

# Shareholder Action PROGRAM

2005 STATUS REPORT

December 2005

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# Preface

We are pleased to bring you the first annual Status Report for the 2005 Shareholder Action Program, which covers all aspects of our engagement practices throughout the past year, and previews what's in store for 2006.

This report represents a first in Canada: no other mutual fund company has ever provided such a complete description of how it uses the tools of active ownership—direct engagement, shareholder proposals, and proxy voting—to improve the environmental, social, and governance (ESG) performance of publicly-traded corporations.

## Why does Ethical Funds actively engage companies in this way?

For us, socially responsible investing (SRI) is not just about investing in good companies—it's about making good companies better. By using the tools of shareholder action, we can enter into a structured dialogue with the highest levels of the company, alerting directors and managers to new concerns and new risks, and proposing new solutions to the tough challenges they face.

Our goal is to ensure that companies maximize the benefits of business activity while working to minimize and eliminate any negative impacts. Our ultimate objective is to see publicly-traded corporations advance long-term wealth creation in support of a more just and sustainable world.

## Why have we prepared this report?

Our Shareholder Action Program is all about working to keep companies accountable to all their stakeholders—investors, employees, suppliers, customers, and communities. So, **Ethical Funds**® must walk its talk. Just as we ask companies to be accountable to society, so too must we embrace our responsibility to be accountable to our investors and to the Canadian public in general.

## Where we're going

The coming year will be an important one for shareholder action in Canada, as **The Ethical Funds Company** expands its program and works to develop effective shareholder coalitions in this country.

Your feedback helps guide us in our work. We welcome your comments on this Status Report and your ideas on what more can be done to improve corporate sustainability, responsibility, and accountability, both here at home and around the world.

### SHAREHOLDER ACTION: ONE OF THE PILLARS OF SUSTAINABLE INVESTING

The Shareholder Action Program is just one aspect of our Sustainable Investing Program. For more information on the philosophy and activities that guide our approach to investment, view our Sustainable Investing Guidebook at [ethicalfunds.com](http://ethicalfunds.com)

# The Process of Change

The Shareholder Action Program Status Report describes the environmental, social, and corporate governance (ESG) issues we focused on in 2005.

In this report, we identify the companies we engaged in 2005 and describe how their performance is improving. We also tell you where the Shareholder Action Program is going in 2006—how the issues are evolving, the companies we're focusing on, and the targets we have set for the year.

**We focus on engaging Canadian companies.** In our Shareholder Action Program, we allocate the bulk of our engagement resources to dialogues with Canadian companies. We do this for three reasons:

1. Most of our investors' assets are invested in Canadian companies, so this is where we have our greatest portfolio exposure to ESG risks and concerns.
2. Canadian companies have more day-to-day impact on the lives of our investors than most companies based in the United States or overseas. We also know that Canadians care most about the performance of Canadian companies.
3. We believe we have a duty to change the culture of shareholder passivism that exists in this country. Very few investment institutions in Canada make use of the tools of shareholder action to effect positive change. We want to create competitive pressure among all Canadian mutual funds to become more responsible and accountable to their investors and to raise the bar for every publicly-traded company in Canada.

That is not to say our program ignores companies outside Canada. **The Ethical Funds Company** allies with investment institutions based in the United States to dialogue with US companies on a common set of goals and objectives. We are grateful to our American cousins for the effective work they do and the leadership they have demonstrated.

**Sustainability Perspectives Series.** This report also tells you about a new research initiative we introduced in 2005 called Sustainability Perspectives. In this Status Report, we will tell you how we're integrating this research into our dialogues, and as such, increasing the effectiveness of our Shareholder Action Program.

The first paper, entitled, "*Bridging the Chasm: Canadian Energy and Mining Companies and the HIV/AIDS Epidemic*," describes why energy and mining companies need to establish systems for avoiding prosecution for human rights violations under international humanitarian law.

The second paper of the series is entitled, "*Canadian Energy and Mining Companies: Navigating International Humanitarian Law in the 21st Century*." It describes the business risks for companies operating in countries where the HIV/AIDS pandemic has taken hold and what companies need to do help fight the war on AIDS.

## THE POWER OF NUMBERS: WORKING IN COALITIONS

The main network for engaging US companies is the Interfaith Centre on Corporate Responsibility (ICCR), a coalition of more than 275 institutions, based in New York City.

**The Ethical Funds Company** has been an associate member of ICCR since 2000.

For more than thirty years, ICCR members have pioneered socially responsible shareholder action, focusing on issues and themes that are consistent with the engagement priorities of **The Ethical Funds Company**. Membership has allowed us to plug in and add our voice to more than two dozen dialogues in 2005, and to learn from the most experienced active shareholders on the planet.

Other key partnerships include Ceres, a US-based network of investment funds, environmental organizations, and business working to advance environmental stewardship, and the Global Reporting Initiative, a UN-sponsored initiative to create a common format for corporate sustainability reports.

# The Dialogue Protocol

**Understanding Shareholder Action.** In an ideal world, active shareholders would be able to target the worst corporate environmental, social, and governance performers and turn them into stars overnight.

In reality, it doesn't work that way. The dialogue process can be slow and change often comes incrementally. In some cases, companies can remain intransigent, refusing to budge on certain issues. We have found that we are most effective when we can build broad coalitions of support among stakeholders and, eventually, within the company itself. This form of change takes time. But it can be more effective as policies, programs, and practices initiated by internal champions become embedded in the company's culture and the expectations of its stakeholders.

Shareholder action at **The Ethical Funds Company** follows these steps:

## **Step 1 – Identify Candidates for Shareholder Action**

We use five criteria to identify candidate companies for our Shareholder Action Program: environmental and social values as expressed by Canadians in opinion surveys; expert opinion; portfolio exposure; Corporate Sustainability Scorecard results; and business risks and opportunities. These companies are placed on our Focus List, which is published each fall.

## **Step 2 – Establish Strategy**

We set our objectives for engaging companies in dialogue. This process involves identifying effective dialogue tools and establishing criteria for measuring success.

## **Step 3 – Identify Potential Allies**

We identify other institutional shareholders wishing to join our team for the purposes of engaging the targeted company in active dialogue.

## **Step 4 – Identify Key Operational Staff and Decision-makers**

We strive to identify those individuals in the company who have key operational responsibilities and who have the authority to make decisions.

## **Step 5 – Contact the Company**

We write to the company to detail the reasons why we believe it is underperforming in specific areas, offer ideas for improvement, and indicate that we wish to engage in a structured dialogue on the issue.

## THE MECHANICS OF FILING A SHAREHOLDER PROPOSAL

In most Canadian jurisdictions, investors who have owned more than \$2,000 worth of common stock for longer than six months are able to sponsor shareholder proposals. Proposals can be no longer than 500 words and must be submitted prior to a filing deadline established by the company.

Companies are obligated to include the proposal in the management proxy circular, a legal document that companies send to all shareholders in advance of its annual general meeting. In almost all cases, the company's management will describe the reasons why shareholders should vote against the proposal. Shareholders then have an opportunity to vote at the AGM, as part of the formal agenda.

### Step 6 – Meet with Company Representatives

At this stage, we seek a meeting with the company. At that meeting we articulate our concerns, solicit company views, and propose a plan of action.

### Step 7 – Determine Probabilities of Success

We assess our chances for prompting company change. If success appears likely, we establish—with company input—a set of goals, a plan of action, and a timeline for resolving issues.

### Step 8 – Sponsor a Shareholder Proposal

If there is fundamental disagreement over an issue, or if we determine that companies are not willing to engage in good faith dialogue, we sponsor a shareholder proposal for inclusion in the management proxy circular and discussion at the company's annual general meeting (AGM).

### Step 9 – Solicit Shareholder Support

Prior to the AGM, we build support for our proposal among key institutional shareholders and consulting firms that provide proxy analysis and recommendations to institutional investors.

### Step 10 – Move the Resolution at the Company's AGM

Finally, we attend company AGMs to persuade last minute voters, move resolutions, and make further contact with the company.

#### **The function of a shareholder proposal**

Shareholder proposals can help raise awareness of key ESG issues for directors, senior executives, and other shareholders. It's important to note that shareholder resolutions generally don't go to a vote. The three month period between the date we file the proposal and the time when the company has to finalize the management proxy circular for distribution to all shareholders often results in fruitful dialogue; companies most often wish to have the resolution removed from the agenda of the AGM.

When shareholder resolutions do go to a vote, they seldom win a majority. But they seldom need to. Upon seeing shareholder concern for an issue, companies often demonstrate a willingness to negotiate after the annual meeting. In these cases, they begin adopting progressive policies—slowly but surely—usually in recognition that stakeholder concern is building and that the proposal advanced by shareholders offers a rational and effective response to significant business challenges they face.

# Proxy Voting

Proxy voting is a big part of our Shareholder Action Program, and we devote a great deal of time and resources to ensuring we vote the proxies owned by our investors in accordance with our detailed proxy voting guidelines.

The opportunity to vote our proxies comes every year as companies organize for their annual general meeting (AGM). By law, companies are required to submit key issues, such as appointing auditors, amending articles of incorporation, and electing board directors, to a shareholder vote at the AGM. In addition, in most jurisdictions, companies are required to submit proposals sponsored by shareholders to a vote.

Proposals from the company's management and from shareholders appear as items in the company's "management proxy circular." This document is mailed to every shareholder prior to the company's AGM. The management proxy circular (sometimes called the management "information" circular) sets out the time and place for the meeting and provides a financial, operational, and strategic report. If shareholders can't attend the meeting they can vote on these issues, or sign their votes over to another individual or institution to vote on their behalf by "proxy" (hence the name "proxy voting"). The management circular provides a form that encourages shareholders to follow this practice.

Our proxy voting guidelines can be downloaded at:  
[www.ethicalfunds.com/pdf2/sri/proxy\\_voting\\_guidelines.pdf](http://www.ethicalfunds.com/pdf2/sri/proxy_voting_guidelines.pdf)

Our proxy voting activity can be viewed at:  
[www.ethicalfunds.com/do\\_the\\_right\\_thing/sri/shareholder\\_action/proxy\\_voting\\_report.asp](http://www.ethicalfunds.com/do_the_right_thing/sri/shareholder_action/proxy_voting_report.asp)

## SHARE OWNERSHIP AND MUTUAL FUND INVESTORS

Mutual fund investors don't directly own the shares of the companies invested in by a mutual fund. Rather, they own "units" in the mutual fund. As such, mutual fund investors rely upon the mutual fund managers to vote the proxies in their best interests. In practical terms, mutual fund investors don't receive the management proxy circular from each company owned by the mutual fund. Instead, the proxy circulars go to the mutual fund manager.

The disadvantage for mutual fund investors is that they do not have the opportunity to specify how they would like to see shares voted on each proxy issue with every company. The advantage is that they don't have to sort through hundreds of proxy circulars and thousands of proxy issues. At **The Ethical Funds Company**, this task is performed by our Sustainability Analysts with the support of specialized research services.

# 2005: A Year in Review

In 2005, we participated in more than 700 dialogues at varying levels of intensity. While we had 51 companies on our Focus List for direct engagement, and filed 10 shareholder proposals, we also wrote to 153 companies listed on the S&P/TSX Composite Index, asking each to do a better job of disclosing information related to their environmental, social, and governance performance. In this letter we recommended the use of a reporting format advanced by the Global Reporting Initiative (GRI). We did not contact companies already using the GRI format for their reports, nor did we contact those companies that fail to meet our baseline standards.

In addition, we participated in the Carbon Disclosure Project, a coalition of institutional investors with more than US\$21 trillion in assets. Each year, coalition members collectively appeal to the world's largest 500 companies to disclose greenhouse gas emissions, action plans for emissions reductions, and allocation of management responsibilities for implementing these plans.

Of course, direct dialogue is only one way to engage companies. We also voted our proxies on 2,467 proposals at 274 annual meetings. We voted against management almost one third of the time. Most of our negative votes were cast against directors that failed to meet our criteria for independence. **The Ethical Funds Company** believes that director independence is the starting point for good corporate governance. In order to fulfill their responsibilities, board directors must be independent of management and not rely on the company for any benefit, beyond remuneration as directors.

