2010, on the "company's water withdrawals at each thermoelectric power plant. The report should also

compare those measurements to projected water withdrawals that would result from expanding thermoelectric generation, and to projected water withdrawals that would result from investing in less water-intensive renewable energy methods such as wind."

The proponents cite Energy Department (DOE) statistics that the electric power industry consumes 190 billion gallons of water a day and is the second-largest user of fresh water in the United States. They say water scarcity is increasing, and the problem is being exacerbated by climate change. They quote the DOE's Climate Change Science Program as reporting that "There is agreement among climate models that there will be a redistribution of water, as well as changes in the availability by season. As currently designed, power plants require significant amounts of water, and they will be vulnerable to fluctuations in water."

The proponents point to the Carbon Disclosure Project's (CDP) launch of a water disclosure program in November, noting that NiSource participates in the CDP but hasn't disclosed its own water use. In an interview, a Green Century representative pointed out to RiskMetrics that NiSource also issues a sustainability report but does not discuss water use there. The proponents say they see it as a generally environmentally responsible company, but believe it can be doing more.

## Other Water-Related Issues

Those three new energy-related issues aren't the only resolutions raising questions about water use that will be before shareholders in 2010.

The American Baptist Home Mission Society has a new resolution with **Tyson Foods** asking the company to report by June 2010 "on the measures that our company is taking to prevent runoff and other forms of water pollution from all company-owned facilities and from facilities under contract to Tyson." The proponents say the company uses some 28 billion gallons of water a year to produce its food products. It applauds the company for recent innovations that have enabled it to conserve and re-use water, but they cite a "pattern of repeated water pollution violations by Tyson and its contract suppliers" that they believe is damaging its reputation, and they want the company to report on how it can do better.

NorthStar Asset Management is continuing for a third year a campaign to get companies to adhere to the United Nations declaration in its General Comment 15 that asserts that "the human right to water entitles everyone to sufficient, safe, acceptable, physically accessible and affordable water." This year it is sponsoring resolutions to four companies, asking them to "create a comprehensive policy articulating our company's respect for and commitment to the human right to water." The proposal is pending at **Connecticut Water Service**, **Ecolab**, **ExxonMobil**, and **Intel**. It came to a vote only at Intel last year, where it received 5.9 percent support.

*Like other corporations being prodded on the fracking issue, Halliburton said it 'believes that existing state oil and gas regulatory programs — combined with existing federal programs regarding chemical disclosure — are more than sufficient to ensure that any risks associated with hydraulic fracturing are properly and effectively managed.'*

While the Baptists' resolution to Tyson is devoted almost entirely to allegations about water violations at the company, NorthStar's resolutions on water use are more general discussions of the underlying issue. However, its resolutions do note that ExxonMobil uses nearly 60 million gallons of water for oil extraction each year in Canada's Alberta province alone; that Intel "uses vast quantities of water in its semiconductor manufacturing process and operates in water-scarce areas of the world like Israel and the American Southwest;" that water is "a top ingredient in both the production and use" of Ecolab's cleaning and sanitation products; and that nearly 300,000 Connecticut residents "rely on Connecticut Water Service's water service for survival."

RiskMetrics is adding to its 2010 checklist of social issues shareholder resolutions almost daily now as information on new proposals come in, and more resolutions raising water issues are expected to appear. Proponents have reported that some resolutions on climate change and sustainability will have water-use angles.

SHAREHOLDER ACTIVISM

## 2010 U.S. Proxy Season

# SEC Reverses Decision to Allow Omission of Tyson Pork Resolution

*By Carolyn Mathiasen*

It's rare for the U.S. Securities and Exchange Commission staff to reverse itself on a "no-action" decision allowing a company to omit a social policy shareholder resolution from its proxy statement. That happened Dec. 15, however, when the staff told **Tyson Foods Inc.** that it would have bring a proposal on antibiotics in hog feed to a vote at its February 2010 annual meeting after all.

The resolution, co-sponsored by the **Adrian Dominican Sisters** and **Christus Health**, asks Tyson's board to adopt a policy and practices for both its own hog production and its contract suppliers of hogs that would phase out the routine use of animal feeds that contain certain antibiotics. The proposal also requested a report on the timetable and measures for implementing the policy, as well as the annual publication of data on the use of antibiotics in the feed given to livestock owned or purchased by Tyson.

