

PROXY VOTING ON LABOR STANDARDS: A CASE-BY-CASE GUIDE FOR PRI SIGNATORIES

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Proxy Voting and Active Ownership

The second of the UN's Principles for Responsible Investment commits signatories to active ownership with regard to environmental, social, and governance (ESG) issues. Proxy voting is an important means of exercising this active ownership, but can also be challenging to execute. The ESG issues currently addressed by shareholder and management proposals are varied, complex and growing more so. To avoid committing an institution to automatic support of a certain type of resolution, many proxy voting guidelines state that proposals on certain topics will be considered on a "case-by-case" basis. The individuals tasked with applying these guidelines, then, must not only understand the topic of the resolution, but also determine whether it deserves support at a particular company.

To help our clients with tasks of this kind, The Corporate Library has developed a number of proxy voting supplements. The goal of these supplements is not to offer voting recommendations on specific proposals, but to give investors the background they need to evaluate proposals on a given topic, so that they can decide for themselves how to vote in each individual case. As part of our own PRI signatory commitment, we are now releasing, free of charge, this voting guide for labor standards resolutions. The question-and-answer series below is intended to aid in 1) understanding the resolutions; 2) evaluating them in the context of particular companies; and 3) deciding how to vote.

I. Understanding the Resolutions

Who Sponsors These Resolutions?

In the 2008 and 2009 proxy seasons, over forty shareholder proposals addressing labor standards appeared on North American ballots of North American companies. (This list includes general human rights resolutions, which are typically understood to include labor rights, but excludes proposals addressing specific non-labor human rights issues.) Many of the proposals were co-filed by several proponents. Lead filers have included funds managed by union-owned Amalgamated Bank (which filed at Urban Outfitters in 2008); the Service Employees International Union's Master Trust (filed at Cummins Inc. in 2009); and socially responsible fund managers like Domini Social Investments (which has filed at Xerox, Nucor and Cummins in the last two years). They also include a number of faith-based investors associated with the Interfaith Center for Corporate Responsibility (ICCR), including the Chicago-based Sisters of Charity, who filed at Halliburton in both 2008 and 2009. In addition, the various pension funds of New York City have been active on this issue at multiple companies, with Archer-Daniels-Midland and Cooper Industries receiving resolutions from them in both years.

Investors should be aware that the number of resolutions appearing on ballots significantly understates the number of shareholders or shareholder coalitions who are filing proposals. Many shareholders file a proposal as a means of raising an issue, and later withdraw it if the company engages in a constructive dialogue. (Many shareholder advocates consider these resolutions that never appear to be among their most successful.) Because proposals are filed directly with the company and need not be made public, there is no precise way to measure how many such resolutions are withdrawn before proxies are printed.

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How Successful Are They?

Like many resolutions on social topics, proposals in this category rarely receive majority votes. However, given the dispersed nature of many companies' ownership and the fact that so many investors do not vote their proxies actively, even much lower vote percentages may indicate substantial shareholder support for the proponent's positions. Exact average support levels may be misleading if calculated in retrospect, both because the specific texts of the resolutions vary substantially (making it hard to compare votes), and because some of the ballot proposals receive no officially tallied votes at all. This occurs if they are withdrawn after the proxy is printed but before, or at, the annual meeting. Like pre-proxy withdrawals, these are typically the result of a successful dialogue: for example, Walden Asset Management's 2008 proposal at United Natural Foods was withdrawn when the company agreed to adopt a code of conduct for its suppliers.

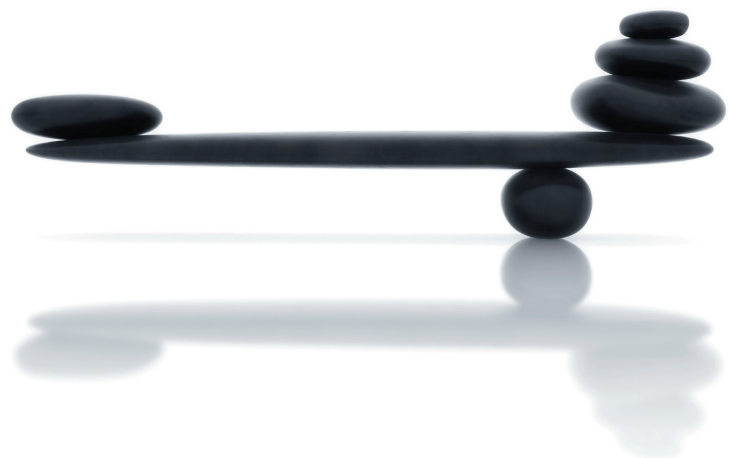
Resolutions that have come to a vote in the 2008 and 2009 proxy seasons have often garnered between 7% and 15% of the votes cast for and against, with over a quarter receiving support of over 20%. Examples of the latter include proposals at Altria about tobacco harvesters; at Nucor regarding forced labor in Brazil; and at Archer-Daniels-Midland, Urban Outfitters, United Technologies, Chevron and Halliburton about either labor issues or human rights (including labor rights) in their supply chains and overseas operations.

In short, these labor standards resolutions are receiving significant attention, particularly at certain companies.

What's the Investment Case?

The following are among the main reasons that advocates see labor standards giving rise to potential investment risk.