## 2005 Activity Overview

### Number of Company Engagements

Carbon Disclosure Project	500
GRI Reporting	153
Focus List Companies	51

### 2005 Focus List Engagement Issues

Environment	15
Fair Trade/GMOs	4
Human Rights	6
HIV/AIDS	3
Sweatshops	6
Community Engagement	4
Sustainability Reporting	10

### 2005 Focus List Companies - Results

Number of Successful Outcomes	22
Number of Progressive Dialogues	7
Number of Neutral Outcomes	16
Number of Unsatisfactory Outcomes	3
Number of Divestments	3

### 2005 Proxy Voting Activity Report

Total Number of Meetings	291
Number of Items Voted	3895
Number of Votes For Management	2662
Number of Votes Against Management	1107
Number of Abstentions	126



## Highlights

### Labour Standards and Supply Chain Compliance

Visible signs of progress came from some unexpected places in 2005. Three years of dialogue resulted in **Wal-Mart** incorporating freedom of association and the right to collective bargaining within its code of conduct for overseas suppliers—a standard that some Canadian retail companies have yet to meet.

In 2005, we wrote to the **Forzani Group**, owner of Sport Chek, Sport Mart, Coast Mountain Sports, and National Sports, asking the company to adopt a code of conduct that would incorporate all the Core Conventions of the International Labour Organization. Forzani told us that it was in the process of finalizing its supplier code and selecting a monitoring organization. We reviewed the proposed code and concluded that it was consistent with best international practices. Forzani also reported that it was negotiating with a monitoring organization based in Europe, and would make information about its code, monitoring systems, and performance available on its Web site in the fall of 2005.

We also engaged **Magna International** asking for information on workplace conditions at the company's factories located in developing countries, as well as how Magna would respond to the Ford Motor Company's recent commitment to safeguarding labour and human rights in Ford's supplier factories. Ford's Code of Basic Working Conditions covers forced and child labour, freedom of association and collective bargaining, harassment and discrimination, health and safety, work hours, and verification procedures. Magna informed us that as a primary supplier, they would be complying with Ford's code.

Significant progress also came from **Dell**, **Intel**, and **IBM**, as these companies (led by **Hewlett Packard**) initiated an Electronics Industry Code of Conduct. As more components production goes overseas, these companies are attempting to put in place a set of industry-wide standards that will protect workers' rights, promote healthy workplaces, and allow this industry to avoid the reputational damage suffered by retailers and sportswear, toy, and apparel companies in the 1990s.

### Climate Change

On the climate change issue we saw progress at **Anadarko**, **Apache**, and **ConocoPhillips** as these oil and gas companies agreed to inventory, disclose, and introduce action plans to reduce greenhouse gas emissions—all in the absence of any regulatory push from the Bush Administration. Far less surprisingly, **Petro-Canada** quickly agreed to our shareholder proposal asking the company to disclose how it evaluates new opportunities for investments in renewable energy and to provide some convincing evidence for supporting its focus on cellulosic fuel ethanol. We have had an excellent relationship with Petro-Canada and appreciate their responsiveness to our dialogue requests.

The **Carbon Disclosure Project (CDP)**, also met with greater success in 2005, as responses to the survey increased and plans for reducing greenhouse gas emissions became more concrete—even in the United States. The CDP report concludes that:

*“Wall Street is waking up to climate risks and opportunities. Considerably more of the world's largest corporations are getting a handle on what climate change means for the business and what they need to do to capture opportunities and mitigate risks.”*

## Sustainability Reporting

In terms of disclosure, we saw considerable progress on sustainability reporting from many companies listed on the S&P/TSX Composite Index. We also secured commitments from **Cott** and **EnCana** to begin using the GRI format in future reports. **Terasen** and **Home Depot** also disclosed their intention to publish sustainability reports in the coming year.

## Human Rights

We were also pleased by **Petro-Canada's** readiness to implement a comprehensive human rights policy and their agreement to better disclose how they are meeting international human rights obligations in their overseas operations. We received similar commitments from **Alcan** and **Barrick Gold**. Barrick has seen its fair share of controversy in this area and is now responding by adopting the **Global Compact**—a United Nations initiative that commits signatories to supporting international human rights, environmental, and anti-corruption principles—and to report on its implementation.

## Equator Principles

We were less surprised by the quick adoption by Canadian banks of the Equator Principles, a set of procedures that financial institutions should use to identify, evaluate, and mitigate environmental risks associated with project finance. **CIBC**, **Bank of Montreal**, **Royal Bank of Canada**, and **Scotiabank** have all adopted the Equator Principles and have begun implementation. **JP Morgan Chase** also joined this group in 2005.

## Community Impacts

In the Spring of 2005, **Brascan** was added to our Focus List following its purchase of BC Coastal wood assets from Weyerhaeuser, a US-based forest company that had experienced considerable challenges with a number of First Nations communities, including the Haida on Haida Gwaii. Our goal was to ensure that Brascan recognized the need for genuine community consultation and impact benefit agreements with local communities. Following two rounds of correspondence and a meeting with the company, we were informed that Brascan had succeeded in drafting a Memorandum of Understanding with the Haida Nation concerning these woodlands.

Following some initial difficulties, Quebec-based grocer **Metro Inc.** moved quickly to promote fair trade products in their stores. This dialogue marked our first collaboration with socially responsible investment institutions in Quebec—a collaboration we will bring to other dialogues in 2006. In a similar pattern, **Anheuser-Busch** at first refused to commit to a policy barring the use of genetically-modified products in its beer. This all changed in March when the company publicly announced that it would not make use of a controversial genetically-modified grain under development in Missouri.

## Divestments

Not all dialogues ended so happily. In January 2005 we divested from **ABB Ltd.** due to its continuing operations in Sudan. We also divested from **Fortis Inc.** because of a controversial Challilo Dam project in Belize. Finally, we divested from **Placer Dome** because of that company's unwillingness to commit to a policy of not using riverine tailings disposal in future mine projects.

# Engagement on the Environment

In 2005, we focused on:

1. Climate change
2. Equator Principles
3. Riverine tailings disposal
4. Genetically modified organisms (GMOs)
5. Community impacts

In addition to climate change, food safety and GMOs, and community engagement, we will add two new categories to our Focus List in 2006: Environmental Justice and Biodiversity Protection.

## 1. Climate Change

### Long Term Objective

- Stop climate change.

### Objectives in 2005

- To encourage US oil and gas companies to begin measuring and disclosing their greenhouse gas emissions and action plans to reduce emissions.
- To encourage investments in renewable energy technologies.
- To encourage companies across all sectors to assess and mitigate risks associated with climate change.

### Background

Global climate change has emerged as the most significant environmental threat to the world today. The main threats to human health and the environment include:

- rising sea levels resulting in massive displacements of existing populations, disease, and in developing countries, hunger and starvation;
- extreme weather conditions leading to floods, droughts, landslides, and storms, resulting in increased incidence of diseases such as cholera, malaria, yellow fever, and Dengue fever; and,

- irreversible damage to vulnerable ecosystems with increased risk of extinction of vulnerable species, and the loss of ecosystem services such as flood control, drinking water, and carbon storage.

Responsible companies are taking precautionary action to reduce greenhouse gases, the main cause of climate change. The optimal approach is to take significant action now to reduce the long-term risks.

For more information on the science of climate change, see [www.ipcc.ch](http://www.ipcc.ch).

## 2005 Dialogues

### Greenhouse gas emissions and renewables

As a signatory to the Kyoto Protocol, the Federal Government is already negotiating emissions reductions agreements with large industrial emitters in Canada. Therefore, in this emerging regulatory environment, we felt it best to work on US companies operating under no federal regulatory obligation to reduce emissions.

While the United States has refused to require companies to cap their emissions, survey data shows that nearly 80% of Americans favour mandatory controls on greenhouse gas. Further, mainstream investment analysts have begun to sound the alarm about the long-term risks oil and gas companies face if they fail to make a transition to a more diversified energy portfolio. Industry publications have also stated that the sector's environmental record is hurting its ability to attract strong employees.

So, in 2005 we focused on the American oil and gas companies in our funds: **Anadarko, Apache, ConocoPhillips, and Devon Energy**. Working with the Coalition for Responsible Economies (Ceres) and the oil and gas working group of the Interfaith Centre on Corporate Responsibility (ICCR), dialogue with each of these companies was initiated in the fall of 2004.

We co-filed shareholder proposals with Anadarko and Apache asking them to assess how they were responding to rising competitive and public pressure to reduce greenhouse gas emissions. In March 2005, we withdrew our proposals when both companies agreed to comply with our request. Beginning in 2005, they will introduce formal board oversight of the climate change issue, gather baseline data on greenhouse gas emissions, and disclose reduction strategies. Led by Trillium Asset Management in the US, we were also able to secure a similar agreement from ConocoPhillips without having to resort to a shareholder proposal.

After promising a dialogue in the fall of 2004, Devon Energy failed to respond to repeated meeting requests.

We also engaged **Petro-Canada** on the climate change issue, a continuation of a four-year dialogue with this company. In previous years, we had focused on basic greenhouse gas disclosure, action plans to reduce emissions, and the necessity of climate risk scenario-building, to help them think about transitioning from an oil and gas company to an energy company with a diversified portfolio of renewable energy technologies. In 2005, we filed a proposal asking Petro-Canada to describe how the company was evaluating market opportunities in wind, solar, and other renewable energy sources.

## CARBON DISCLOSURE PROJECT

In addition to these company-specific dialogues, **The Ethical Funds Company** also supports the Carbon Disclosure Project (CDP), a coalition of institutional investors.

Representing more than US\$21 trillion in assets, the CDP is a powerful collective voice for promoting corporate awareness of climate change risks. The CDP also represents an efficient process whereby institutional investors collectively sign a single global request for disclosure of information on greenhouse gas emissions. The CDP Secretariat then sends this request to the 500 largest companies in the world. More than 300 currently report their emissions through the CDP Web site.

The 2005 CDP report shows a marked increase in awareness of climate change and disclosure of related data among US corporations—long the global laggard in this area. The report concludes that: “Wall Street is waking up to climate risks and opportunities. Considerably more of the world’s largest corporations are getting a handle on what climate change means for the business and what they need to do to capture opportunities and mitigate risks.”

For more information on the Carbon Disclosure Project, visit [www.cdproject.net](http://www.cdproject.net).

Petro-Canada has long had a focus on producing fuel ethanol from waste by-products of the agricultural industry, through a partnership with Iogen. Fuel ethanol is a controversial renewable energy source. Some experts maintain that more energy will be consumed in the production of fuel ethanol than the amount of energy the fuel would generate once produced. **The Ethical Funds Company** wants to make sure that Petro-Canada has its eyes open and ears to the ground in case fuel ethanol turns out to be a bust.

In February 2005, we met with Petro-Canada and agreed to withdraw the proposal in exchange for analysis demonstrating that the ethanol technology they are developing (made from plant fibre rather than the edible portion) is environmentally and socially superior to traditional ethanol (made from corn, or the “fruit” of the plant). Petro-Canada also agreed to disclose their framework for assessing new opportunities in renewables.

### Continuing Dialogues for 2006

In 2006, our focus will remain on US oil and gas companies and the need for basic disclosure of greenhouse gas baseline data and plans to reduce emissions.

We will engage both US and Canadian oil and gas companies to begin long-term scenario planning, transitioning them from oil and gas to a broader definition of what it means to be an energy provider.

In addition, we will expand our climate change dialogues to include Canada’s five major banks—**Bank of Montreal, CIBC, TD Bank, Royal Bank of Canada, and Scotiabank**—asking them to:

1. Establish procedures to identify and take advantage of environmentally beneficial business opportunities;
2. Assess the greenhouse gas emissions within existing lending portfolios and begin to work with clients to set targets for emissions reductions;
3. Disclose climate risk assessments and action plans in the Management & Discussion Analysis—a document most often read by investment analysts and fund managers to help them make buy-sell decisions.

## 2. Equator Principles

### Long Term Objective

- To stop the financing of infrastructure projects that harm the environment and fail to benefit the poor.

### Objectives in 2005

- To encourage banks to adopt and implement the Equator Principles to guide project finance and commercial lending policies.
- To improve and enhance the Equator Principles in association with banks and socially responsible investment institutions.

### Background

The Equator Principles are a set of categorization, assessment, and management standards for dealing with environmental and social risks in the project finance sector. The Equator Principles are based on the policies and guidelines of the International Finance Corporation (IFC), the private sector development arm of the World Bank.

The Equator Principles were created in June 2003 by the IFC and the world's major project financiers. Today, the Equator Principles cover 80% of the project finance market.