On Nov. 25, the SEC staff issued a "no-action" letter concluding that Tyson could omit the resolution from its proxy statement because it dealt with an ordinary business matter that should be up to management, not shareholders, to decide. The ordinary business exclusion is the one used most frequently to exclude social issues resolutions, and in this case the staff defined the ordinary business element as "the choice of production methods and decisions relating to supplier relationships."

Paul Neuhauser, the long-time lawyer on issues involving the shareholder proposal rule for church groups affiliated with the **Interfaith Center on Corporate Responsibility**, told RiskMetrics at the time that he was "flabbergasted" by the ruling. While appeals of staff rulings usually come to naught, he sent a letter to the SEC on Dec. 7 protesting that the staff had failed to "discern a significant policy issue" that now clearly exists. He argued that the effects on people of eating pork that has been fed antibiotics to keep it healthy raised a serious public health threat, not a mundane ordinary business matter, noting that the "threat may primarily be in the future, but that does not make the threat any less grave, or less real."

Neuhauser also pointed out that the Food and Drug Administration (FDA) "already has criteria for denying applications by drug makers for the use of new drugs in animals, but unfortunately these rules were not applied retroactively when the FDA adopted them in 2003."

In its Dec. 15 response reversing the earlier decision, the staff noted that there had been precedent for the original judgment in the exclusion of resolutions in 2002 and 2003. But it added, "At this time, in view of the widespread public debate concerning antimicrobial resistance and the increasing recognition that the use of antibiotics in raising livestock raises significant policy issues, it is our view that proposals relating to the use of antibiotics in raising livestock cannot be considered matters relating to a meat producer's ordinary business operations. In arriving at this position, we note that since 2006, the European Union has banned the use of most antibiotics as feed additives and that legislation to prohibit the non-therapeutic use of antibiotics in animals absent certain safety findings relating to antimicrobial resistance has recently been introduced in Congress."

# Despite Setbacks, Some Signs of Progress at Global Climate Summit

*By Mario Lopez-Alcala*

As the Copenhagen climate summit draws to a close, many are disappointed by the lack of progress being made here. The biggest announcement is likely to be a plan to compensate countries that preserve forests and other natural landscapes that store carbon dioxide, the main greenhouse gas tied to global warming. While other agreements could be reached to place carbon regulations on aviation and shipping, other goals to curb industrial emissions of greenhouse gases and set new financing mechanisms to help developing countries mitigate and adapt to climate change remain elusive. Now the hope is to reach a legally binding agreement sometime next year.

## Very Different World From a Year Ago

Still, as U.S. Deputy Special Envoy for Climate Change Jonathan Pershing observed at Copenhagen's Bella Center last week, today's world is very different from the one we lived in a year ago when it comes to climate politics. The Copenhagen summit has brought developing countries to the fore, with progressive proposals on mitigation, adaptation, and finance. The United States has also undergone a sharp policy reversal, with President Barack Obama due here on Dec. 18, 2009, to underscore the U.S. administration's commitment to tackling climate change. This sets the stage for a changing global regulatory environment that will benefit low-carbon investments.

The road ahead will be bumpy, however. In Copenhagen there have been heated debates on the legal outcome of two parallel negotiating paths: one under the Framework Convention on Climate Change, in which the U.S. is a party; and one under the Kyoto Protocol, in which the U.S. is an observer. A bloc of Small Islands States led by Tuvalu has proposed developing a new negotiating group to work toward a binding treaty to succeed the Kyoto Protocol with even more ambitious targets. The U.S. regards this extension of Kyoto as a non-starter. Another proposal forged by the Mexican and Norwegian delegations would substantially increase the amount of predictable funding available for climate change actions in developing countries. However, beyond a commitment by the European Union to provide USD 10 billion annually in such funding as a down payment toward larger giving, the pledges have been few.

## Significant Forest Protection Agreement

In any event, the forest protection program expected at Copenhagen (formally known as Reducing Emissions from Deforestation and Forest Degradation, or REDD) should not be overlooked for its significance. Rainforest destruction and land conversion are responsible for about 20 percent of annual emissions that contribute to global warming. The REDD program puts financial incentives in place for developing countries to preserve these natural habitats effectively as a carbon-storing bank. Industrial countries would be able to purchase credits from this bank to offset emissions that exceed their own reduction targets. The current U.S. legislative proposal as passed by the House of Representatives would allow up to one-quarter of the nation's emissions to be offset by such credits from international providers. REDD would help assure that a large bank of credits would be available at affordable prices, easing the pressure on domestic industries to achieve emissions cuts from their own operations.

