QUESTIONS AND ANSWERS ON THE SECURITIES AND EXCHANGE COMMISSION'S EXCLUSIONS OF RISK EVALUATION RESOLUTIONS

Q: How is the SEC blocking shareholders from filing resolutions on evaluation of risk?

A: Shareholders have rights under federal law to have a proposal published on a corporate proxy statement, provided it complies with Securities and Exchange Commission rules and other state and federal laws.

Companies that receive shareholder proposals often try to exclude them from the proxy by asserting violations of SEC rules. To do so, the company must notify the SEC of their intention to exclude the resolution by filing a request, known as a "No Action Request," because it asks the SEC staff to declare that no enforcement action will be taken if the company excludes the resolution. The SEC staff then considers the matter in light of the 13 reasons provided in SEC Rule 14a-8 that allow companies to exclude the resolution. Some of the more important reasons include: the issue concerns the "ordinary business" of the company; is false or misleading; or has been substantially implemented by the company. While these No Action letters are not formal legal opinions, they tend to be treated as precedent within the Securities and Exchange Commission.

Shareholders often seek information bearing on the value of their investments through shareholder resolutions, seeking disclosure of information that helps them to better forecast the value of their holdings. For instance, during the 1990s and into 2003, shareholders filed resolutions seeking disclosure of an array of information related to environmental and human rights issues. For example, in 1994 shareholders of Southwestern Bell Corporation filed a resolution to request that the Board of Directors issue a "report detailing the anticipated impact of the North American Free Trade Agreement ("NAFTA"), or any other trade agreement of a similar nature with Mexico, on our Company's competitive strategies and long-term shareholder value . . . [including] . . . The specific impact of NAFTA on the Company's competitive strategies and the policies and programs for their implementation; on workers, customers, shareholders, suppliers and the communities".

Historically, the SEC would review such a proposal to determine whether it improperly focused on the "ordinary business" of the company. Under this standard the SEC has held that *the proposal may be excluded only after the proposal is also found to raise no substantial policy consideration*.

However, since 2003, the SEC staff has issued a number of unfavorable rulings on shareholder resolutions because, according to the staff, the resolutions asked companies for an *evaluation of financial risks* associated with environmental, human rights or other issues that the SEC staff has decided to treat as excludable ordinary business. This trend in staff decisions dramatically limits the scope of previously acceptable shareholder proposals, and therefore curtails the rights and protections of investors to ask for the financial impact of significant environmental and social policy issues on companies.

In 2004 and early 2005 the SEC staff went even further and began to apply the exclusion in even broader ways, including applying it to a proposal on the HIV/AIDS, tuberculosis and malaria pandemics. See *Texas Instruments* (January 28, 2005).

In June, 2005 the SEC staff stated in Staff Legal Bulletin No. 14C ("SLB 14C") that the staff would exclude *environmental* resolutions focused on internal assessment of risk:

> To the extent that a proposal and supporting statement focus on the company engaging in an internal assessment of the risks or liabilities that the company faces as a result of its operations that may adversely affect the environment or the public's health, we concur with the company's view that there is a basis for it to exclude the proposal under rule 14a-8(i)(7) as relating to an evaluation of risk.

By 2006, the reach of this rationale grew even further. In that calendar year, 13 shareholder resolutions were excluded on "evaluation of risk" grounds. These decisions included reversing proposals that were deemed permissible in previous years. See excluded proposal *Ryland Group, Inc.* (February 13, 2006) (energy efficiency) – a virtually identical proposal, *Ryland Group, Inc.* (February 1, 2005) , was permitted in 2005. Also see, excluded proposal *General Electric Company* (January 13, 2006) (report evaluating the risk of damage to GE's brand name and reputation in the United States as a result of outsourcing and offshoring work to other countries) – three virtually identical proposals, *General Electric Company* (February 3, 2004); *Sprint* (February 5, 2004); and *General Electric Company* (January 19, 2000), were permitted in 2000 and 2004.

Furthermore, the SEC staff began excluding proposals on "evaluation of risk" grounds that addressed *labor (General Electric Company* (January 13, 2006)) and *pharmaceutical pricing* issues (*Pfizer* (January 13, 2006) and *Merck* (January 11, 2006)).

Q: Aren't a lot of resolutions filed and voted on that relate to "risk" issue areas?