The Equator Principles can be used in three ways:

1. To exclude financing of project that fail to meet certain minimum standards;
2. To set markers for improving project design and performance; and
3. To hold clients accountable for meeting environmental and social performance standards:

The Equator Principles can be seen as an acknowledgement by financiers of their responsibility in advancing responsible social and environmental practices, particularly in emerging markets. Implementation of the Equator Principles will promote sustainable development and corporate social responsibility. They are a recognition that responsible development makes commercial sense, because environmental and social controversies have the potential to affect the profitability of projects, increase political risk, and tarnish the reputations of those who promote and finance them.

For more information on the Equator Principles, visit [www.equator-principles.com](http://www.equator-principles.com).

## 2005 Dialogues

Over the past three years, **The Ethical Funds Company** has worked with socially responsible investment institutions to encourage **Citigroup** to stop lending to environmentally and socially harmful development projects. This work resulted in the creation of the Equator Principles.

In 2003, at Citigroup's urging, we began to encourage the five major Canadian banks to join this initiative. Currently, **Bank of Montreal, CIBC, Royal Bank, and Scotiabank** have adopted the Equator Principles, joining 27 other banks representing 80% of the global project finance market. So far, TD Bank has refused to adopt the Equator Principles on the grounds that it is not involved in the project finance market. **JP Morgan Chase** also joined this group in 2005.

## Continuing Dialogues in 2006

**The Ethical Funds Company** will continue to monitor and participate in the Equator Principles dialogues with **Citigroup** and support dialogues with other US and European Equator banks. Our end objective is to see the Equator Principles implemented effectively. We are also interested to see how human rights criteria can be integrated into the Equator Principles—a project advanced by Barclay's bank in the context of the Business Leaders Initiative on Human Rights. See [www.blihr.org](http://www.blihr.org).

In 2006, our dialogue with Canadian banks will shift to the set of issues described under Biodiversity and the Canadian Boreal Initiative, on page 22 and 23 of this report.

# 3. Riverine Tailings Disposal

## Long Term Objective

- To end the practice of dumping mine waste into rivers.

## Objective in 2005

- To ensure that mining companies commit to eliminating the use of riverine tailings disposal as a method for eliminating mine waste.

## Background

Riverine tailings disposal (RTD) is the practice of dumping mine waste into rivers and lakes. RTD is not in use in Canada; the Mining, Minerals, and Sustainable Development Project final report calls for mines currently using RTD to phase out this practice. See [www.iiied.org/mmsd](http://www.iiied.org/mmsd).

## 2005 Dialogues

Our focus in 2005 concerning RTD centered on Placer Dome, one of just three companies in the world that still uses this method of tailings disposal.

**The Ethical Funds Company** has been in dialogue with Placer Dome on a wide range of environmental issues since 2002. In 2003, we sponsored a shareholder proposal asking for the company to report to shareholders describing potential financial liabilities and risks associated with cyanide heap leaching, RTD, operating in countries known for human rights abuse, and long-term strategies designed to mitigate and eliminate risks associated with these activities.

In succeeding years, Placer Dome made significant progress on a number of fronts. Most significantly, the company has become a global leader in the mining sector in terms of its sustainability reporting practices.

Placer Dome still uses RTD at its Porgera Mine in Papua New Guinea. The company maintains that because this region is seismically active and receives 3.7 metres of rain per year, a tailings pond is not a viable option for tailings disposal. They also maintain that they are an excellent employer, make significant contributions to the local and national economies, and that the environmental impacts of their operations are minimal.

**The Ethical Funds Company** met with Placer Dome twice this past year to discuss our ongoing concerns about RTD. Our last meeting was held with their chief executive officer in June 2005.

Throughout our dialogue, we have not asked Placer Dome to shut down this mine. We have only asked that the company make a commitment to refrain from using RTD at any future mine. We have pointed out that the practice of RTD is now viewed as unacceptable by most of the international mining industry.

Placer Dome told us that while it cannot foresee a day when it would again use RTD, it is not prepared to make a formal commitment to refrain from using this disposal method at mines developed in future.

For this reason, we sold our position in Placer Dome.



## 4. Genetically Modified Organisms

### Long Term Objective

- To ensure the safety of our food supply and the integrity of ecosystems that could be impacted by genetically modified organisms.

### Objectives in 2005

- To discourage the sale and distribution of food and beverage products that contain genetically modified ingredients until such products are proven to be safe.

### Background

Genetically modified (GM) agriculture and food products are created by transferring targeted genes from one species to another with the objective of introducing new and useful traits that would be impossible to achieve through traditional breeding techniques. This differs from classical breeding that occurs within the same species and combines the full array of genes from both organisms.

### Health concerns

Concerns have been raised that food and agricultural products developed through genetic engineering have been introduced into the marketplace without due regard for human health.

One of the most contentious issues in the GM foods debate is the possibility of allergic reactions stemming from the combination of genes present in the final product. Uncertainty arises when assessing novel proteins in GM foods from sources not known to have allergic properties or that do not have an established history of human exposure. In Canada, recommendations have been made to Canadian government agencies to develop and/or strengthen the regulatory infrastructure to identify and assess possible allergic reactions, as well as monitor GM foods after regulatory approval has been granted.

### Consumer labeling

The public debate around GM foods has also highlighted the consumer's right to know what they are eating in order to make informed choices. For this reason, mandatory labeling has been proposed to satisfy consumer rights. Globally, 50 countries now require mandatory labeling of genetically modified organisms (GMOs) in food. So far, Canada has taken a voluntary labeling approach to GM foods, and a national advisory committee on voluntary labeling has been working on developing a national standard for the past several years.

## THE PRECAUTIONARY PRINCIPLE

The Ethical Funds Company's policy on GM foods is informed by the precautionary principle, a concept that now provides the foundation for over 20 international agreements. The central tenet of the precautionary principle is to protect human health and the environment from unknown and unpredictable consequences of human activity.

The concise definition of the precautionary principle is "when an activity raises threats of harm to human health or the environment, precautionary measures should be taken even when cause and effect relationships are not fully established scientifically."

The emergence of the precautionary principle as a policy-making tool is a response to one of the growing tensions in the field of science. That tension is the realization that the innovative powers of science may be outstripping the ability to accurately predict the consequences of its applications.

## Environmental concerns

Opponents have also raised the concern that the introduction and long-term use of GM crops will have a negative impact on biodiversity. There are at least four potential risks:

1. Genetic alterations in wild plant populations as a result of changing agricultural practices (e.g., increased herbicide-resistant crops affecting surrounding weed populations).
2. Contamination of wild gene pools of the world's major crops, especially in areas where domesticated crops are in contact with numerous wild relatives.
3. Exacerbation of biodiversity loss attributed to the conversion of natural ecosystems to intensive agro-ecosystems.
4. Loss of wildlands and their constituent biodiversity due to GM crops that permit agricultural production where it was previously unsuitable (e.g., deserts, rainforests).

Scientists have observed that the impact of GMOs on biodiversity is one of the least understood of the issues associated with their use. In a 2001 review of GMOs, the Royal Society of Canada concluded that "detailed studies are urgently needed to assess the impact of large-scale growing of GM crops on the maintenance of biodiversity in agricultural ecosystems."

The ethics of GMOs are hotly debated. You can learn more about this debate by visiting [www.fao.org/news/2001/010405-e.htm](http://www.fao.org/news/2001/010405-e.htm), [www.agbios.com](http://www.agbios.com), or [www.rsc.ca//index.php?lang\\_id=1&page\\_id=119](http://www.rsc.ca//index.php?lang_id=1&page_id=119)

## 2005 Dialogues

In 2005, **The Ethical Funds Company** began to work with members of ICCR asking food and beverage companies to refrain from making use of genetically modified ingredients until they were proven safe for the environment and human health.

The dialogue team wrote to **Anheuser-Busch** in October 2004 asking the company to provide information on its position on the use of a genetically modified rice product under development in the state of Missouri. (In the United States it is legal to use rice, instead of barley, to brew beer.)

Following an exchange of correspondence in early 2005, we secured Anheuser-Busch's public agreement to not purchase Missouri grown rice if GMO rice cultivation is allowed to proceed in that state.

## Continuing Dialogues in 2006

Beginning in 2005, we met with **Maple Leaf Foods** to discuss its environmental management systems and industrial hog farming. During the course of this conversation the company reported that they are actively working to expand into the European market. We alerted Maple Leaf Foods to the potential for significant resistance from European consumers to any genetically modified foods, and that this is likely to be seen as a food safety issue (food safety is a major component of Maple Leaf Food's branding strategy).

In 2006, we will continue our work with Maple Leaf Foods on this issue and on the risks associated with genetically modified organisms. We are also expanding this dialogue to ask **Loblaw, Metro, and Sobey's** to support the consumers' right to know what is contained in the food they are eating.

## 5. Community Consultation

### Long Term Objective

- To ensure that impacted communities benefit from and support industrial activity.

### Objective in 2005

- To ensure that companies engage in meaningful consultation with communities impacted by their projects.

### 2005 Dialogues

#### Alcan

In November 2004, we entered into a dialogue with **Alcan** on its participation in a joint venture project (45% ownership) to develop a bauxite mine and alumina refinery in Utkal, India. The controlling partner is Hindalco, a company of the Aditya Birla Group, based in India.

This project has a long history of controversy and protest. It is alleged that police have used excessive force in repressing community protests and that people have died as a result. **The Ethical Funds Company** is concerned that Hindalco did not engage with the local communities in an appropriate manner. This has raised the issue of stakeholder consultation practices at Alcan in general.

On April 15, 2005, **The Ethical Funds Company** met with Alcan representatives to discuss the company's position on the community controversy surrounding the Utkal project. During this meeting we learned that Alcan officials were traveling to India to assess the situation.

Alcan conceded that Hindalco must better communicate the project benefits and impacts to the local community. To this end Alcan has suggested that Hindalco designate a corporate liaison to work with identified community leaders on the project going forward.

Alcan has also developed a Web site to better communicate its activities on projects worldwide to all stakeholders. This Web update was completed in 2005 and includes a summary of the Utkal community compensation plan. As of November 2005, Alcan says it has not made a decision to follow through on project development. This decision is expected in the first quarter of 2006.

We also engaged Alcan on the issue of power sales from the company's hydro-electric generation plant in Kitimat, British Columbia to BC Hydro. The City of Kitimat maintains that these sales are illegal under the original terms of agreement between Alcan and the Province of British Columbia and that the company must commit to operating the refinery at Kitimat at full capacity. The claim of illegality is rejected by Alcan and the Government of British Columbia.

On April 26, 2005, we sent an email to Alcan seeking comment on the controversy in Kitimat. In a conference call held June 30th, 2005, Alcan BC confirmed that they were in fact recalling the long term power sale to BC Hydro. This recall will come into effect in 2009 as the company is obligated, under the terms of their power sale agreement, to provide BC Hydro five years advance notice of their decision. Alcan BC also informed us that they were planning to upgrade the smelter in Kitimat and return it to full capacity.

**The Ethical Funds Company** met with the mayor of Kitimat on August 8, who maintains that Alcan intends to continue selling power to BC Hydro. We will maintain a close watch on developments at Kitimat and will ask Alcan to make public their commitment to upgrade the Kitimat refinery and return it to full capacity.

### **Brascan**

**Brascan** was added to the Focus List in March 2005 following the real estate conglomerate's announcement of a proposal to acquire Weyerhaeuser's BC Coastal wood assets. Weyerhaeuser had experienced considerable challenges with a number of First Nations communities. These challenges were most acute on the Queen Charlotte Islands (Haida Gwaii), where the Haida First Nation had set up blockades preventing the company from accessing areas where they were licensed to harvest timber.

**The Ethical Funds Company** sent a letter March 11, 2005 requesting information on Brascan's plans for community consultation with First Nations. A response was received March 18, and a meeting was subsequently scheduled for April 21, 2005. At this meeting, Brascan indicated their intention to draft a Memorandum of Understanding (MoU) with the Haida Nation. The company was also surveying 43 other First Nations groups in an effort to establish standards of practice going forward.

On April 21, we met with Brascan to discuss the company's environmental and community engagement responsibility in acquiring the BC Coastal wood assets. We stated our view that these responsibilities include meaningful consultation with the impacted First Nations communities and other affected communities as well as establishment of impact benefit agreements. In June, we were informed that Brascan had succeeded in drafting a Memorandum of Understanding with the Haida Nation concerning these woodlands.