- Mistreatment of workers, at home or abroad, can impair productivity, raise turnover costs, and increase supply chain instability.
- Labor rights violations in foreign countries can alienate host communities whose cooperation is essential to a corporation's success.
- Companies that fail to protect workers are exposed to reputational/brand risk, which can have serious financial consequences.



What Do Proposals Typically Ask For?

Proposals typically request:

- **The adoption of a code or policy** related to this issue. This could be a code or policy governing labor standards (or “vendor standards”) in the company’s supply chain or operations as a whole. It might also be a broader human rights policy, which is generally understood to include certain labor rights.
- **A report** on how the company is addressing a particular labor issue (such as forced labor in the supply chain for a particular product) or how it is monitoring compliance with its labor or human rights standards in general.

Less often, proposals will ask for a more specific action. For example, over the past two years proponent John Harrington has asked a number of companies to amend their bylaws to create a human rights committee.

What Else Do Proposals Typically Say?

Companies are often asked to ensure that workers’ rights under the following two international standards are protected:

- **The ILO Conventions:** The International Labor Organization (ILO) was founded after World War I to protect workers’ rights. It is now an agency of the UN, where it brings together representatives of governments, industry and labor. It has developed a set of international labor standards or conventions, the most important of which cover the rights to freedom of association and collective bargaining, as well as the freedom from forced labor, child labor, and employment discrimination.
- **The Universal Declaration of Human Rights:** Adopted by the UN in 1948, this declaration asserts that all people have certain rights, including a number which are work-related (e.g., freedom from forced labor and discrimination, the right to organize, and the right to a decent standard of living).

Proposals may also discuss particular controversies or challenges facing a company or an entire industry. These may include the use of children or forced labor in the supply chain for a particular product; allegations of harassment, intimidation, or violence against workers or union organizers in a particular location; or general concerns about workers’ health, safety, work schedules, and pay levels at a company’s operations or those of its vendors.



II. Assessing the Relevance of the Proposal for a Particular Company

How Can I Tell If a Proposal Is Material to a Particular Company?

Investors use several different methods to decide whether they think a social issue, which they may think is important in the abstract, is material to a particular company. Many investors, of course, consider multiple factors in this list.

- **Percentage of revenues:** Some investors think a resolution is material if the issue it addresses affects a business line or operation representing a certain percentage of the company's revenues --- say, 5%, 10%, or 20%.
- **Issue impact:** At large companies, a business line that represents only a small portion of revenues may still be large in absolute terms and in terms of the company's impact on an issue (for example, a company may be one of the largest employers in a particular country or region although the revenues it derives from that operation are small in terms of its bottom line).
- **Industry position:** The company may have a leadership role in its industry, and handling the issue well may be an opportunity to demonstrate this.
- **Strategic impact:** The area of the business impacted may be currently minor, but important to future growth.
- **Reputational risk:** The company may be consumer-facing and vulnerable to negative publicity regarding the issue.

How Can I Tell If a Company Is Already Addressing an Issue Adequately?

Companies' statements in opposition to resolutions typically assert either that the issue is not important for the company or that it has already been addressed. Here's how to cut through the PR and see the real evidence.

A company's statements should be considered less persuasive if:

- The company says it already has a policy or code, but doesn't explain much about what it is based on, how compliance with it is monitored, or how violations are addressed.
- A company acknowledges controversies and says they have been addressed, but doesn't clarify what's being done to prevent a repetition of similar problems in the future.
- The company cites only pilot programs, anecdotes, or charitable initiatives as its response to the issue, or cites a few facts and figures without context to make them meaningful.
- The company refers only to participation in an industry-level vendor code or labor-rights initiative. The efforts of industry groups of contributions are essential in situations (like those in many Asian factories) where vendors serve many clients, and no one firm can compel compliance with its own individual standards. However, the process of reaching consensus on a code often weakens it, and leading companies are going beyond industry baselines as they enforce labor standards in their own particular operations and supply chains.

A company's statements should be considered more persuasive if:

- The company references international norms as the framework for its code or policy, and explains specifically how it is monitored and enforced.
- The company openly addresses any controversies, and can cite company or division-wide programs and policies that are integrated into its ordinary operations (or its contract relationships with vendors) to address labor issues.
- The company provides useful context to understand the meaning of labor-related data (for example, year-over-year comparisons to illustrate trends at vendor facilities).
- The company participates in groups that involve multiple stakeholders concerned with labor issues (e.g., representatives of labor, governments, and investors as well as companies).
- The company enlists third-party assistance in enforcing its standards (e.g., through unannounced social audits conducted by outside firms with relevant linguistic and other expertise).

III. Deciding How to Vote

How Can I Make My Final Voting Decision?

Investors who conclude that a resolution is germane to the company's business and that the company's board and management are not yet adequately addressing the business risks and opportunities it poses are likely to support the resolution. Those who conclude that the issue is not significant for the company, or that it is significant but the company is already taking adequate steps to address it, may oppose the resolution. Some investors in the latter group, however, may also choose to abstain on the resolution, in order to signal support for investor attention to the issue in general, even if it does not seem pressing at this particular company at this time. Some investors also oppose or abstain on resolutions they believe are overly prescriptive or poorly constructed, even if they agree that the issue is important.





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