Director Notes

Review of Shareholder Proposals on Environmental Issues

by Thomas Singer

This report looks at the content of shareholder proposals on environmental issues that went to a vote during the 2012 proxy season to determine what specific environmental issues were most often brought to boards of directors and to evaluate which issues received the greatest overall support from company shareholders.

Over the last several years, sustainability topics have increasingly made their way into company boardrooms. In fact, according to "Shareholder Proposals: Trends from Recent Proxy Seasons (2007-2011)," a working paper by two researchers for The Conference Board, proposals on social and environmental policy issues increased from 2007 levels despite a decline in all other subjects.[1] In 2012, during the period between January 1 and June 30, a total of 48 shareholder proposals on environmental issues went to a vote, constituting 7 percent of all shareholder proposals for the period. For comparison, 47 environmental proposals were voted on during the same period in 2008, or 5 percent of all shareholder proposals for that period.[2]

The growth in shareholder proposals on environmental issues can be attributed to the growing discourse on the role of business and sustainability, and to an increase in shareholders' expectations for companies to drive long-term value. Shareholders increasingly expect companies to disclose and manage their environmental risks, and in particular, the potential risks posed by climate change. To this end, the 2012 proxy season saw a number of proposals related to sustainability disclosure, including requests for companies to publish comprehensive annual sustainability reports.

This report contains data on shareholder proposals on environmental issues appearing in company proxies during the period January 1—June 30, 2012. Proposals are grouped into topics according to the content of the proposals. Additional details, including the text of sample proposals, are provided for the topics most frequently voted on by shareholders.

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Top Environmental Issues by Frequency

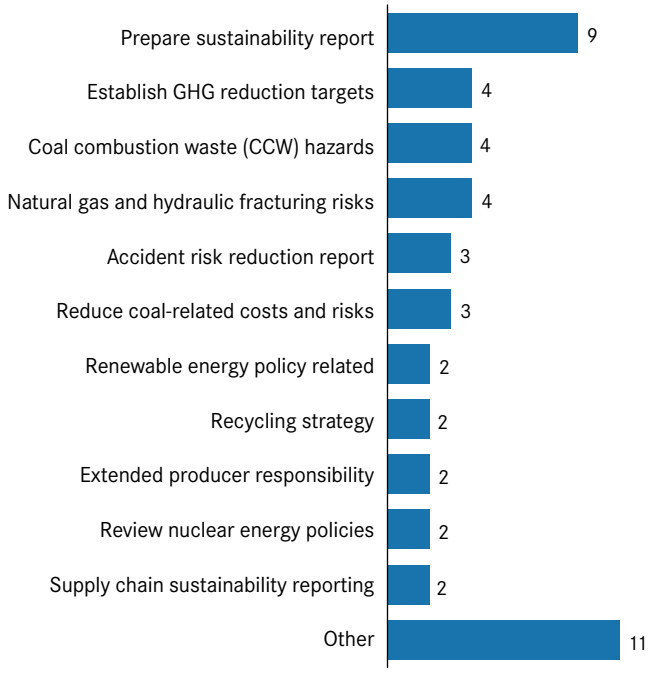
As shown in Chart 1, the majority of environmental proposals urged companies to prepare a sustainability report. Nine such proposals were voted on during the 2012 proxy season. The next three most frequently voted topics each had four proposals in 2012. These topics were: proposals requesting that companies establish greenhouse gas (GHG) reduction goals, proposals asking companies to report on the environmental and health hazards associated with coal combustion waste (CCW), and proposals requesting companies assess the risks and impacts associated with expanded natural gas exploration and hydraulic fracturing. Other notable topics included proposals asking companies to report on steps taken to reduce the risk of accidents and proposals requesting that companies disclose their plans to reduce their exposure to coal-related risks and costs. Topics that had only one proposal issued in 2012 are grouped into the "other" category.

Top Environmental Issues by Votes

In 2012, the environmental issues voted on most frequently by shareholders were also among the issues receiving the highest levels of shareholder support. As shown on Chart 2, the four topics most frequently voted on during the 2012 period examined received average shareholder support of over 25 percent of *for* votes (as a percentage of yes/no votes). Proposals asking companies to prepare a sustainability report received the highest average of *for* votes (36.2 percent). Proposals related to coal combustion waste received the second strongest support (27.8 percent of *for* votes), followed closely by proposals requesting companies establish GHG reduction targets (27 percent of *for* votes). Proposals related to hydraulic fracturing received average shareholder support of 25.5 percent of *for* votes.