## Fortis

We were far less successful in our dialogue with **Fortis**. For several years, **The Ethical Funds Company** has attempted to engage Fortis on a controversial hydro-electric development in Belize. In our view, Fortis had not adequately addressed the concerns of impacted communities and environmental organizations. We wrote extensive letters expressing our concerns and offering guidance on strategies for engaging communities honestly and effectively. Fortis responded with brief letters that did not sufficiently address our concerns. Because Fortis is incorporated in Newfoundland, where the law does not provide for a shareholder resolution process, available tools for pressing the issue were limited. As a result, we divested from Fortis in May 2005.

## Metro, Inc.

We had a much more productive experience with **Metro Inc.**, a Quebec grocery store chain. In September 2004, we wrote the company, asking for information on efforts to promote the sale of fair trade coffee in their stores. Fair trade products ensure that farmers in developing countries receive fair prices for their products and promote best environmental practices agricultural production.

We received no response from Metro to our initial inquiry. In December, we filed a shareholder proposal asking the company how it was planning to meet market demand for fair trade coffee. In January 2005, Metro informed us they would not circulate the proposal, but would agree to a meeting with concerned shareholders. Led by socially responsible investors in Quebec, Metro quickly reached an agreement to meet with Oxfam Quebec—an organization dedicated to the promotion of fair trade products—to identify marketing and training opportunities for fair trade and organic products in their stores. By June, Oxfam Quebec cited Metro Inc. as a leader among Quebec grocery retailers in promoting fair trade products to consumers.

This dialogue marked our first collaboration with socially responsible investment institutions based in Quebec, a set of collaborations we will expand in 2006.

For more information on fair trade coffee, see [www.transfair.ca](http://www.transfair.ca).

## New for 2006 – Environmental Justice

### Objective

- To ensure fair distribution of benefits and impacts of economic activity.

### Background

To capture the range of issues and concerns involved in our dialogues with companies on community relations, we're creating a new category for 2006 called Environmental Justice.

Environmental Justice refers to the fair distribution of the benefits of resource extraction and industrial activity. Environmental justice also maintains that disadvantaged communities should not bear the brunt of adverse environmental impacts associated with business operations.

## FREE, PRIOR, AND INFORMED CONSENT

Free, prior, and informed consent (FPIC) represents an emerging standard for effective community consultation, and is becoming enshrined in international conventions and standards.

## 2006 Dialogues

In 2006 we will engage **Alcan, Barrick Gold, Costco, EnCana, and Teck Cominco** to determine how environmental impacts in all of their projects can be mitigated or eliminated. We will also initiate conversations on how community consultation procedures can be improved for project design, implementation, and (where applicable) closure. We anticipate that more companies will be added under this category over the course of the year as controversies arise and communities make their concerns known.

We also anticipate that the methodologies for meaningful community consultation will become more significant in the coming years, as resource extraction companies are increasingly being asked to demonstrate how their operations benefit local communities.

To improve our understanding of FPIC we are now partnering with member organizations of ICCR to fund research and develop background materials. In 2006, we plan to specify our concept of FPIC and evaluate how Canadian energy and mining companies are measuring up, which will be the subject of our next Sustainability Perspectives publication. This paper will serve as the basis for more extensive dialogues in 2007.

## New for 2006 – Biodiversity Protection

### Long Term Objective

- To ensure that companies protect and restore biodiversity and ecosystem services worldwide.

### Objective in 2006

- To ensure that companies adopt biodiversity policies and management systems.

### Background

Biodiversity refers to the variety of life in all its forms, including ecosystem diversity, species diversity, and genetic diversity. Biodiversity is essential to the health of the planet and the well-being of its inhabitants. It supports the ecological processes that sustain life, and provides human society with food, medicines, natural resources, ecological services, and spiritual and aesthetic benefits. It is not a minor factor of economic production; rather, it is the envelope containing, provisioning, and sustaining the entire economy.

Biodiversity is under greater threat than ever before from human activity. These threats include loss of habitat, invasive species that threaten native species, and overexploitation of plants and animals. Given technology and the scale of economic activity, the relationship between humankind and the earth has been completely transformed.

## MILLENNIUM ECOSYSTEM ASSESSMENT

The Millennium Ecosystem Assessment, a major report released in the spring of 2005, concluded that two thirds of the ecosystems services examined are being used unsustainably. If current trends continue, the ecosystem services that are freely available today will cease to be available tomorrow. Society cannot function if ecosystems and the services they deliver—water purification, food, fibre, fuel, nutrient recycling, pest and disease regulation, sediment retention, climate regulation, carbon sequestration, flood protection, and erosion control—are not sustained.

For more information, visit [www.millenniumassessment.org](http://www.millenniumassessment.org).

The Report of the Commissioner of the Environment and Sustainable Development in the Office of the Auditor General of Canada recently concluded that despite ratification of the 1992 **Convention on Biological Diversity**, the federal government's progress in implementing the Canadian National Biodiversity Strategy is unsatisfactory. Nearly 10 years after endorsement of this strategy, Ottawa lacks a coherent plan for implementation and has failed to improve capacity to inventory, understand, and manage biodiversity information. This lack of information limits the ability to help conserve biodiversity, use it sustainably, and reduce its loss.

For more information on the Convention on Biological Diversity, visit [www.biodiv.org/default.shtml](http://www.biodiv.org/default.shtml).

For more information on the Report of the Commissioner, visit [www.oag-bvg.gc.ca/domino/reports.nsf/html/c2005menu\\_e.html](http://www.oag-bvg.gc.ca/domino/reports.nsf/html/c2005menu_e.html).

## 2006 Dialogues

### Energy, Mining, and Biodiversity Protection

In 2006, **The Ethical Funds Company** will ask Canadian energy, mining, and forest companies to establish formal policies and management systems for biodiversity protection. In particular, **Canadian Natural Resources, Enbridge, EnCana, Husky Energy, and Petro-Canada** are being asked to adopt the policies, processes, and systems recommended by the **Energy and Biodiversity Initiative (EBI)**.

The EBI is a collaboration of BP, Chevron Texaco, Shell, Statoil, Conservation International, Smithsonian Institution, The Nature Conservancy, Fauna and Flora International, and the World Conservation Union.

The EBI provides guidance for integrating biodiversity conservation into upstream oil and gas development and has published a series of detailed guides for integrating biodiversity into environmental management systems, social impact assessment processes, site selection processes, and monitoring impacts and conservation actions.

**The Ethical Funds Company** believes that the EBI guides are of value to mining companies as well. For more information, visit [www.ebi.org](http://www.ebi.org).

**Alcan, Barrick Gold, Falconbridge, Potash, and Teck Cominco** will also be asked to consider the EBI recommendations and the best practices derived from the collaboration between the International Union for Conservation of Nature and Natural Resources and the International Council on Mining & Metals.

We are also asking Canada's five major banks—**Bank of Montreal, CIBC, TD Bank, Royal Bank, and Scotiabank**—to establish lending policies to protect biodiversity generally, and Canada's boreal forest specifically.

### Protecting Canada's Boreal Forest

Canada's boreal region is one of the world's largest remaining intact forest ecosystems, providing crucial breeding habitat for more than 30% of North America's bird population. Covering approximately 58% of Canada's land mass, stretching from the Yukon to Newfoundland, Canada's boreal region holds substantial ecological value for all Canadians.

## CANADIAN BOREAL INITIATIVE

The CBI is a multi-stakeholder organization, made up of non-governmental organizations, companies, and First Nations.

The CBI serves as the secretariat for the Boreal Leadership Council and its central mission is to implement the Boreal Forest Conservation Framework. This framework, drafted by the Boreal Leadership Council, offers a balanced approach to conservation and development in Canada's boreal region.

The boreal is also an important economic resource, providing almost half of Canada's annual forest harvest and contributing to the more than \$400 million in fees received by the government from the forestry sector annually.

Canadians have perhaps one of the world's few remaining opportunities to ensure the sustainable development of this important region—development that balances the need for conservation with that of industrial development. Through improved lending policies, Canada's financial institutions can play a key role in this movement to ensure the longevity of the Canadian boreal and other high conservation value forests in Canada.

As part of the effort to protect Canada's boreal forests, we are asking the banks to become signatories to the Boreal Leadership Conservation Framework vision promulgated by the **Canadian Boreal Initiative (CBI)**.

The ten resource companies identified above in the section on Biodiversity, plus **Cascades**, are also being asked to adopt the Boreal Forest Conservation Framework and to establish action plans for implementation.

For more information on the CBI, visit [www.borealcanada.org](http://www.borealcanada.org).



# Engagement on Human Rights

## Long Term Objective

- To advance human dignity by ensuring that companies protect and promote international human rights standards.

## Objectives in 2005

- To stop sweatshops by ensuring that companies comply with labour rights standards when sourcing products from developing countries.
- To ensure that companies adopt policies and management systems designed to preserve, protect, and promote the observation of international human rights standards.

## Background

The global economy offers unprecedented opportunities for business. Companies are investing directly in developing countries while others source products from an ever-increasing number of emerging markets. These opportunities bring with them serious threats to business, as companies feel compelled to operate in conflict zones, under regimes with a weak rule of law where human rights are violated, and where corruption is rife.

Business has an interest in advancing international human rights standards. Human rights violations destabilize the investment climate and threaten employee safety, company assets, project viability, and corporate reputation. As the influence of global companies grows in the world economy, and as their impact on the societies in which they work deepens, it is becoming evident that their license to operate and their reputation depend on their acceptability to society at large.

**The Ethical Funds Company** believes that company obligations are rooted in the **Universal Declaration of Human Rights (UDHR)**. Adopted by the United Nations on December 10, 1948, the UDHR calls upon “every individual and organ of society” to play its part in securing the universal observance of human rights. These include:

- Everyone is equal before the law.
- Everyone has the right to life, liberty, and security of person.

- Everyone has the right to the standard of living adequate for health and well-being; no one shall be held in slavery.
- No one shall be subject to torture.
- No one shall be subjected to arbitrary arrest, detention or exile.
- Everyone has the right to freedom of thought, conscience, religion, opinion, and expression.

**The Ethical Funds Company** also works to promote the rights specified in the Core Conventions of the **International Labor Organization (ILO)**, including no child labour, no forced labour, and respect for freedom of association and collective bargaining.

The UDHR can be found at [www.un.org/rights](http://www.un.org/rights). The ILO labour conventions can be found at [www.ilo.org/dyn/declaris/DECLARATIONWEB.INDEXPAGE](http://www.ilo.org/dyn/declaris/DECLARATIONWEB.INDEXPAGE).

## 2005 Dialogues

### **Sweatshops and Supply Chain Compliance**

As the production of clothing, shoes, toys, sporting goods, and electronics has increasingly gone global, socially responsible investors have asked retail companies to ensure that factories manufacturing these goods are in compliance with international labour standards.

### **Forzani Group**

In 2005, **The Ethical Funds Company** asked **Forzani Group** to establish a supplier code of conduct and monitoring system to ensure compliance when sourcing products from developing countries.

Forzani informed us that they were finalizing their supplier code and were in the process of select a monitoring organization. The code will incorporate all the Core Conventions of the ILO. The proposed code was reviewed by **The Ethical Funds Company** and viewed as consistent with best international practices. Forzani also reported that it is negotiating with a monitoring organization based in Europe, and would make information about its code, monitoring systems, and performance available on its Web site in October 2005.

In a follow-up letter dated March 31, **The Ethical Funds Company** offered input on the monitoring organization and asked the company to consider reporting using the Global Reporting Initiative framework.

### **Magna International**

We also engaged **Magna International**, asking for information on workplace conditions at the company's factories located in developing countries, and for how it plans to respond to the Ford Motor Company's recent commitment to safeguarding labour and human rights in Ford's supplier factories. Ford's Code of Basic Working Conditions covers the ILO core conventions and provides for verification procedures.

Magna responded in writing on April 8, 2005, providing an explanation of their membership in the Ford Sustainability Forum. At this point, we believe that Ford Motor Company, as Magna's largest customer, will provide sufficient incentive to ensure Magna puts in place a supplier code and monitoring system that meets or exceeds the supplier code in place at Ford Motor Company.