REDD also could be a shot in the arm for the Clean Development Mechanism (CDM), a project-based source of carbon credits that can be used in emissions trading schemes established under the Kyoto Protocol. So far, the CDM has suffered from heavy bureaucratic oversight and limited geographic scope. However, new measures potentially could arise from talks seeking ways to lessen these drawbacks for CDM projects. By virtue of the location of the world's rainforests, REDD could help disperse funding assistance across Asia, Latin America and Africa. Some representatives at Copenhagen are even lobbying to extend REDD's provisions to northern boreal forests, which also provide a substantial sink for carbon. However the REDD program works out, it will be a while before the aid starts flowing. Details that remain to be worked out include setting exact targets and timetables for emissions reductions, and what systems should be used to measure and verify carbon storage of various habitats.

## Climate Clock Keeps Ticking

Meanwhile, the climate clock keeps ticking. Scientists presenting at Copenhagen stressed the importance of bringing global emissions to a peak within the next decade and then starting a fast decline, led by a 25- to 40-percent reduction by industrial countries from 1990 levels by 2020. Each year of delay heightens the pace at which emissions reductions must be achieved thereafter. United Nations Secretary General Ban Ki-moon admonished Copenhagen delegates in an address on Dec. 15 as they moved into their final days of negotiations. "We do not have another year to deliberate," he reminded them. "Nature does not negotiate."

*Mario Lopez-Alcala is a member of RiskMetrics Group's Climate Risk Management team. He is attending the Copenhagen climate summit as an official observer.*

REPORT FROM COPENHAGEN

# More Lobbying, Exxon Takeover Strengthen U.S. Natural Gas Expansion

*By Seb Brinkmann & Hewson Baltzell*

An interesting coalition of groups had a side event at the Copenhagen climate change summit on Dec. 12. Gathered were the Worldwatch Institute, a respected U.S. think tank represented by its leader, Christopher Flavin; the United Nations Foundation, established by Ted Turner, and represented by its head, Tim Wirth, a former U.S. senator and the main U.S. negotiator for the Kyoto Climate Conference during the Clinton administration; and the American Clean Skies Foundation, which promotes natural gas as a clean alternative to coal, represented by its CEO, Gregory Staple. Their three-hour conference was about shale gas.

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One of the lead speakers was Aubrey McClendon, CEO of **Chesapeake Energy**, a large U.S. natural gas producer. He stated that he was in Copenhagen to drive home the point that shale gas production was a game changer in "de-carbonizing" the U.S. economy.

The message that McClendon delivered is well-established:

- New technologies (hydraulic fracturing and horizontal drilling) have made vast "new" reserves of natural gas in the United States recoverable and commercially viable;
- Natural gas emits about 25 percent less $CO_2$ than oil and 50 percent less than coal;
- Installed natural gas electricity capacity is already in place, and could meet current U.S. energy demands (unlike nuclear, wind, solar, and coal adapted with carbon capture and storage, or CCS);
- Natural gas provides the flexibility needed to support the intermittency common in renewable energy; and
- Unconventional U.S. gas would reduce the nation's dependency on foreign (OPEC) hydrocarbons.

While this message has been delivered consistently to investors by many of the U.S.'s independent gas players, the industry has been accused of failing to deliver this message successfully to the electorate and to the U.S. Congress. While the coal, electric utility, and railroad industries have employed the top lobbyists to represent their interests, the natural gas industry is generally regarded as having been missing in action during the drafting of climate change regulations, and it's seen as being at risk of not fulfilling its potential.

## Gas' Share of U.S. Energy Seen Growing

In its assessment of the American Clean Energy and Security Act of 2009 (also known as ACES, and the Waxman-Markey bill), the U.S. Energy Information Administration projected that the share of natural gas in U.S. electricity production could increase to 31 percent by 2020 from a 2007 level of 21 percent. EIA further projects a 39-percent contribution to the U.S. electricity supply from natural gas by 2030. This would lift the share of natural gas in the overall U.S. energy supply to 26 percent in 2020, up 3 percentage points from 23 percent in 2007, and to 28 percent by 2030. These increases are, however, contingent on the restricted access to international carbon offsets and delayed deployment of low-carbon technologies such as CCS and nuclear that exist for the U.S. The U.S. natural gas industry believes that its outlook could, and should have been, significantly augmented with greater explicit support for gas in the draft carbon regulation and also by incorporating a far less lenient approach to coal, particularly in the allocation of emissions allowances.