Chart 1

Number of shareholder proposals on environmental issues, by topic (2012)



Source: The Conference Board/FactSet, 2012.

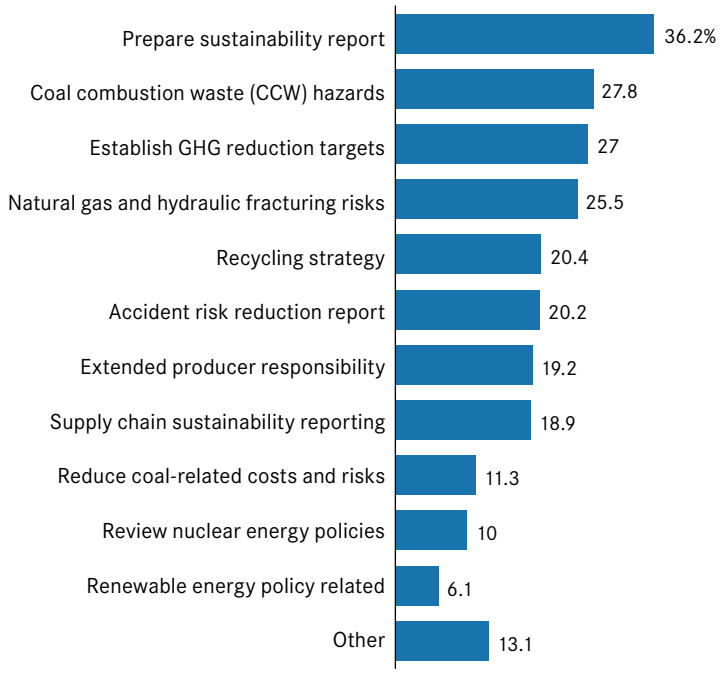
Topics in the "other" category

Each of the topics below had only one proposal issued in 2012

- Adopt a sustainable palm oil policy
- Adopt policies to address environmental hazards of oil- and gas-related activities in coastal areas
- Conduct an energy assessment
- Establish a board sustainability committee
- Establish a stormwater management policy
- Establish energy reduction targets
- Prepare a climate change report
- Prepare a sustainable paper purchasing report
- Report on impacts of mountaintop coal removal
- Report on risks and impacts associated with GMO contamination
- Report on supply chain impacts on deforestation

Chart 2

Average "for" votes (% yes/no) for environmental issues, by topic (2012)



Source: The Conference Board/FactSet, 2012.

Overview of Top Environmental Issues

Topic 1: Sustainability reporting Shareholder proposals requesting that companies publish a sustainability report were not only the most frequently voted environmental proposals during the 2012 period examined, but also the most strongly supported by shareholders. Despite the growing importance of sustainability issues for companies, the number of U.S. companies publishing sustainability reports remains relatively low. According to The Conference Board report *Sustainability Practices*, less than half of S&P 500 companies publish a sustainability report.[3] When it comes to sustainability reporting, U.S. companies lag significantly behind their European counterparts. The Global Reporting Initiative (GRI), the leading framework for sustainability reporting, indicates that Europe accounted for 45 percent of GRI reports in 2010. Asia had the next largest representation (20 percent of GRI reports), while North American companies accounted for only 14 percent of GRI reports.[4]

Sustainability reports offer companies a useful tool to communicate with key stakeholders, including employees, customers, suppliers, and the local communities in which companies operate. These reports allow companies to share important sustainability metrics with their stakeholders, and they can also be a useful tool for tracking and measuring a company's sustainability performance over time. The growth of sustainability reporting can, in part, be attributed to the understanding that long-term business success hinges on a wide range of intangible corporate assets, and that financial performance figures alone offer an incomplete portrait of a company and its prospects. Sustainability reports aim to foreground a discussion of nonfinancial performance metrics. Sustainability reporting has also been on the agenda of the most recent United Nations Conference on Sustainable Development (Rio+20), which encouraged companies to "consider sustainability issues and to integrate sustainability information within the reporting cycle."[5] In addition, the United Kingdom introduced regulations earlier this year that will require companies listed on the London Stock Exchange to begin carbon reporting in 2013.