For more information about Ford's Code, visit:  
[www.ford.com/en/company/about/corporateCitizenship/report/articles/HumanRightsExtending.htm](http://www.ford.com/en/company/about/corporateCitizenship/report/articles/HumanRightsExtending.htm)

### **Computer Electronics Industry**

**The Ethical Funds Company** also participated in dialogues with **Dell**, **Hewlett Packard**, and **IBM** on the establishment of an **Electronics Industry Code of Conduct (EICC)**. The EICC dialogue represents a significant leap forward for electronics companies wisely seeking to uphold human rights while avoiding the controversy experienced by many retail companies tarred with the "sweatshop" brush.

For more information, visit [www.eicc.info](http://www.eicc.info).

### **Wal-Mart**

**The Ethical Funds Company** also participated in an extensive dialogue with **Wal-Mart** on labour conditions at overseas factories, as well as the overall sustainability of its business model. The dialogue was organized by the Interfaith Center on Corporate Responsibility.

In the fall of 2004, Wal-Mart provided the dialogue team with an opportunity to comment on a draft of the company's "Factory Certification Report March 2003-2004." The report was scheduled for posting to the company's Web site after receiving our comments and recommendations under advisement.

Wal-Mart has undertaken a number of initiatives to improve its code of conduct for suppliers, its monitoring system, and, ultimately, working conditions in factories overseas. These improvements include:

- Raising the bar for code compliance by reclassifying minimum wage and egregious working hour infringements from medium to high risk violations (which triggers a requirement for factories to submit a Corrective Action Plan within 15 days and re-inspection in 60 days);
- Increasing its compliance staff to 247 (up from 104); and
- Introducing recognition of freedom of association and the right to collective bargaining in its 2005 supplier standards.

Wal-Mart's 2004 Report on Standards for Suppliers can be viewed at:  
[www.walmartfacts.com/newsdesk/article.aspx?id=1235](http://www.walmartfacts.com/newsdesk/article.aspx?id=1235).

With these developments, the dialogue team decided not to file a labour standards resolution for the 2005 annual general meeting. However, we did file a proposal asking the company to publish a Sustainability Report by December 2005.

## BUSINESS LEADER'S INITIATIVE ON HUMAN RIGHTS

BLIHR is a three-year program created to help lead the business response to increased demands for corporations to promote international human rights standards. The Initiative was founded in May 2003 by seven companies: ABB Ltd, Barclays plc, MTV Networks Europe, National Grid plc, Novartis Foundation for Sustainable Development, Novo Nordisk, and The Body Shop International plc. During 2004, Hewlett-Packard Company, Statoil, and Gap Inc. also joined.

For more information on the BLIHR initiative, visit [www.blihr.org](http://www.blihr.org).

The proposal is designed to get Wal-Mart thinking about protecting its brand in an era when the overall sustainability of its business model is being called into question. We believe that the company's drive for "lower prices every day" leads to externalized costs: that is, the costs of doing business for Wal-Mart are not seen on the company's balance sheet; rather, those costs are borne by employees, communities, and the environment. One day, people and communities will refuse to bear those costs and that refusal will have real and devastating impacts on the company. Eventually, Wal-Mart must find alternative strategies for increasing the productivity of its retail work force through wages, employee benefit plans, and a shift in corporate culture. It must also find ways to win the support of communities that are now rejecting Wal-Mart stores by becoming more environmentally friendly and economically beneficial to local economies.

The General Pension Board of Pension and Health Benefits of The United Methodist Church and The Enterprise Fund, an investment partnership whose general partner is Rockefeller & Co., are the co-primary filers on this action.

**The Ethical Funds Company** and co-filers met with CEO, Lee Scott and senior executives in New York City on February 11, 2005. At that meeting Mr. Scott agreed to produce a sustainability report, but did not commit to a timeline. Given the company's unwillingness to set a timeline, shareholders did not withdraw the sustainability resolution. On March 14, 2005, Wal-Mart provided a statement of opposition to the filers of the sustainability resolution. The proposal was voted on at the company's AGM in June, which received 25% of independent shareholder votes. The text of the proposal is available at [www.ethicalfunds.com](http://www.ethicalfunds.com).

**The Ethical Funds Company** also engaged Wal-Mart's subsidiary in Canada, Wal-Mart Canada, following news of a pending store closure in Quebec. Union representatives suggested the store was closed not because of poor sales as stated by Wal-Mart Canada, but rather to send a message to Wal-Mart Canada employees that the company would not tolerate unionization of its stores. Concerned about Wal-Mart Canada's poor labour relations record and a possible consumer backlash over the company's Quebec store closure, we sent a letter to Wal-Mart Canada on March 10, 2005, asking the company to explain how it defines unfair labour practices and sensitivity. Wal-Mart Canada responded in a letter dated June 7th, disagreeing with our characterization of their labour practices.

### Human Rights and Foreign Direct Investment

In 2005, **The Ethical Funds Company** attempted to engage **ABB Ltd.**, a Swiss engineering firm with very progressive human rights policies and a member of the **Business Leaders Initiative on Human Rights (BLIHR)**.

BLIHR companies—including ABB—are attempting to integrate the human rights obligations described in the **United Nations Norms on Responsibilities of Transnational Corporations with regard to Human Rights (UN Norms)** into their existing policies and procedures. The UN Norms provides a set of comprehensive human rights standards that specifically apply to corporations and represent current best practice.

In 2005, **The Ethical Funds Company** made a submission to the UN Commission on Human Rights calling for the adoption of the UN Norms and the creation of an international civil court to ensure that the Norms are observed.

For more information about our submission to the UN, visit [www.ethicalfunds.com/do\\_the\\_right\\_thing/features/09\\_28\\_04.asp](http://www.ethicalfunds.com/do_the_right_thing/features/09_28_04.asp).

We began our engagement with ABB last year upon learning that the company was involved in two projects in Sudan. The Government of Sudan has been accused of human rights atrocities associated with a civil war involving north-south tensions and, most recently, in Darfur, where government-supported militias are accused of perpetrating attacks on civilian populations. Some human rights observers maintain that the Government of Sudan is committing genocide in that region.

We sent a letter to ABB on November 4, 2004 to determine the nature of the company's involvement and to ask how it reconciled its operations in Sudan with its human rights policies and BLIHR commitments. In our view, it is not possible for companies to do business in Sudan without supporting the government's capacity to inflict harm on civilian populations and commit human rights violations.

We received a letter back from the company, dated November 19, 2004, acknowledging our inquiry and indicating that a detailed response was forthcoming.

That response never materialized. In January 2005 we sold our position in ABB and placed it on our Red List—a list of companies not eligible for investment by **The Ethical Funds Company**.

Our position is consistent with a growing divestment campaign, called **Divest Sudan**, which has gained support from numerous state and university pension funds in the US, including the New Jersey and Illinois state pensions as well as Stanford University. You may find more details on the Divest Sudan campaign at [www.divestsudan.org](http://www.divestsudan.org).

### **Human Rights and the Global Compact**

In 2005, we began to engage Canadian companies with direct investments in countries where human rights violations are a concern.

In February we withdrew a shareholder proposal filed with **Petro-Canada** after the company agreed to disclose human rights policy implementation including specification of board and management responsibilities, staff allocation and training opportunities, integration of policy implementation into staff compensation plans, monitoring, and public reporting.

We also initiated dialogues with **Alcan, EnCana, Placer Dome, Falconbridge, and Barrick Gold** on human rights policies and management systems. In June, Barrick informed us they would be adopting the Global Compact as their framework for human rights policies and management systems.

## GLOBAL COMPACT

The Global Compact is a United Nations initiative consisting of companies, non-governmental organizations, and labour unions to support universal social and environmental principles. Businesses that adopt the Global Compact are committed to supporting internationally proclaimed human rights as well as environmental and anti-corruption principles. Global Compact companies are also expected to communicate with stakeholders on an annual basis about their progress in implementing the Global Compact principles.

The Ethical Funds Company regards the adoption of the Global Compact as a valid first step for developing human rights policies, management systems, and a reporting framework.

## VOLUNTARY PRINCIPLES

We are recommending that companies adopt the Voluntary Principles on Security and Human Rights to help guide policy development in this area.

The Voluntary Principles were first developed by the governments of the United States and the United Kingdom in association with resource extraction companies (Chevron, Texaco, Freeport McMoran, Conoco, Shell, BP, Rio Tinto), human rights organizations (Amnesty International, Human Rights Watch, International Alert, Lawyers Committee for Human Rights, Fund for Peace, Council on Economic Priorities), business associations involved in promoting corporate social responsibility (Business for Social Responsibility and the Prince of Wales Business Leaders Forum), and labour (the International Federation of Chemical, Energy, Mine and General Workers' Unions). This multi-stakeholder development process provides a high level of credibility for these Principles.

For more information, visit [www.voluntaryprinciples.org](http://www.voluntaryprinciples.org).

**Alcan** and **Placer Dome** were already signatories to the Global Compact and have committed to public reporting on the implementation of its principles. With the sale of its Ecuadoran assets, **EnCana's** exposure to human rights risk has been substantially reduced.

### Security of Assets and Human Rights

Following the deaths of two illegal miners at its mine in Porgera, Papua New Guinea in 2005, **Placer Dome** has expressed interest in improving its policies to maintain the safety and security of its operations within an operating framework that ensures respect for human rights.

The Porgera mine has become a magnet for poverty-stricken Papua New Guineans who seek to gain access to the open pit to mine gold illegally. In these cases, people have suffered falls or found themselves too close to blasting operations by hiding in locations where the mine operators cannot detect their presence. There have also been violent clashes with security personnel during which lethal force has been used.

In June 2005, **Placer Dome** reported that the Voluntary Principles were under consideration.

**The Ethical Funds Company** wrote to **Falconbridge** on January 18, 2005 seeking more information on the company's stated human rights policy, including definitions and implementation systems and country risk assessment procedures.

On February 16, 2005 we met by conference call to discuss our questions. We were struck by the level of informality and lack of structure to support Falconbridge's stated human rights policies. On February 17, 2005, we wrote to Falconbridge asking them to provide information on human rights implementation procedures and global initiatives.

A meeting was held on June 16, 2005 to discuss the concerns outlined in our February letter, including the need for formal policies to support their human rights system. The company acknowledges the lack of formal policies yet seems complacent about taking steps to address this concern. We are considering filing a resolution requesting the company adopt the Voluntary Principles on Security and Human Rights.

## Continuing Dialogues in 2006

### Energy and Mining Companies

In 2006, we are using our research on human rights as the basis for engaging six energy and mining companies: **Alcan, Barrick Gold, Canadian Natural Resources, Falconbridge, Husky Energy, and Petro-Canada.**

We are also presenting our views on human rights to the Prospectors & Developers Association of Canada (P&DA), a national association representing the interests of the mineral exploration and development industry. The P&DA encourages junior mining companies to adopt a set of best practices for environmental protection and community engagement during the early stages of mine development. In 2006, this organization is considering how human rights should be integrated into these guidelines.

## SUSTAINABILITY PERSPECTIVES

In 2005, The Ethical Funds Company published *Canadian Energy and Mining Companies: Navigating International Human Rights Law in the 21st Century*. In this paper, we describe emerging legal risks associated with the violation of human rights standards, and offer practical guidance for companies wishing to support international human rights and avoid legal liabilities.

This paper can be downloaded at [www.ethicalfunds.com](http://www.ethicalfunds.com).

Overall, we are asking these companies to implement a full suite of due diligence procedures designed to protect human rights. This includes:

### 1. **Country risk assessments, mitigation, and impact benefit plans**

Companies need to make good faith efforts to closely examine local practices and ensure their operations do not contribute to the state's capacity to violate international humanitarian law. Country risk assessments should include identification of security risks, potential for violence, human rights records, levels of corruption, the rule of law, and the protection of civil liberties.

If considering operations in a country where conflict is occurring, a conflict impact assessment should be made at the pre-investment phase to determine the possible impacts of investment, intended and otherwise. Mitigation plans should be established to ensure the development of conflict-sensitive business practices that benefit host communities as well as the wider regional and international contexts. Company investments should avoid exacerbating conflict and define the contributions it can make to contribute to peace and stability.

### 2. **Human rights policy**

In addition to economic, social, cultural, civil, and environmental rights, human rights policies should include specific reference to the protections individuals require in order to be free from genocide, torture, war crimes, and crimes against humanity. Some companies make explicit commitments not to be complicit in human rights violations but fail to make reference to the categories of rights violations that occur under international humanitarian law.