## Forming a Coherent Industry Strategy

In order to redress this perceived imbalance, the U.S natural gas industry has organized its previously disparate forces into a coherent strategy. This was evidenced in Copenhagen and is also manifest by the coming together of 28 of the largest U.S. natural gas independents to form the "American Natural Gas Alliance," which is charged with promoting the benefits of U.S.-produced natural gas to the country's public.

Bolstering the prospects of the natural gas industry's ability to affect climate change regulations also has been Exxon-Mobil's recently announced USD 41 billion, all-stock acquisition of XTO Energy, an offer price that represents a 25 percent premium to Dec. 11's XTO closing stock price. XTO

has the largest proved natural gas reserves among the U.S. independents, and Exxon's commitment to unconventional natural gas production in the U.S. not only will offset some of the carbon risks inherent in Exxon's portfolio, but it will also bolster the industry's ability to lobby Congress as it takes up climate change legislation in 2010.

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## Environmental Concerns

While natural gas is set to play a more significant role in the U.S. energy mix, there are a number of significant caveats that could derail its progress. These center primarily on environmental concerns. The industry will need to spend as much political capital on addressing these concerns as it will on improving the overall position of natural gas in U.S. carbon legislation. High on the list of these concerns are the environmental impacts of hydraulic fracturing. (See additional stories about this issue in the November edition of Sustainability Risk Monitor and on Page 6 of this newsletter.)

Investors also should be aware that some of the U.S. independents will be affected to differing degrees by climate change legislation to come the U.S., feeling the alterations both positively and negatively. Current legislation could impose a direct cost on the midstream gathering and processing operations of independent producers. Again, it is necessary to consider the potential risk of this exposure as well as each company's policies to mitigate these risks through investments in offsets and verified emissions reductions.

# International Gaming Companies Place Their Bets on Macau in Downturn

*By Mildred Mudambo*

About four times smaller than New York's borough of Manhattan, nestled off the southeastern coast of China lays Macau, the Las Vegas of Asia. While the battle for legalization of casinos continues to rage in longtime holdout countries such as Japan and Taiwan, Macau is the only place in China where casino gambling is legally permitted. Gambling has always been one of the most important and lucrative sectors of Macau's economy; it's now grown to overtake Las Vegas and Atlantic City in terms of gaming revenues. Macao generated HKD 105.6 billion (USD 13.5 billion) in gross gaming revenue in 2008, more than double the HKD 46.7 billion-equivalent amount generated by Las Vegas' Strip during the same period. The government assesses a 35 percent tax on casino profits, which makes up three-quarters of Macau's revenue.

## Longtime Gambling Mecca

A former Portuguese colony, Macau legalized gambling in 1847 and reverted to Chinese rule in 1999. Prior to 2002, casino operations and ownership there were mainly handled through private negotiations. A gambling monopoly controlled by billionaire Stanley Ho's Sociedade do Jogos de Macau (SJM) existed for four decades. The Chinese government brought it to an end by opening up the islands' gaming industry to other casino operators and foreign companies. It granted new gaming licenses to Las Vegas Sands Corp., Wynn Resorts, Galaxy Entertainment Group Ltd., Melco Crown Entertainment and a casino run by MGM Mirage and local businesswoman Pansy Ho. In this progression, the first U.S.-owned casino in Macau was The Sands Macau. There are 4,312 gaming tables, 12,835 slot machines, and 28 casino facilities in Macau, with the largest, The Venetian Macau, operated by Las Vegas Sands. Pari-mutuel betting facilities such as horse and greyhound racing tracks, sports betting and lottery are also available.