While many companies have yet to issue their first sustainability report, a few companies are already venturing into integrated reporting, which is the next step in the evolution of sustainability reporting. Integrated reports combine the discussion of financial and nonfinancial performance metrics into a single resource to offer a unified and comprehensive overview of a company's performance. While integrated reporting is not yet a mainstream practice, a number of companies are currently integrating environmental, social, and governance (ESG) data into their traditional annual reports. Notable examples include American Electric Power, Novozymes, Philips, and United Technologies.

Topic 2: Greenhouse gas reduction goals Shareholder proposals requesting that companies establish GHG reduction goals were the second-most frequently voted environmental proposal in 2012, and they received the third highest average support. The relatively high frequency and support for these proposals is not surprising, as companies and governments are increasingly focusing on efforts to reduce GHG emissions in response to the threat of climate change.

GHGs are the gases that absorb and trap in the atmosphere sunlight infrared radiation, therefore contributing to a gradual rise of the temperature of the planet. Human activities, such as burning fossil fuels or livestock farming, are proven to have dramatically increased the concentration of certain GHGs. Estimates by scientists indicate that

Snapshot of an Integrated Report: Novo Nordisk

The Novo Nordisk Annual Report 2011 integrates financial, environmental, and social performance

		2011	2010	Change
Financial performance				
Sales total	DKK million	66,346	60,776	9.2%
Diabetes care	DKK million	50,425	45,710	10.3%
– of which modern insulins	DKK million	28,765	26,601	8.1%
– of which Victoza®	DKK million	5,991	2,317	158.6%
Biopharmaceuticals	DKK million	15,921	15,066	5.7%
Gross profit	DKK million	53,757	49,096	9.5%
Gross margin	% of sales	81.0	80.8	
Sales and distribution costs	% of sales	28.6	29.9	
Research and development costs	% of sales	14.5	15.8	
Administrative expenses	% of sales	4.9	5.0	
Operating profit	DKK million	22,374	18,891	18.4%
Net profit	DKK million	17,097	14,403	18.7%
Effective tax rate	%	22.0	21.2	
Capital expenditure, net	DKK million	3,003	3,308	(9.2%)
Free cash flow	DKK million	18,112	17,013	6.5%
Long-term financial targets				**Long-term financial targets**[1]
Operating profit margin	%	33.7	31.1	35%
Growth in operating profit	%	18.4	26.5	15%
Operating profit after tax to net operating assets[1]	%	77.9	63.6	90%
Cash to earnings (three-year average)	%	112.8	115.6	90%
Social performance				
Healthcare professionals trained or educated in diabetes	1,000	835	373	123.9%
Donations	DKK million	81	84	(3.6%)
Employees (total)	Number	32,632	30,483	7.0%
Average of full-time employees	Number	31,499	29,423	7.1%
Employee turnover	%	9.8	9.1	
Relevant employees trained in business ethics	%	99	98	
Long-term social targets				**Long-term social targets**
Least developed countries where Novo Nordisk sells insulin according to the differential pricing policy	%	75	67	100%
Engaging culture	Scale 1– 5	4.3	4.3	4.0
Diverse senior management teams	%	62	54	100% by 2014
Environmental performance				
Energy consumption	1,000 GJ	2,187	2,234	(2.1%)
Water consumption	1,000 m^3	2,136	2,047	4.3%
CO_2 emissions from energy consumption	1,000 tons	93	95	(2.1%)
Long-term environmental targets				**Long-term environmental targets**
Energy consumption (change compared with 2007)	%	(21)	(20)	11% reduction by 2011
Water consumption (change compared with 2007)	%	(34)	(37)	11% reduction by 2011
CO_2 emissions from energy consumption (change compared with 2004)	%	(56)	(55)	10% reduction by 2014
Share performance				
Diluted earnings per share/ADR	DKK	29.99	24.60	21.9%
Dividend per share (proposed)	DKK	14.00	10.00	40.0%
Closing share price (B shares)	DKK	660	629	4.9%
Market capitalisation (B shares)[2]	DKK billion	296	292	1.4%

1. The long-term financial targets were updated in February 2012.
2. Novo Nordisk B shares (excluding treasury shares).

Source: Novo Nordisk Annual Report 2011, inside front cover (http://annualreport2011.novonordisk.com/web-media/pdfs/Novo-Nordisk-AR-2011-en.pdf).

