

Fiduciary Duties and Toxic Liabilities

Myths & Realities

Toxic chemicals, such as lead or the additives in some plastics, are found in toys and other household and office products and frequently can be found in humans.

Hazards from such exposures are a growing scientific, public, regulatory, and reputational concern.

Myth: Toxic chemicals and environmental health are not financial issues.

Reality: Toxic Chemical Issues Impact Value, Risk and Return.

Toxic chemicals often have a material impact on the value of companies. A strong business case has been made by many academics, business consultants and NGOs about the impact of various toxic chemicals on the value of the companies that produce, use or sell them. As a consequence, such information is often information which a reasonable investor would consider to be significant – in other words, it is “materially significant”.

Myth: Fiduciaries can't consider chemical risk in portfolio management.

Reality: Considering Chemical Risk Issues is Part of Prudent Portfolio Management.

In an October 2005 report written for the United Nations Environment Program Finance Initiative, the world's third largest law firm, Freshfields Bruckhaus Deringer, concluded that integrating environmental considerations into an investment decisions is required when they are relevant to investment management.¹ This thorough and rigorous analysis of United States fiduciary law applies to the specific issues raised by toxic chemicals and environmental health. Further, it requires that fiduciaries incorporate information regarding a portfolio company's production and use of toxic chemicals and the impact of that activity on human health when it impacts value, risk and return.

Myth: Environmental performance is not important to Mainstream investors.

Reality: Mainstream Investors are Considering Environmental Issues.

A growing number of major institutional investors regard incorporating environmental considerations into investment decisions reasonable, and are developing a variety of tools to do so. For example, in July 2006, the UNEP Finance Initiative Asset Management Working Group issued a report containing analysis from large mainstream analysts which concluded that there is “significant evidence of the positive and negative impacts environmental, social and governance issues can have on share price across multiple sectors.”² Also, in 2005 Citigroup subsidiary Smith Barney issued a report that assessed sustainability issues across 28 sectors. Goldman Sachs developed a methodology correlating 42 ESG criteria in the energy sector to financial performance. UBS established a framework to measure corporate social liabilities across nine sectors in its SRI report. Merrill Lynch partnered with an environmental NGO - the World Resources Institute - to produce a report analyzing investment opportunities due to climate change in the auto sector, making specific stock recommendations on seven companies.³

¹ *A legal framework for the integration of environmental, social and governance issues into institutional investment*, Fall 2005. UNEP-FI Freshfields Bruckhaus Deringer, unepfi.org/fileadmin/documents/freshfields_legal_resp_20051123.pdf. Attorney Jonas Kron (see below) was a contributor to the Freshfields report.

² “Show Me The Money: Linking Environmental, Social and Governance Issues to Company Value,” UNEP Finance Initiative Asset Management Working Group. July 2006. (available at http://www.unepfi.org/fileadmin/documents/show_me_the_money.pdf)

³ Bill Baue, Top Five Socially Responsible Investing Stories of 2005, January 6, 2006. www.socialfunds.com/news/article.cgi/article1898.html

Fiduciary Duties

We are bringing together fiduciaries from the public and private sectors to address how they can take active steps to protect and enhance the value of the assets they are responsible for.

Myth: Fiduciaries do not have an obligation to monitor their portfolio companies' environmental performance.

Reality: The Duty to Monitor Requires Fiduciaries to Monitor their Investments for Liabilities.

Future courts could find fiduciaries liable for failing to effectively monitor their investments for environmental liabilities. Fiduciaries are clearly under a duty to monitor their investments. See UPIA and Restatement (Third) of Trusts. As has been seen in a number of industries - asbestos being the best known example - significant liabilities have gone unaddressed for years in part because shareholders have not made any genuine effort to challenge the bald assertions and assumptions made by management regarding those potential liabilities. Since fiduciaries are obligated to ensure that the information they are using to make investment management decisions is complete and current, the fiduciary duty to monitor requires the simple step of investigating whether liabilities are being properly disclosed and addressed by portfolio companies.

Myth: It's OK to automatically vote with management against an environmental shareholder resolution.

Reality: Shareholder Resolutions Concerning Toxic Chemicals Must be Fully Considered.

Existing law requires fiduciaries to consider the facts and circumstances presented by shareholder resolutions. Consequently, when an institutional investor or its proxy adviser is making a decision about how to vote on an environmental health risk shareholder proposal, the fiduciary must not vote blindly with management. Rather, they have an affirmative duty to inquire into the facts presented by the proposal and consider the impact of the issues.

Myth: If fiduciaries have issues with a portfolio company's performance, the correct response is to divest.

Reality: Encouraging Portfolio Companies to Improve Environmental Performance Maintains Investment Diversity and May Improve Financial Performance .

Many fiduciaries have found that engaging companies on environmental and social governance issues increases shareholder value. For example, Wilshire Associates attributed to CalPERS corporate governance program \$750 million in additional shareholder value during the first five years of the program's implementation. Wilshire called this dramatic increase "the CalPERS Effect."

For more information please contact the Investor Environmental Health Network
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