While gambling in places such as Macau long has been touted as a means of bolstering economies by generating tax revenue that can contribute to shortfalls in budgets and provide employment opportunities, many believe there is a need to more closely examine the resulting social, economic and environmental impacts that gaming has. More rigorous gaming legislation, reinvestment by gambling companies in the communities surrounding the casinos, and a mitigation of the negative social impacts that are always attached to casino development are some ways that the gambling industry can be made more palatable to communities where they face opposition. In this vein, the Macau government is leading initiatives to review the size of its gambling industry by revising its current gaming rules, which include raising the minimum age of casino customers to 21 years from 18 years, limiting the number of tables, and moving slot machine halls to commercial zones, away from residential areas. Worried about rising prostitution and political corruption, China has imposed a limit of two trips a year to Macau on gamers.

Singapore learned from Macau's uncontrolled gambling growth by enacting more restrictive legislation to avoid flooding its island with gambling establishments: Singapore's Casino Control Act of 2006 only permits the operation of two casinos there for 10 years. The two companies currently permitted to operate are Malaysia's Genting Bhd. and the U.S.-based Las Vegas Sands.

## Macau Investment Continues to Grow

The world's gaming capital continues to grow. The strip of casinos in Macau, known as the Cotai Strip, is 1.8 miles of reclaimed land fusing two islands, Coloane and Taipa. It continues to draw investment from casino and hotel operators worldwide. Las Vegas Sands owns most of the Cotai Strip's hotel and casino infrastructure. Bloomberg reports that Sands has already spent USD 1.6 billion on its Macau hotel and casino complex.

*While gambling in places such as Macau long has been touted as a means of bolstering economies by generating tax revenue, many believe there is a need to more closely examine the resulting social, economic and environmental impacts that gaming has.*

Given recent initial public offerings on the Hong Kong Stock Exchange by Sands China (which operates The Venetian Macau, Sands Macau, and Four Seasons Macau) and Wynn Macau, the future looks bright for Macau as a gambling destination, despite the economic downturn, not a condition all gambling centers share. Russia shut down thousands of casinos, slot-machine parlors, and betting halls in July, using new restrictions requiring all gambling businesses to relocate to the four most remote regions of the country.

Macau gains a strategic advantage being a part of China, which brings access to the world's largest consumer market. It's also well-placed to benefit from the popularity of gambling among Asians living in several neighboring countries.

*Las Vegas giants and multinational corporations with investments around the globe are still hungry for the growth and huge future prospects for their industry that they see in the Asia-Pacific region.*

Las Vegas giants and multinational corporations with investments around the globe are still hungry for the growth and huge future prospects for their industry that they see in the Asia-Pacific region. Their experience in large-scale casino and investment asset management, amid a struggling U.S. gambling market in the throes of a recession, also make Macau and Asia attractive for these companies. Gaming revenue has dropped steadily in the last year in both Las Vegas and Atlantic City, so the companies that dominate operations there are looking for profitable expansion possibilities.

*RiskMetrics Sustainability Solutions offers an ethical, or "negative" screening service for investors who want to avoid companies involved in the gambling industry. RiskMetrics provides a comprehensive list of global companies that operate or hold any percentage of interest in a business segment involved in gaming operations and gaming support or service activities that include casinos, bingo, lottery, racetrack operations, mobile gambling, sports betting, specialty gambling machines, and also provides subscribers with the revenue figures associated with the companies' gambling involvement.*

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# Following the Crowd Might Help Us Avoid Another Credit Crisis

*By Hugh Wheelan*

Charles Mackay's 1841 classic book "Extraordinary Popular Delusions and the Madness of Crowds," has been a staple for readers — notably financiers — interested in some of the biggest and strangest societal neuroses in recent centuries. Alongside a fascinating chapter on the "Influence of politics and religion on the hair and beard" (bear with me), there are accounts of the wildest and most damaging historical financial speculations: Tulipomania in 17th-century Holland, the South Sea bubble in 18th-century England, and the Mississippi Scheme of 1720, in which Scots rogue John Law bankrupted the French state and many of its citizens with promises of riches in the Americas. The book records the seemingly inexorable link between greed, folly, and herd mentality: all present and correct in our latest financial breakdown to such devastating effect.

*Such an institutionalized 'anonymous' and regular investor survey could represent a neutral starting point for regulatory discussion and perhaps act as a vital bellwether for the prevention of future financial catastrophes.*

Re-reading Mackay got me thinking about the practical, tangible responses of regulators and institutional investors to the credit crunch, trying to ensure it doesn't happen again. Amidst the political and public clamor for resolution, I wondered if there had actually been any action yet, outside of short-term banker bonus hysteria? Are we doomed to relive the same calamitous bubble manias over and over again, and can we afford to?