the earth's climate is about 30 degrees Celsius warmer than it would otherwise be because of the greenhouse effect. The implications of a warmer climate on business are numerous (including challenges associated with rising sea levels, more severe droughts, more frequent natural disasters, and biodiversity loss), which explains one of the reasons why the business community is actively trying to manage GHG emissions. According to *Sustainability Practices*, slightly over half of S&P 500 companies have initiatives aimed at reducing emissions.[6] Furthermore, the *Carbon Disclosure Project S&P 500 Report* shows that 64 percent (214) of S&P 500 respondents to the Carbon Disclosure Project (CDP) have established GHG emissions reduction targets.[7]

GHG reduction targets are typically set as either absolute targets or intensity targets. Absolute targets are expressed as a percentage reduction in emissions by a specific date based on a set baseline. Bank of America, for example, set a goal to reduce the company's GHG emissions by 15 percent from 2011 to 2015, based on a 2010 baseline.[8] From a governmental perspective, the European Union set a commitment in 2007 to reduce emissions by at least 20 percent of 1990 levels by 2020, with a possibility to increase the commitment to a 30 percent reduction.[9] Intensity targets, on the other hand, define a reduction of emissions in relation to some other indicator, such as revenue or units of production. Alcoa, for example, established a goal to reduce 2005 levels of carbon dioxide (CO_2) intensity (metric tons of CO_2 per ton of production) by 20 percent by 2020 and 30 percent by 2030.[10]

As a reference point, the United Nations Intergovernmental Panel on Climate Change (IPCC) indicates that global emissions will need to be reduced 50-80 percent by 2050 (compared to 1990 levels) in order to avoid serious consequences of climate change.

Below is an example of the text of a proposal on GHG reduction goals brought forth by shareholders in 2012:

> Shareholders request that the board of directors adopt quantitative goals, based on current technologies, for reducing total greenhouse gas emissions from the company's products and operations; and that the company report to shareholders by November 30, 2012, on its plan to achieve these goals. Such a report will omit proprietary information and be prepared at reasonable cost.[11]

Topic 3: Environmental and health hazards of coal combustion waste (CCW) Shareholder proposals asking companies to disclose efforts to manage coal combustion waste (CCW) were the third most frequent proposals and received the second strongest support. Specifically, these proposals requested companies to report on efforts to reduce environmental and health hazards associated with CCW ponds, impoundments, and mines, such as the implementation of caps, liners, groundwater monitoring, and/or leachate collection systems.

CCW is composed of the materials that remain after coal is burned for electricity production, and typically consists of fly ash, bottom ash, boiler slag, and flue gas desulfurized gypsum. The waste stream is also known to include a number of metals, such as arsenic, selenium, and cadmium.[12] According to the American Coal Ash Association, over 130 million tons of CCW was generated in 2010, making CCW one of the largest waste streams in the United States.[13] CCW is not currently classified as hazardous waste and is not regulated at the federal level—something critics point to as a problem because it has led to a patchwork of inconsistent state regulations.

The large volume of CCW and the lack of federal regulation to address it have raised concerns about the potential environmental and health hazards associated with this waste stream. Inadequate CCW disposal practices, such as in unlined landfills and surface impoundments, can result in health and environmental risks from toxic substances released to surface and groundwater. Concern over CCW disposal received high-profile attention in 2008 when a breach in an impoundment pond at a Tennessee Valley Authority (TVA) plant released 1.1 billion gallons of coal fly ash slurry. The release spread to over 300 acres, causing significant damage to homes and property that resulted in estimated cleanup costs of $1.2 billion.[14]

The potential environmental, health, and financial risks associated with CCW have encouraged shareholders to request that directors disclose greater information regarding companies' management of CCW. Below is an example of a proposal brought forth in 2012:

> Shareholders request that the board prepare a report on the company's efforts, above and beyond current compliance, to reduce environmental and health hazards associated with coal combustion waste contaminating water