We recommend that companies make these specific commitments in the context of articulating a broader human rights policy. Reference should be made to the Universal Declaration of Human Rights and the newly-minted United Nations Norms on Responsibilities of Transnational Corporations with regard to Human Rights, to anticipate rising public expectations and further evolution of international human rights law.

### 3. **Security arrangements**

Companies must ensure that security forces hired to protect corporate assets do not become involved in violations of international humanitarian law.

Policy development in this area should be guided by the United Nations Code of Conduct for Law Enforcement Officials and the UN Basic Principles on the Use of Force and Firearms.

Companies should adopt the US/UK Code of Conduct on Security and Human Rights. The Principles are designed to guide companies in maintaining the safety and security of their operations within an operating framework that ensures respect for human rights and fundamental freedoms.

#### **4. Transparency of revenue payments and revenue management plans**

Energy and mining companies have the capacity to generate enormous revenues for host countries. When spent effectively, these revenues have the potential to improve lives. When allocated ineffectively they can fuel corruption, exacerbate conflict, and increase the ability of governments to violate international humanitarian law.

All companies, Canadian and foreign, should disclose royalty and tax payments to governments in host countries. By providing full disclosure of these revenue transfers, companies can help reduce corruption and allow citizens, multilateral organizations, and international human rights groups to hold governments accountable for the use of proceeds in funding social and economic development and implementing environmental safeguards.

In Canada, energy and mining companies are required to disclose revenues and royalties paid to host governments. Most companies offer this disclosure in their annual report. Despite this disclosure, many host governments receiving those payments are not required to disclose all revenues received from resource companies. In many cases, it is clear that they are not disbursing those funds to communities under stress.

To address this situation, companies should encourage host governments to participate in the **Extractives Industry Transparency Initiative (EITI)**. The EITI is a coalition of resource companies that work in partnership with host governments to ensure transparency of revenue payments. For more information, visit [www.eititransparency.org](http://www.eititransparency.org).

In addition, companies should begin to raise with governments the need for transparent Revenue Management Plans to ensure that the proceeds from resource development benefit the impoverished and those involuntarily impacted by resource development.

#### **5. Crisis management, monitoring, and action plan**

Despite comprehensive country risk assessments, situations can deteriorate. When host governments become implicated in violations of international humanitarian law, companies must protest such violations in the strongest terms possible with government officials, re-evaluate their country risk assessment, and determine the point at which operations will cease or disposal of assets will occur. Companies must also have in place a communications plan to ensure that the public knows all steps are being taken to end the violations and that there is threshold for rights violations that will trigger exit.

#### **6. Joint ventures**

Companies should attain clear agreement with project partners on the need for and importance of these procedures, particularly in cases where other companies have operational control.

#### **7. Management system and disclosure**

Full implementation of a comprehensive human rights policy will include specification of board and senior management responsibilities, staff allocations, training opportunities, integration of human rights policy implementation into compensation plans, monitoring mechanisms,



and public reporting. Reporting of human rights-related risks and procedures for mitigation should be disclosed to shareholders in the Annual Report, Annual Information Form, the Management Discussion & Analysis (under risks and uncertainties), and in corporate responsibility or sustainability reports.

### **Sweatshops and Supply Chain Compliance**

In 2006, **The Ethical Funds Company** will work with socially responsible investment institutions and **Dell**, **IBM**, and **Intel** on effective code implementation, and have begun to encourage **Bell Canada Enterprises** to adopt the **Electronics Industry Code of Conduct** (EICC). We'll also work with EICC companies to identify potential candidates for adoption among other electronics companies in our funds.

We will continue to work with ICCR on **Wal-Mart's** supply chain compliance and the overall sustainability of the company's business model. New in 2006, we will work with Quebec-based investors to ask the Government of Canada to review Wal-Mart Canada's compliance with the **Organization for Economic Cooperation and Development's (OECD) Guidelines for Multinational Enterprises**. The OECD Guidelines call for the recognition of the right for employees to be represented by trade unions and other bona fide representatives. Signatories to the Guidelines, including the Government of Canada, have established National Contact Points, mandated to ensure effective implementation. For more information, visit [www.ncp-pcn.gc.ca/national\\_contact-en.asp](http://www.ncp-pcn.gc.ca/national_contact-en.asp).

We will continue to monitor code compliance, monitoring, and reporting at **Forzani** and **Magna International** and other retail and supplier companies as they enter our portfolios over the course of the year.

## **New for 2006 – Qinghai-Tibet Railway**

We have also begun to engage **Nortel**, **Bombardier**, and **Power Financial** on their participation in the construction of the controversial Qinghai-Tibet Railway. Among the concerns articulated by human rights organizations we note:

1. The project will increase the influx of migrants from China, thus threatening the livelihoods and culture of the Tibetan people, as well as their prospect of achieving political autonomy.
2. Accelerated economic development of the high Tibetan Plateau will increase rates of deforestation, soil erosion, and loss of biodiversity.
3. The railway will increase the capacity of Beijing to strengthen its military presence in Tibet. Such capacity-building has regional and global implications because the railway has the potential to allow Beijing to deploy nuclear missile launchers up and down the line, concealed in tunnels throughout the mountainous terrain. Such a deployment would increase the threat to other regional nuclear powers, most notably India.

Despite its integration into the global economy, China has yet to demonstrate a willingness to observe international human rights standards. Amnesty International reports that China made no attempt in 2004 to introduce the fundamental legal and institutional reforms necessary to bring an end to serious human rights violations. Tens of thousands of people continue to be detained or imprisoned in violation of their rights to freedom of expression and association, and are at serious risk of torture or ill-treatment. Thousands of people have been sentenced to death or executed. Restrictions increased on the cultural and religious rights of the mainly Muslim Uighur community in Xinjiang, where thousands of people have been detained or imprisoned for so-called “separatist” or “terrorist” offences.

The US State Department's recent publication, “Country Reports on Human Rights Practices - 2004,” reported that China's human rights record in the Tibetan areas of China has “remained poor.” The report also highlighted that the Chinese authorities “continued to commit serious human rights abuses, including extra-judicial killing, torture, arbitrary arrest, detention without public trial, and lengthy detention of Tibetans for peacefully expressing their political or religious views.” Under international human rights law, these violations fall under the category of crimes against humanity.

We have six requests for the organizations on our Focus List:

1. Adopt human rights policies that include commitments to the protections individuals require to be free from genocide, torture, war crimes, and crimes against humanity. The policy should make specific reference to the Universal Declaration of Human Rights.
2. Consider “road-testing” the United Nations Norms on the Responsibilities of Transnational Corporations with regard to Human Rights to anticipate rising public expectations and the further evolution of international human rights law. We reference the Business Leaders for International Human Rights (BLIHR) Web site as an example of several companies already taking steps to implement the UN Norms.
3. Take steps to ensure that security forces used to protect corporate assets do not become complicit in human rights violations. Policy development in this area should be guided by the United Nations Code of Conduct for Law Enforcement Officials and the UN Basic Principles on the Use of Force and Firearms.
4. Adopt the US/UK Code of Conduct on Security and Human Rights.
5. Work with Beijing, project partners, and Tibetans to establish means by which the economic benefits of the project flow to the people of Tibet. Such Revenue Management and Impact Benefit Plans are rapidly evolving in the world of resource extraction and we urge Nortel to adopt best practice in this area.
6. Specify board and senior management responsibilities, staff allocations, training opportunities, integration of human rights policy implementation into compensation mechanisms, and public reporting.

# Engagement on HIV/AIDS

## Long Term Objective

- Win the war on AIDS.

## Objective in 2005

- To ensure that companies contribute to the war against the HIV/AIDS pandemic by establishing policies and programs to assist in preventing and treating the disease.

## HEALTH CRISIS

The Joint United Nations Program on HIV/AIDS (UNAIDS) estimates that at the end of 2004 there were approximately 39.4 million people living with HIV, including 2.2 million children under the age of 15. The crisis is particularly acute in sub-Saharan Africa where more than 25 million people are living with it.

## Background

HIV/AIDS is the greatest health crisis the world faces today and the biggest threat to life and prosperity in many developing countries. Humankind has not experienced a disease of such significant proportions since the influenza epidemic that killed an estimated 20-50 million people worldwide between 1917 and 1919.

Fighting the war on AIDS also means fighting malaria and tuberculosis. These diseases are often called “opportunistic infections” because they take advantage of the weakened immune system and thereby contribute to the high mortality rates of AIDS victims.

A growing coalition of leaders recognize the negative impacts of HIV/AIDS on the economy and business. These include loss of human capital, declining household spending, diverted investments, constraints on national budgets, declining labour productivity, rising health care costs, and lower profitability.

The macro-economic impacts may be severe: a World Bank study into the impact of HIV/AIDS on South Africa predicts complete economic collapse in the absence of a concerted effort to combat the disease.

Health experts are growing increasingly concerned about the “next wave” of the epidemic and predict a grim death toll for Russia, India, and China. A recent study suggests that even under mild scenarios, the cumulative total of new HIV cases in these three countries between 2000 and 2025 will be about 66 million—compared to UNAIDS estimates of about 65 million infected globally to date. Cumulative AIDS deaths for these three countries are predicted to range from a low of 43 million to a high of 155 million. Russia, India, and China account for roughly 40% of the world's population and are integrated into the global economy. Therefore, an HIV/AIDS epidemic in those countries has the potential to disrupt global economic growth and cause significant political instability.

## BUSINESS RESPONSE TO HIV/AIDS

A recent survey conducted by the World Economic Forum and UNAIDS showed that only 14% of firms worldwide have conducted quantitative risk assessments. Even in countries with the most serious epidemics, less than one third of the firms have carried out such analyses. The survey shows that businesses rarely draw up written policies until infection rates reach 20%.

In Canada, health experts are becoming alarmed about HIV/AIDS prevalence rates among Canada's aboriginal population. Health Canada's Centre for Infectious Disease Prevention and Control (CIDPC) reports that between 1998 and the end of June 2003, of the HIV test reports that include ethnicity data, aboriginals account for 23% of positive HIV tests, while making up just 6% of the population for the provinces and territories that report ethnic information with positive HIV tests.

Survey evidence to date indicates that the majority of global enterprises are making neither serious efforts to understand the nature of the risk presented by HIV/AIDS nor putting in place strategies and resources required to fight the global pandemic.

### 2005 Dialogues

In 2005, **The Ethical Funds Company** worked with member organizations of the Interfaith Center on Corporate Responsibility (ICCR) to persuade **Eli Lilly**, **GlaxoSmithKline**, and **Pfizer** to establish more aggressive responses to fighting the HIV/AIDS pandemic.

Also in 2005, **The Ethical Funds Company** published *Canadian Energy and Mining Companies and the HIV/AIDS Pandemic: Bridging the Chasm*, an investigation of how Canadian companies with exposure to the pandemic are responding. We found that consistent with companies based in other countries, only a minority of Canadian firms are putting in place aggressive responses to HIV/AIDS.

### Continuing Dialogues in 2006

In 2006, **The Ethical Funds Company** will continue to work with ICCR members on the large pharmaceutical companies in our funds, including **Eli Lilly**, **GlaxoSmithKline**, **Johnson & Johnson**, **Novartis**, **Pfizer**, and **Schering-Plough**. Our core demand-set for pharmaceutical companies is as follows:

1. Collaborate to produce generic versions of fixed doses combinations (FDCs), which greatly reduces the complexity of supplying, tracking, and most importantly, actually taking anti-retroviral drugs.
2. Conduct research into neglected opportunistic diseases, such as malaria, which greatly increase the mortality of HIV/AIDS patients.
3. Create and cut the prices of pediatric AIDS formulations.
4. Relax patent protection for AIDS drugs and agree to voluntarily license generic manufacturers to expand access to essential medicines.
5. Charge lower prices in markets with reduced ability to pay.