A: While the staff is allowing shareholder resolutions that ask for reports on how a company's actions will affect the environment or human rights, it is ***not*** allowing resolutions that ask how any outside issues (such as climate risk, homeland security or the HIV/AIDS pandemic in Africa) may affect the financial performance of the company. Given that the latter is a core concern to investors, the "evaluation of risk" exclusions are undermining the clear interests of investors.

Q: How big a problem is this?

A: We believe it is a very big problem. Shareholders are being barred from asking in shareholder resolutions for the information that they most need as fiduciaries.

SEC staff's use of the "evaluation of risk" rationale has expanded over recent years.

In calendar 2007, 10 proposals were excluded explicitly on evaluation of risk grounds and implicitly on another 14 occasions. However, the sheer number of resolutions excluded is not a complete reflection of the impact of these rulings on shareholders. Shareholders are largely self-censoring their resolutions to avoid the prohibited requests; the SEC rulings have forced shareowners to rewrite their proposals to avoid excludible requests for the financially relevant information.

Q: What are some examples of resolutions that have been blocked by the SEC exclusion of risk evaluation?

A: Here are a few examples:

In 2004, the Nathan Cummings Foundation introduced a shareholder proposal at The Ryland Group Incorporated, a home building company, asking the company to "assess how the company is responding to rising regulatory, competitive, and public pressure to increase energy efficiency and reduce greenhouse gas emissions." The SEC staff, after being presented with an evaluation of risk argument from the company, allowed the proposal to appear in the company 2005 proxy. But in 2005, the Foundation submitted a virtually identical proposal for the company's 2006 proxy. In contrast to 2005, the Staff on this occasion reversed itself and **excluded** the proposal on the basis of risk evaluation.

In February 2006, the Staff issued three No Action letters allowing exclusion of an identical proposal at Norfolk Southern Corp., Union Pacific Corp. and Kansas City Southern. That proposal sought "information relevant to the Company's efforts to both safeguard the security of their operations and minimize material financial risk arising from a terrorist attack and/or other homeland security incidents." The Staff allowed the companies to exclude the proposal as relating to an evaluation of risk. These proposals were distinct in not requesting the company to consider alternative policies or even to discuss how a public policy issue could impact the company. They simply sought a report on efforts to secure operations and protect the financial health of the company.

In 2006, General Electric Company sought to exclude from its proxy materials a shareholder proposal which requested "a report evaluating the risk of damage to GE's brand name and reputation in the United States as a result of the growing tendency to send manufacturing and service work to other countries (outsourcing and offshoring)". The Staff concluded that GE could exclude the proposal as requesting an evaluation of risk. In response the proponent sought full commission review of the decision pointing out that the decision "may represent the most important staff change in its interpretation of Rule 14a-8(i) (7)." The request for full commission was denied by the Staff.

A resolution, which staff allowed to be excluded in 2005 based on the risk assessment rationale, would have requested a report from Dow Chemical on the impacts that the outstanding issues in Bhopal, India, if left unresolved, could reasonably pose on the company, its reputation, its finances and its expansion in Asia and elsewhere. In 2006 and 2007, the New York City Pension Funds changed the resolved clause to request a report on "any new initiatives" the company is taking to address the outstanding needs of the Bhopal survivors. This format has survived No Action challenge by Dow Chemical. However, it does not address the core needs of investors to know how the Bhopal issue is affecting the company. In April 2007, Amnesty International discovered a letter from the CEO of Dow Chemical to the Indian Ambassador to the US acknowledging that the outstanding issues in Bhopal are an impediment to Dow's investing in India. (Amnesty filed a complaint with the SEC, asserting that this may represent material information that should have been available to investors.) The 2005 resolution that was rejected by the SEC could have been an opportunity for the company to better inform investors of these issues.

In 2008, the staff rejected a Proposal directed at Washington Mutual requesting the Company's Board of Directors to produce a report discussing the Company's "potential financial exposure as a result of the mortgage securities crisis." The staff No Action letter allowed exclusion as "risk evaluation." The Proposal requested that such report include discussion of the percentage of the Company's mortgage originations and/or mortgage securitizations could be categorized as subprime, Alt-A or other non-agency loan types; the long-term strategic and financial implications of the Company's recent decision to reduce its resources and capacity in the subprime area and what the Company anticipates will be its ultimate realized losses related to the mortgage securities crisis.

Fact Sheet prepared by
Attorneys Sanford Lewis and Jonas Kron

Researched with the support of
Trillium Asset Management, Calvert Funds, Domini Investments,
Boston Common Asset Management, Harrington Investments and Citizens Funds