## Systemic Blowouts Are Avoidable

The answer to the last question should, I hope, be no, with the caveat that financial bubbles are probably unavoidable. Systemic blowouts, however, almost certainly are avoidable, if the right monetary policy and regulation is applied. And where institutional investors manage public money, the avoidance of systemic breakdown arguably should be hardwired into their investment DNA. Savers cannot be penalized twice: both as backstop bailout taxpayers and victims of market catastrophes that destroy the value of their pensions and investments.

The lack of action got me wondering whether our current governments, regulators, and institutional investors might not be prey to an extraordinary delusion. Paul Myners, the United Kingdom's Financial Services Secretary and former chief executive of Gartmore, the U.K. fund manager, certainly appears to think institutional investors are. Apologies for a U.K.-based analogy, but I think it demonstrates a broader point. In a speech last month to the U.K. All Party Parliamentary Group on Corporate Governance, Myners didn't mince his words: "To date, institutional investors have said little about the lessons they have learnt over the last two years. Put simply, they have not produced satisfactory answers to the question, 'What were the owners of these banks doing?'

"Remember that shareholders approved value-destroying transactions," Myners continued, "and remuneration practices that now appear to have been poorly aligned with corporate health and shareholder wealth. I expect institutional investors, on behalf of their clients, to be much more challenging in the future than they have in the past, but I wonder whether their clients have similar increased expectation and have reflected this in their manager dispositions and incentives."

Tough words, which Myners intimated would be followed by action: "There will be more regulation. And there will be tighter supervision. And both will need to be linked to stronger organizational governance and effectiveness. We can use regulation to make governance better, but it is incumbent on investors and their agents to be the drivers of change."

Yet Myners' last point was key. Since he made the speech, the U.K. Walker report on governance of banks and financial institutions was released. In my view, the report — looked at by investors worldwide as a potential template for better corporate oversight — does relatively little to tighten up the rules, outside of bonuses paid in shares over longer timeframes. Walker, like Myners, favored further exhortations of investor activism as the "drivers of change."

The actions, rather than the words of both Myners and Walker, look like a "realpolitik" regulatory cop-out. Politicians

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tend not to regulate financial institutions too heavily on the domestic front these days, for fear the institutions will decamp to lighter regulatory regimes, taking their tax revenue with them. Government financial policy is decided within the G8 or G20 country meetings or the current International Monetary Fund discussions on banking reform, all fraught with the potential for beggar-thy-neighbor regulatory arbitrage. If governments are loath to legislate forcefully on governance to prevent future crises, can investors really be expected to take up the slack?

## Ingredients for a Remedy

It reminds me of the impasse over long-term mandates. Many in the investment world believe they would be a good idea to promote better governance and sustainable corporate investment. Yet, after decades of debate, we are no nearer to seeing them because investors will not, perhaps understandably, relinquish the right to fire underperforming fund managers. Could some of the ingredients for a remedy to this institutional paralysis be under our collective noses, though?

A recent survey co-produced at Responsible-Investor.com with the Network for Sustainable Financial Markets (NSFM), an international online network of senior financial market professionals and academics, and AQ Research, a investment research and data group, yielded some fascinating responses.

The survey, titled: "Credit Crisis: Business as Usual for Institutional Investors?" as answered under guarantee of anonymity by 208 investment professionals. Half of these were from mainstream asset management firms, while 32.6 percent responded from sustainable-investment specialists. The results were evaluated for bias between the views of mainstream and sustainability-driven managers, but there was no discernible difference.

Tellingly, more than 90 percent of these institutional investors believed financial markets were now threatened by increased "moral hazard" – the belief that banks and other investors will take excessive risks based on implicit government guarantees – after the credit crisis bailouts than they did before it, and that fixing this must be a priority to ensure the sustainable functioning of markets. Just under a third of these same investors (28 percent) were pessimistic that the right lessons from the crisis had been learned to avoid future market blowouts. And 80.5 percent said the response of regulators had so far fallen short of what is needed to fix the system.

The results suggest that while we see very little group action from investors, many financial market participants are privately very concerned about our collective response, or lack thereof, to the credit crunch and its future financial and social implications. In public, relatively few are willing to speak out against the group or the prevailing market orthodoxy.