We are also engaging **Alcan, Barrick Gold, Coca-Cola, Canadian Natural Resources, Falconbridge, and Potash Corporation** on the HIV/AIDS issue. We are asking these companies to review their operations to identify the risk of HIV/AIDS to their business, believing that they have both a social and financial responsibility to respond. In our view, the following ten points constitute the main parameters of an effective HIV/AIDS strategy for resource extraction companies:

1. Conduct an impact assessment to determine the extent to which HIV/AIDS has taken hold in the communities in which the company locates operations and within its employee population. Commit to annual assessments to project future HIV/AIDS prevalence rates among relevant populations.
2. Take responsibility for acting on HIV/AIDS with support and leadership from the CEO and the Board. Consider provision of treatment for HIV/AIDS to be a human right.
3. Work cooperatively with employees, unions, and local and national health authorities to establish a comprehensive and responsive HIV/AIDS policy.
4. Implement a zero tolerance policy for discrimination against people infected with HIV/AIDS in the workplace. Take all steps necessary to ensure confidentiality for HIV-positive employees.
5. Assign policy implementation to a senior manager (most likely Environment, Health & Safety) who reports to the CEO. Ensure adequate budget and staff resources. The Board should ensure that its EH&S Committee receives regular reports on policy implementation.
6. Provide clear and concise HIV/AIDS information to all employees. Provide and promote voluntary counseling and testing while ensuring confidentiality. Establish peer education and peer support programs as the foundation for the company's HIV-prevention program. Provide preventive education, support behavioural change, and provide condoms at an affordable rate or for free. Develop contingency plans to replace lost skills and a strategy for addressing staff morale.
7. Provide anti-retroviral therapy to employees and their families.
8. Review how corporate activities may be contributing to the underlying causes of HIV/AIDS (e.g., migrant workforce, transportation route vectors) and develop strategies to remove these causes.
9. Establish capacity to track trends and maintain awareness of developments in the treatment of HIV/AIDS. Consider joining the Global Business Coalition on HIV/AIDS to develop an effective knowledge network and trend-spotting system.
10. Establish specific HIV/AIDS key performance indicators and targets and implement an ongoing monitoring, implementation, and reporting procedure. Disclosures should adhere to the Reporting Guidance on HIV/AIDS published by the Global Reporting Initiative.

# Engagement on Corporate Governance & Proxy Voting

## Long Term Objective

- To ensure that corporations build long term and sustainable value for all stakeholders including employees, communities, customers, suppliers, and shareholders.

## Objectives in 2005

- To improve corporate governance practices and transparency.
- To advance a governance framework that explicitly recognizes and incorporates stakeholder interests (shareholders, employees, communities, customers, suppliers, and future generations) in corporate decision-making.
- To advance the view that all corporations must work toward long-term value creation—including social and environmental value creation.

## Background

Corporate governance is the system by which corporations are directed and controlled. The governance structure specifies the distribution of rights and responsibilities among different participants in the corporation and provides the structure for setting company objectives, establishing the means for attaining those objectives, and monitoring performance.

Conventional investment institutions believe that companies must work toward a single objective: share price maximization. **The Ethical Funds Company** believes that this focus leads to short-term thinking that eventually brings harm to the corporation's ability to create long-term value for shareholders and long-term health for society. We believe that companies can most effectively work toward long-term value creation by recognizing the rights and interests of all stakeholders.

## CANADIAN COALITION FOR GOOD GOVERNANCE

To fulfill its mission, the CCGG:

1. Broadcasts its corporate governance guidelines to the people and publicly-traded companies of Canada through its Web site, the media, and professional organizations;
2. Engages directly with company chairs, CEOs, and corporate secretaries to promote good corporate governance policies and practices; and,
3. Participates in the evolution of public policy to influence the future shape of the investment industry.

The CCGG's Web site is at [ccgg.ca](http://ccgg.ca).

## 2005 Dialogues

**The Ethical Funds Company** is a member of the **Canadian Coalition for Good Governance**, a coalition of major institutional investors working to promote best corporate governance practices. In 2005, the CCGG had 45 institutional members whose assets under management totaled \$810 billion.

In 2005, the CCGG developed a set of tools to assist directors serving on compensation committees to do their jobs more effectively, advanced the principle that shareholders should have the opportunity to vote for or against individual directors rather than board slates, worked toward the enforcement of the requirement that companies disclose voting results, and continued to play a significant role as a leading advocate for good corporate practices amongst government and regulators.

The CCGG's Annual Report is available at: [www.ccgg.ca/web/ccgg.nsf/web/CCGGAnnualReport2005/\\$FILE/CCGGAnnualReport2005.pdf](http://www.ccgg.ca/web/ccgg.nsf/web/CCGGAnnualReport2005/$FILE/CCGGAnnualReport2005.pdf)

### Promoting the Global Reporting Initiative

In addition to supporting the CCGG, **The Ethical Funds Company** wrote to 153 companies listed on the S&P/TSX Composite Index, asking each to publish comprehensive social and environmental reports using the **Global Reporting Initiative** (GRI) as a reporting framework. We did not contact those companies already issuing GRI reports or those companies that are on our list of excluded companies.

The GRI Sustainability Reporting Guidelines provide:

- a set of reporting principles (such as transparency, inclusivity, completeness, relevance, and comparability) essential to producing a balanced and reasonable report, and
- guidance for report content, including the company's profile, vision, strategy, governance structure and management systems, and performance against core indicators in six categories (direct economic impacts, environmental, labour practices and decent work conditions, human rights, society, and product responsibility).

Corporate reporting on such themes is a growing trend around the world and across corporate sectors. More than 600 companies have undertaken sustainability reporting using the GRI Guidelines. Canadian users include Suncor, Petro-Canada, Hydro Quebec, PotashCorp, and BC Hydro, among others.

There is growing investor interest in sustainability reporting using the GRI Guidelines. North American research analysts at 18 socially responsible investment firms representing over \$230 billion in assets under management released an Analyst Statement on Sustainability Reporting that:

- articulates common expectations for corporate reporting of social and environmental performance information;

- provides answers to companies' most frequent questions on reporting; and,
- suggests ways companies can enhance the usefulness and credibility of their reports.

## GLOBAL REPORTING INITIATIVE

The GRI—a United Nations-sponsored initiative—is elevating sustainability reporting to higher levels of rigour and comparability. It has incorporated the active participation of hundreds of businesses, accountancy, environmental, human rights, and labour organizations from around the world. The GRI has employed a consensus-based process to design voluntary reporting practices that are harmonized with other emerging national and global standards and disclosure programs.

The GRI's Web site can be found at [www.globalreporting.org](http://www.globalreporting.org).

This statement can be viewed at [www.socialinvest.org/areas/research/other/2004-1004GRIreporting.pdf](http://www.socialinvest.org/areas/research/other/2004-1004GRIreporting.pdf).

We also brought the GRI issue directly to the attention of **EnCana**, **Cott Corporation**, **Home Depot**, and **Terasen**. Each has agreed to move in the direction of GRI reporting in 2006.

### Continuing Dialogues for 2006

In 2006, **The Ethical Funds Company** will review the state of corporate sustainability reporting among publicly-traded corporations in Canada and will again encourage the use of the Global Reporting Initiative format.

## New for 2006 – Executive Compensation and Sustainability

**The Ethical Funds Company** will raise awareness among all companies in the **Ethical** Canadian Index on the need to link executive compensation to sustainability criteria.

In our view, companies today rely far too much on stock options as a means for compensating and providing incentives to executives.

The use of stock options has become increasingly controversial in recent years. Many shareholder and compensation experts fear that stock options dilute the earnings and voting strength for shareholders, do not expose executives to downside risk, reward and punish executives for performance they cannot control, and lead to a focus on short-term share price performance to the detriment of long-term wealth creation.

This latter behaviour is fundamentally at odds with logic, corporate vitality, and sustainability. In one 2005 survey a majority of executives said they would forego an investment that offered a decent return if it meant missing quarterly earnings expectations. In another survey, more than 80% of the executives were willing to cut expenditures on research and development to ensure they hit quarterly earnings targets—even if they believed that the cuts were destroying value over the long term.



**The Ethical Funds Company** therefore believes that executive compensation should be linked to factors that lead to long-term wealth creation and long-term health for society. To our delight, the vast majority of directors and investors share this belief. According to a survey conducted by McKinsey & Company for the Canadian Coalition for Good Governance (CCGG), nearly 90% of directors in Canada and 82% of investors believe that executive compensation should be directly tied to sustainable development.

In the United States, corporations are increasingly incorporating social performance criteria into their executive compensation policies. A review of the Fortune 100 companies by the Investor Responsibility Research Center (IRRC) found that nearly half report using social performance measures. Links to employee diversity, employee development, values and integrity, and the environment are the most common criteria.

In 2006, we'll be asking companies to establish compensation schemes with transparent links between the pay provided and the achievement of long-term financial, environmental, social, and governance goals.

### Proxy Voting in 2005

Historically, mutual funds have not disclosed their proxy voting guidelines or actual proxy voting activity. Many corporate governance specialists have criticized this practice, noting both the enormous influence of mutual funds and the potential conflict of interest that arises when a fund manager also seeks to manage the retirement plan assets of a company whose securities are held by the fund.

In these situations, a fund manager may have an incentive to further its own business interests by supporting management recommendations, rather than the interests of the fund unitholder. Further, recent corporate governance scandals have underscored the need for mutual funds and other institutional investors to play a more active role and embrace a higher standard of duty and care as stockholders and fiduciaries.

**The Ethical Funds Company** was the first mutual fund company to disclose its proxy voting guidelines (2000) and its actual proxy voting activity (2001). We have also lobbied the Securities Exchange Commission (SEC) in the US and the Canadian Securities Administrators to make mutual fund proxy voting disclosure mandatory. In the US, this disclosure became mandatory in 2005. Proxy voting disclosure will become mandatory for Canadian mutual fund companies in 2006.

To view our proxy voting guidelines online, visit [www.ethicalfunds.com/pdf2/sri/proxy\\_voting\\_guidelines.pdf](http://www.ethicalfunds.com/pdf2/sri/proxy_voting_guidelines.pdf).

To view our proxy voting activity online, visit [www.ethicalfunds.com/do\\_the\\_right\\_thing/sri/shareholder\\_action/proxy\\_voting\\_report.asp](http://www.ethicalfunds.com/do_the_right_thing/sri/shareholder_action/proxy_voting_report.asp).

To view submissions made to regulators, visit  
[www.ethicalfunds.com/do\\_the\\_right\\_thing/about\\_ef/newsroom/2002\\_articles/09\\_30\\_02.asp](http://www.ethicalfunds.com/do_the_right_thing/about_ef/newsroom/2002_articles/09_30_02.asp),

[http://www.ethicalfunds.com/do\\_the\\_right\\_thing/about\\_ef/newsroom/2004\\_articles/07\\_29\\_04.asp](http://www.ethicalfunds.com/do_the_right_thing/about_ef/newsroom/2004_articles/07_29_04.asp)

[www.ethicalfunds.com/do\\_the\\_right\\_thing/sri/shareholder\\_action/submission\\_to\\_csa.asp](http://www.ethicalfunds.com/do_the_right_thing/sri/shareholder_action/submission_to_csa.asp)

## Proxy Voting Disclosure in 2006

In the fall of 2005, the Department of Finance requested comment on the regulatory and legislative issues regarding defined benefit pension plans under the federal Pension Benefits Standards Act. **The Ethical Funds Company** responded via submissions sent by the Social Investment Organization (our industry association) and the Legislative Affairs Committee of Credit Union Central of Canada.

In our submissions we pointed out that in July 2000, the UK Pensions Act was amended to require trustees of occupational pension plans to disclose their approach to environmental, social, and governance factors as part of their Statement of Investment Principles. These disclosures are to include how pension funds vote on environmental and social issues.






Since then, France, Germany, Belgium, and Sweden have adopted similar regulations. An excellent review of the British rules and their possible adoption in Canada, commissioned by the Capital Markets Program of the National Roundtable on the Environment and Economy, can be found at:

[http://www.nrtee-trnee.ca/eng/programs/Current\\_Programs/Capital-Markets/Documents/UK-Canada-Pension/UK-Canada-Pension\\_E.pdf](http://www.nrtee-trnee.ca/eng/programs/Current_Programs/Capital-Markets/Documents/UK-Canada-Pension/UK-Canada-Pension_E.pdf)

**The Ethical Funds Company** believes that proxy voting disclosure across the pension industry would help ensure that pension funds are supporting corporate governance practices that are consistent with the best interests of plan beneficiaries. It is less likely that many of the inadequate corporate governance practices would have been tolerated had these been more widely known and recognized as detrimental to the long term health of the corporation. Mandatory proxy voting disclosure is a crucial step toward ensuring that pension funds become part of a process of encouraging improved corporate governance practices.









In 2006, **The Ethical Funds Company** will continue to lobby the federal government for mandatory pension funds proxy voting disclosure.