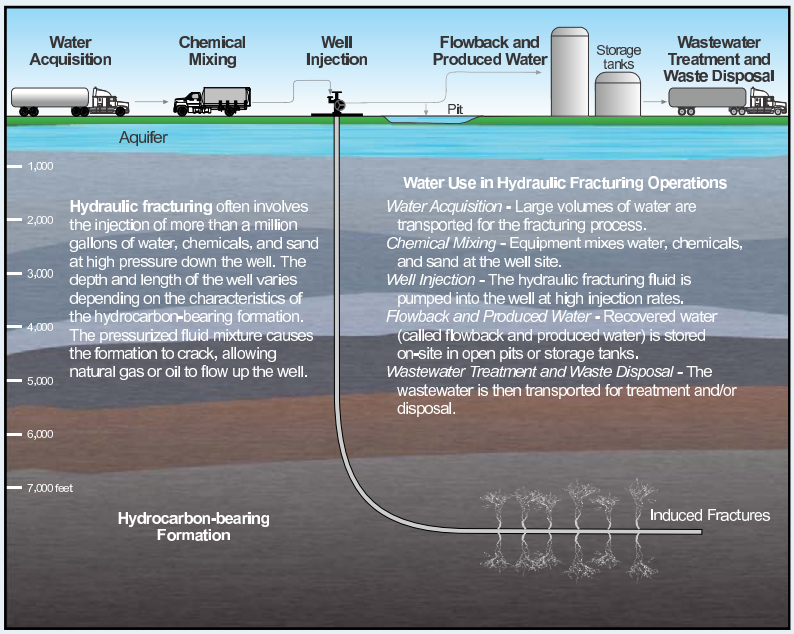
(including the implementation of caps, liners, groundwater monitoring, and/or leachate collection systems), and how those efforts may reduce legal, reputational and other risks to the company's finances and operations. This report should be available to shareholders by August 2012, be prepared at reasonable cost, and omit confidential information such as proprietary data or legal strategy.[15]

Topic 4: Hydraulic fracturing Reports related to hydraulic fracturing were the fourth most frequent environmental proposals and received the fourth strongest support. Proposals on this topic have become fairly common in recent proxy seasons, due in part to a recent resurgence in natural gas exploration. The practice of hydraulic fracturing, which involves pumping water, sand, and chemicals underground to release natural gas from rock formations, has become a topic of much debate in energy policy discussions. Proponents of hydraulic fracturing emphasize that the practice can enable the development of a significant source of new energy supply in the United States, ultimately reducing the country's dependence on foreign oil imports. Natural gas is also a cleaner burning fuel than other fossil fuels, generating about half the carbon dioxide emissions compared to burning coal.[16] Some reports, such as the 2011 MIT study *The Future of Natural Gas,* point to the benefits of natural gas as a bridge facilitating the transition from coal and oil to renewables such as wind, solar, and geothermal.[17] (It is important to note, however, that a growth in natural gas investments could also slow investments in renewable technologies).

Despite the potential advantages of hydraulic fracturing, there are a number of concerns surrounding the environmental and health impacts associated with this practice. Hydraulic fracturing is a water-intensive practice, requiring anywhere from 50,000 to 350,000 gallons of water to fracture one well in a coal bed formation, and 2 million to 5 million gallons of water to fracture one horizontal well in a shale formation.[18] Hydraulic fracturing also requires the usage of potentially toxic chemicals (which remain undisclosed by most companies) that, if leaked, could contaminate underground sources of drinking water. A number of studies and task forces are currently being carried out to better understand the impacts associated with hydraulic fracturing, in part to inform potential regulatory developments. The U.S. Environmental Protection Agency (EPA), for example, has been conducting a study on the effects of hydraulic fracturing on drinking water, and it plans to release the first set of results by the end of 2012, with a final report to be released in 2014. In addition, the White House announced in April 2012 the creation of a taskforce to oversee the development of natural gas resources, known as the Interagency Working Group to Support Safe and Responsible Development of Unconventional Domestic Natural Gas Resources.[19]

Water Lifecycle in Hydraulic Fracturing

This illustration of a horizontal well shows the water lifecycle of hydraulic fracturing



Source: Plan to study the potential impacts of hydraulic fracturing on drinking water resources, U.S. Environmental Protection Agency, November 2011, p. 13 (www.epa.gov/hfstudy/HF_Study__Plan_110211_FINAL_508.pdf).