*'I expect institutional investors, on behalf of their clients, to be much more challenging in the future than they have in the past, but I wonder whether their clients have similar increased expectation and have reflected this in their manager dispositions and incentives.'*

*—Paul Myners,*
*U.K. Financial Services Secretary*

Most people realize there is no magic bullet reform that would prevent future crises, and that managing the last crisis is unlikely to prevent the next. What is needed is active, forward thinking on the regulatory and governance fronts.

Might one solution to the seemingly neurotic powerlessness of governments and investors alike to act meaningfully on the credit crunch be to harness this wisdom of crowds? Such an institutionalized "anonymous" and regular investor survey could represent a neutral starting point for regulatory discussion and perhaps act as a vital bellwether for the prevention of future financial catastrophes.

*Hugh Wheelan is editor and co-founder of www.responsible-investor.com, a free on-line news and features service for ESG and responsible investment.*

# Data Points

## >> MORNINGSTAR INTRODUCES FRESH HORSE TO BATTERED CREDIT RATINGS FIELD

Credit ratings play an integral part in evaluating the risk inherent in a broad spectrum of securities, ranging from emerging-market sovereign debt to mortgage-backed securities. Over the past year, the three leading ratings agencies, **Moody's Corp.**, **Fitch Ratings**, and **Standard & Poor's**, have been accused of improperly evaluating the potential credit risks that led to debt offerings' mispricing, a major cause of the financial crisis that exploded worldwide last year. In the aftermath of the credit crisis, however, it has become increasingly apparent that subprime mortgages remain subprime, no matter how they are split up or rolled together. As a result, Moody's, Fitch, and S&P all have experienced significant reputational damage, and this has opened the door to competitors in an industry they once monopolized.

For example, **Morningstar Inc.** is stepping up to the challenge: The U.S.-based mutual fund rating firm has begun developing its own credit ratings. The first phase of this initiative is focused on creating transparent ratings for 100 large companies covered by the firm's equity research analysts. Morningstar says that its review of these securities will be based on factors such as business-line diversification and competitive analysis, the size and sustainability of a security issuer's free cash flows, and the firm's assessment of the uncertainty surrounding an issuer's operations and future profitability. For now, Morningstar says it will offer its ratings service without charge to issuers, as it's based on the company's equity research analysis. Morningstar has expanded its workforce to develop this new business, and the company intends eventually to increase its ratings universe by 10 times, to 1,000 companies, in the next six months.

In the short term, Morningstar's entry into the credit ratings field with a new strategy for evaluating issuers and their securities represents an important step in helping the market properly price the risks of equities, credit default swaps, and the hundreds of other derivatives and debt products being traded. Morningstar has indicated that it eventually hopes to create a comprehensive credit ratings agency business that will be able to analyze all securities.

*–Ben Lo*

## >> STATE STREET GLOBAL ADVISORS LAUNCHES U.S. COMMUNITY INVESTING INDEX STRATEGY

State Street Global Advisors (SSgA), the investment management arm of **State Street Corp.**, recently launched its U.S. Community Investing Index strategy, which seeks to match the returns and characteristics of the U.S. Community Investing Index (USCII), started in 2005 by the F.B. Heron Foundation and Innovest Strategic Value Advisors, now a part of RiskMetrics Group's Sustainability Solutions research unit. The underlying investment approach for SSgA's USCII strategy is to buy and hold securities mirroring the index, which comprises more than 300 large- and midcap companies in all sectors that have demonstrated successful and proactive engagement with economically underserved populations in rural and urban communities, primarily in the United States. The USCII is supported with research conducted by RiskMetrics Group's Sustainability Solutions team, using a methodology jointly developed with the F. B. Heron Foundation. The index positively evaluates the community investment and engagement performance of a broad range of companies along three main factors: strategic alignment, workforce development and wealth creation, and community engagement and corporate philanthropy.

SSgA says that it has managed environmental, social, and governance (ESG) assets for more than 20 years, offering investment approaches such as sustainability investing, socially responsible investing, or mission-related investing. As of Sept. 30, SSga reported that it managed more than USD 90 billion in ESG assets worldwide.

*Sustainability Risk Monitor offers impartial research and analysis on environmental, social and governance risk factors facing financial market participants. It is published 10 times a year by RiskMetrics Group, a leading provider of risk management and corporate governance services to institutional investors. For more information, please visit: www.riskmetrics.com*

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