## 2005 Shareholder Action Program Results

Legend	
	on target
	positive trend
	neutral
	negative
	divestment












Summary	
Number of Successful Outcomes	24
Number of Progressive Dialogues	7
Number of Neutral Outcomes	10
Number of Unsatisfactory Outcomes	4
Number of Divestments	3

### Sustainable Environmental Management

Company	2005 Objective	2005 Outcome	Status
Maple Leaf Foods	Reduce impacts of industrial hog farming	Company has adequate management systems in place	
Metro	Promote Fair Trade Coffee	In 2005, Metro became one of the largest providers of fair trade products among food retailers in Canada	
Petro-Canada	Adopt & disclose a strategy for renewable energy development	Established a Climate Change committee to evaluate climate change reduction strategies and business development opportunities	
Placer Dome	Phase-out riverine tailings disposal	Divested No formal commitment made to phase out riverine tailings disposal	
Royal Bank	Adopt the Equator Principles	Adopted Global Compact	
ScotiaBank	Adopt the Equator Principles	Adopted Global Compact	
Teck Cominco	Ensure sustainability of Cheviot mine project	Awaiting Supreme Court of Canada decision on EIA	
TD Bank Financial	Adopt the Equator Principles	Established a company-wide environmental policy	

## 2005 Shareholder Action Program Results

### Sustainable Environmental Management

Company	2005 Objective	2005 Outcome	Status
Anadarko Petroleum	Adopt a strategy to reduce greenhouse gas emissions	Included greenhouse gas disclosure in public filings	
Anheuser-Busch	Ban use of genetically modified organisms	Formal statement refusing to purchase Missouri-grown rice if that state cultivates genetically engineered rice for pharmaceutical purposes	
Apache Corporation	Adopt a strategy to reduce greenhouse gas emissions	Included greenhouse gas disclosure in public filings	
Bank of Montreal	Adopt the Equator Principles	Adoption of Equator Principles effective October 2005	
Barrick Gold	Ensure sustainability of Pascua Lama mine project	Awaiting decision of Chilean environmental authority revised Pascua-Lama environmental assessment due September 2005	
CIBC	Adopt the Equator Principles	Adopted Equator Principles	
Citigroup	Implement the Equator Principles	Equator Principles implementation included in 2004 sustainability report	
ConocoPhillips	Adopt a strategy to reduce greenhouse gas emissions	Included greenhouse gas disclosure in public filings	
Devon Energy	Adopt a strategy to reduce greenhouse gas emissions	Established Corporate Global Climate Change Position & Strategy	
JPMorgan Chase	Adopt the Equator Principles	Adopted Equator Principles	
Loblaw Companies	Promote Fair Trade Coffee	Offer a range of fair trade products	

## 2005 Shareholder Action Program Results

### Promotion & Protection of Human Rights

Company	2005 Objective	2005 Outcome	Status
ABB Ltd	Cease operations in Sudan	Divested Company did not respond to our correspondence	X
Alcan	Road test the UN Norms	Disclosure of Global Compact implementation in Alcan's 2004 Sustainability Report	🎯
Barrick Gold	Adopt a formal human rights policy	Company-wide adoption of the Global Compact effective Spring 2005	🎯
Falconbridge	Implement a formal human rights policy & management system	Acknowledged benefits of a formal security policy	→
Petro-Canada	Implement a human rights management system	Agreement to report on human rights management systems for 2006 Adoption of formal security policy by Fall 2005	🎯
Placer Dome	Adopt a formal security policy	Divested - (see Environmental Management) Conducting review of best practices in international security agreements and will work towards adoption of a formal security policy in 2006	X

### Fight HIV/AIDS

Company	2005 Objective	2005 Outcome	Status
Eli Lilly	Establish more aggressive response to the HIV/AIDS pandemic	Neutral	→
GlaxoSmithKline	Establish more aggressive response to the HIV/AIDS pandemic	Neutral	→
Pfizer	Establish more aggressive response to the HIV/AIDS pandemic	Neutral	→

## 2005 Shareholder Action Program Results

### Stakeholder Engagement: Treat Communities Fairly











Company	2005 Objective	2005 Outcome	Status
Alcan	Ensure effectiveness of community consultation procedures	Requested cessation of Kitimat power sales to BC Hydro Returned Kitimat BC smelter working to full capacity Support establishment of a community relations liaison in Utkal, India	↑
Brascan	Negotiate an impact benefit agreement with Haida Nation	Agreement in principle reached between the Haida Nation and Brascan in June 2005	🎯
Barrick Gold	Adopt community consultation procedures	A Community & Sustainability Protocol in development	↑
Fortis	Adopt community consultation procedures	Divested Company failed to adequately respond to our concerns	✗

### Protection of Workers in Developing Countries

Company	2005 Objective	2005 Outcome	Status
Dell	Improve labour conditions in overseas supply chain facilities	Dell joined other leading electronics companies in establishing an Electronics Industry Code of Conduct	🎯
Forzani Group	Improve labour conditions in overseas supply chain facilities	Formal adoption of supplier code of conduct expected for the Fall 2005	🎯
IBM	Improve labour conditions in overseas supply chain facilities	IBM joined other leading electronics companies in establishing an Electronics Industry Code of Conduct	🎯
Intel	Improve labour conditions in overseas supply chain facilities	Intel joined other leading electronics companies in establishing an Electronics Industry Code of Conduct	🎯
Magna International	Report on labour conditions	Member of Ford Sustainability Forum	🎯
Wal-Mart	Improve labour conditions in overseas supply chain facilities	Rights to freedom of association & collective bargaining included in Supplier Code of Conduct	🎯

## 2005 Shareholder Action Program Results

### Sustainability Reporting & Corporate Governance

Company	2005 Objective	2005 Outcome	Status
Cott Corporation	Publish a sustainability report	Agreement to produce a sustainability report	
Encana Corp	Publish a sustainability report	Encana has agreed to produce a report "inspired by" the GRI for 2006	
Home Depot	Publish a sustainability report	Agreement to produce a sustainability report	
Loblaw Companies	Publish a sustainability report	No response from company	
Placer Dome	Publish a sustainability report	Divested (see Environmental Management)	
Sears Canada	Publish a sustainability report	Shareholder resolution achieved 7.5% of votes	
Sobeys Inc	Publish a sustainability report	No response from company	
Teck Comino	Publish a sustainability report	No response from company	
Terasen Inc	Publish a sustainability report	Agreement to produce a sustainability report	
Wal-Mart	Publish a sustainability report	Shareholder resolution received 25% of affirmative vote	

## 2006 Shareholder Action Program Focus List

### Biodiversity Protection

<b>Company</b>	<b>2006 Objective</b>
Alcan	Adopt a biodiversity policy
Bank of Montreal	Adopt corporate lending policies that protect biodiversity Endorse the Canadian Boreal Conservation Framework
Barrick Gold	Ensure sustainability of Pascua Lama mine project Adopt a biodiversity policy
Cascades	Adopt the Canadian Boreal Conservation Framework
CIBC	Adopt corporate lending policies that protect biodiversity Endorse the Canadian Boreal Conservation Framework
Citigroup	Apply Equator Principles to corporate lending policies
Canadian Natural Resources	Adopt a biodiversity policy
Canadian National Railway	Improve track safety & emergency response procedures
Citigroup	Apply the Equator Principles to corporate lending
Encana Corp	Adopt a biodiversity policy
Enbridge	Adopt a biodiversity policy
Falconbridge	Adopt a biodiversity policy
Husky Energy	Adopt a biodiversity policy
Maple Leaf Foods	Reduce impacts of industrial hog farming
Petro-Canada	Adopt a biodiversity policy
Potash Corp	Adopt a biodiversity policy
Royal Bank	Adopt corporate lending policies that protect biodiversity Endorse the Canadian Boreal Conservation Framework
ScotiaBank	Adopt corporate lending policies that protect biodiversity Endorse the Canadian Boreal Conservation Framework
Teck Comino	Adopt a biodiversity policy Ensure sustainability of the Cheviot project
TD Bank Financial	Adopt corporate lending policies that protect biodiversity Endorse the Canadian Boreal Conservation Framework



## 2006 Shareholder Action Program Focus List

### Climate Change

<b>Company</b>	<b>2006 Objective</b>
Anadarko Petroleum	Adopt and report on a greenhouse gas emissions management plan
Apache Corporation	Adopt and report on a greenhouse gas emissions management plan
Bank of Montreal	Adopt corporate lending policies that fight climate change
CIBC	Adopt corporate lending policies that fight climate change
ConocoPhillips	Adopt and report on a greenhouse gas emissions management plan
Royal Bank	Adopt corporate lending policies that fight climate change
ScotiaBank	Adopt corporate lending policies that fight climate change
TD Bank Financial	Adopt corporate lending policies that fight climate change

### Environmental Justice

<b>Company</b>	<b>2006 Objective</b>
Alcan	Improve community engagement procedures Ensure sustainability of Utkal project
Barrick Gold	Improve community engagement procedures Ensure sustainability of Pascua Lama project
Costco	Adopt a land procurement policy
Teck Comino	Improve community engagement procedures Ensure sustainability of Cheviot project

## 2006 Shareholder Action Program Focus List

### Food Safety & Genetically Modified Organisms

<b>Company</b>	<b>2006 Objective</b>
Loblaws Companies	Ensure food safety & support consumer right to know
Maple Leaf Foods	Ensure food safety & support consumer right to know
Metro	Ensure food safety & support consumer right to know
Sobeys	Ensure food safety & support consumer right to know

### Promotion & Protection of Human Rights

<b>Company</b>	<b>2006 Objective</b>
Alcan	Adopt a formal security policy & procedures
Barrick Gold	Adopt a formal security policy & procedures Improve stakeholder relations procedures Report on the Global Compact
Bombardier	Adopt a human rights management system
Canadian Natural Resources	Adopt a formal human rights policy & management system
Falconbridge	Adopt a human rights management system Adopt a formal security policy
Husky Energy	Adopt a formal human rights policy & management system
Nortel	Adopt a human rights management system
Petro-Canada	Adopt a human rights policy & procedures
Power Corporation	Adopt a human rights management system

## 2006 Shareholder Action Program Focus List

### Fight HIV/AIDS

<b>Company</b>	<b>2006 Objective</b>
Barrick Gold	Expand provision of HIV/AIDS programs
Coca-Cola	Enhance HIV/AIDS programs
Canadian Natural Resources	Adopt an HIV/AIDS policy & programs
Eli Lilly	Establish more aggressive response to the HIV/AIDS pandemic
Falconbridge	Enhance HIV/AIDS policy & programs
GlaxoSmithKline	Establish more aggressive response to the HIV/AIDS pandemic
Johnson & Johnson	Establish more aggressive response to the HIV/AIDS pandemic
Novartis AG	Establish more aggressive response to the HIV/AIDS pandemic
Pfizer	Establish more aggressive response to the HIV/AIDS pandemic
Potash Corp	Adopt an HIV/AIDS policy & programs
Roche	Establish more aggressive response to the HIV/AIDS pandemic
Schering-Plough	Establish more aggressive response to the HIV/AIDS pandemic

### Promote & Protect Labour Rights in Developing Countries

<b>Company</b>	<b>2006 Objective</b>
BCE Inc	Improve labour conditions in overseas supply chain facilities
Dell	Improve labour conditions in overseas supply chain facilities
Forzani Group	Report on supply chain compliance
IBM	Improve labour conditions in overseas supply chain facilities
Intel	Improve labour conditions in overseas supply chain facilities
Magna International	Report on supply chain compliance
Telus	Establish Board-level responsibility for employee relations
Kohl's	Adopt vendor standards
Wal-Mart	Improve reporting on supply chain compliance

## About **The Ethical Funds Company**

Launched in 1992, **The Ethical Funds Company** is Canada's leading manager of socially responsible mutual funds. In addition to ensuring all securities in its funds meet baseline corporate sustainability standards, **The Ethical Funds Company** works with companies to encourage corporate accountability and market integrity.

**The Ethical Funds Company** launched its Shareholder Action Program in 2000. Since then we've engaged hundreds of companies and filed more than sixty shareholder proposals—the first mutual fund company in Canada to make use of this tool for engagement. We were also the first to disclose our proxy voting guidelines and our proxy voting activity—a level of disclosure unprecedented in Canada's mutual fund industry, and a level of disclosure that will be required of all mutual funds in 2006.

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