Company shareholders are responding to the scrutiny of hydraulic fracturing practices by asking directors to disclose more information on companies' involvement and risks associated with hydraulic fracturing. The following is an example of a proposal on hydraulic fracturing:

> Shareholders request that the board of directors prepare a report to investors by September 2012, at reasonable cost and excluding confidential or legally prejudicial data, on the short-term and long-term risks to the company's operations, finances and gas exploration associated with community concerns, known regulatory impacts, moratoriums, and public opposition to hydraulic fracturing and related natural gas development.[20]

Conclusion

Shareholder proposals on environmental issues have become one of the fastest growing topics in recent proxy seasons. Shareholders are increasingly asking companies to address a number of sustainability topics, ranging from general requests, such as sustainability reporting, to highly specific issues, such as hydraulic fracturing. While shareholder support for some of these proposals has been relatively low, signs point in the direction of increasing levels of support, particularly as shareholders and investors begin to include ESG data in their evaluations of company performance. As environmental issues continue to gain traction in future proxy seasons, company directors can expect to encounter a greater number of questions regarding their companies' environmental performance and disclosure. Some of these questions may concern the topics mentioned in this report, and others will undoubtedly be on entirely new issues that have yet to emerge.

Endnotes

1 Matteo Tonello and Melissa Aguilar, *Shareholder Proposals: Trends from Recent Proxy Seasons* (2007-2011), February 2012 (www.ssrn.com/abstract=1998378).

2 FactSet data for Russell 3000 companies during the period January 1–June 30, 2012.

3 Matteo Tonello and Thomas Singer, *Sustainability Practices: 2012 Edition*, The Conference Board, Research Report 1493, 2012, p. 23.

4 *GRI Sustainability Reporting Statistics*, Global Reporting Initiative, 2010, p. 3.

5 *The Future We Want – Zero Draft of the Outcome Document*, United Nations Conference on Sustainable Development, 2012 (www.uncsd2012.org/rio20/index.php?menu=144#Vb).

6 Tonello and Singer, *Sustainability Practices: 2012 Edition*, p. 30.

7 *CDP S&P 500 Report 2011*, Carbon Disclosure Project, 2011, p. 9.

8 *Bank of America 2010 Corporate Social Responsibility Report: Executive Summary*, p. 10.

9 *Europe 2020 Strategy*, European Commission, p. 11 (http://eur-lex.europa.eu/LexUriServ/LexUriServ.do?uri=COM:2010:2020:FIN:EN:PDF).

10 *Alcoa 2010 Sustainability Highlights Report*, p. 2.

11 Exxon Mobil proxy statement, filed April 12, 2012, p. 71 (www.sec.gov/Archives/edgar/data/34088/000119312512160085/d277949ddef14a.htm).

12 *Coal Combustion Residuals*, U.S. Environmental Protection Agency (www.epa.gov/osw/nonhaz/industrial/special/fossil/coalashletter.htm).

13 *2010 Coal Combustion Product (CCP) Production & Use Survey Report*, American Coal Ash Association, 2011 (acaa.affiniscape.com/associations/8003/files/2010_CCP_Survey_FINAL_102011.pdf).

14 Linda Luther, *Regulating Coal Combustion Waste Disposal: Issues for Congress*, Congressional Research Service, 2010, p. 1.

15 Southern Company proxy statement, filed April 16, 2012, p. 23 (http://files.shareholder.com/downloads/SO/2085696395x0x559243/397D1005-D4CF-4519-956E-CBA39133A0BD/Southern_Co_2012_Notice_and_Proxy_Statement.pdf).

16 *Natural Gas*, U.S. Environmental Protection Agency (EPA) (www.epa.gov/cleanenergy/energy-and-you/affect/natural-gas.html).

17 *The Future of Natural Gas*, Massachusetts Institute of Technology (MIT), 2011.

18 *Hydraulic Fracturing Fact Sheet*, U.S. Environmental Protection Agency, 2010, p. 2. (www.epa.gov/owindian/tribal/pdf/hydraulic-fracturing-fact-sheet.pdf).

19 See "Executive Order -- Supporting Safe and Responsible Development of Unconventional Domestic Natural Gas Resources", April 13, 2012 (www.whitehouse.gov/the-press-office/2012/04/13/executive-order-supporting-safe-and-responsible-development-unconvention).

20 Exxon Mobil proxy statement, filed April 12, 2012, p. 69 (www.sec.gov/Archives/edgar/data/34088/000119312512160085/d277949ddef14a.htm).

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