6

Corporate Social Responsibility

As noted in an earlier chapter, in the view of many people, shareholders are only one of many stakeholders with legitimate claims on a company's resources. Corporate social responsibility (CSR) is a recognition that companies are social entities, with explicit commitments beyond short-term—and even long-term—shareholder profit maximization. One focus of corporate social responsibility is a concern for the environment. Traditional economic analysis essentially ignores the cost imposed by firms on the environment, treating it as an "externality"—in effect, beyond analysis. Financial reporting, which takes a shareholder/owner perspective, is equally flawed, in that the only costs that it includes in the calculation of profit are those incurred by the firm. Costs that the firm imposes on others (such as the cost of pollution) are excluded (as is the value of inputs that the environment provides without cost, such as clean air and water).

Implementing measures to reduce pollution is costly to shareholders in the short run but results in a net benefit to society as a whole. However, some authors have argued that the impetus provided by the environmental movement—to redesign working conditions to increase efficiency, for example—often results in a net benefit to shareholders as well as lower levels of pollution. Nevertheless, for most firms, reducing the level of pollution is costly. In AWC Inc.: The Ventilation Dilemma, Alex MacDonald, president and owner of AWC, a southwestern Ontario aluminum fabrication operation, has to decide whether to install ventilation equipment that will adversely affect the financial performance of the company, possibly forcing the company out of business. His alternative is to ignore environmental regulations and risk being charged by government authorities for contravening the law. This case provides the opportunity to discuss several environmental forces that affect business decision making and to recognize the rights of various stakeholders in the decision.

No doubt because of increasing public interest in the role of business in preserving the environment, the legitimacy of corporate social responsibility is now a fact of corporate life. Managers often take the initiative in disclosing in their firms' annual reports their efforts to minimize the harm their companies impose on the environment, as well as their contributions to philanthropic causes. Some are probably merely self-serving, whereas others indicate a genuine interest in balancing shareholder interests against society's interests. An ethical utilitarian might argue that as long as the result is better for society, management motivation is secondary.

An ongoing debate is whether corporate social responsibility really is good for shareholders—that is, that there is no conflict between corporate social responsibility and shareholder returns. A range of investment funds is now available to investors who are unwilling to invest in companies with poor records of accomplishment in corporate social responsibility. The Ethical Funds—The Stevensons' Debate case explores a couple's choices. They think that they should direct some of their investment savings into ethical (or socially responsible) mutual funds. The case provides a historical review of the development of such funds and describes and compares the investment performance of a number of specific U.S. and Canadian ethical mutual funds.

Societies in the developed world generally accept a responsibility to transfer some wealth from their richest members to the poorer. Nevertheless, poorer members of society have needs, and business should serve them. However, serving this market poses ethical challenges because consumers are likely to be less educated, less informed about alternative products available to them, more easily misled by advertising, and less likely to make the best choice for themselves. Therefore, a business that targets low-income individuals and families is likely to be under unusual scrutiny not to make "excessive" profits. The Rent-to-Own Industry is such a $4 billion industry in the United States, which rents appliances, furniture, and electronic goods to customers. There is a potential threat to the rent-to-own industry because an article in a national newspaper accuses the industry of taking advantage of poor consumers. Lawmakers and politicians were becoming active on the issue, and the industry must formulate a response. Would the public really care enough about the rent-to-own industry for new laws to be passed that would change their operations? This case deals with the relationship between business, government, and society and implications of public perception.

Perception and the management of communications to key stakeholders are important issues in the Pembina Pipeline Corporation case. Pembina Pipeline Corporation transports light crude oil and natural gas liquids in western Canada. The president of the company is abruptly awakened one night by a phone call from his operations manager. He informs him that one of Pembina's pipelines has burst and is spilling thousands of barrels of crude oil into a nearby river. Emergency crews have responded to the disaster, but more help is needed. The president has to decide how the best way to handle this situation with the media and plan a strategy for the company in containing the spill.

AWC Inc.: The Ventilation Dilemma

Wayne MacLeod

David Ager

Alan Andron

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 Version: (A) 2002–07–30

In July 1991, Alex MacDonald, President and owner of AWC Inc., returned to his office more frustrated and confused than ever. He had just met his 64-year-old father, the company's founder, for lunch to seek his advice. AWC's pollution control systems were not in compliance with Ontario's Environmental Emissions and Health and Safety regulations. To comply with the Health and Safety regulations, the company would have to install new ventilation equipment in the welding shop. The cost of this ventilation equipment was estimated at somewhere between $240,000 and $400,000, and would require a Certificate of Approval under environmental regulations. The costs of such an investment would have a major effect on the company's profits and cash flow.

AWC Inc., founded in 1950 by Jim MacDonald, was a Southwestern Ontario aluminum fabrication plant specializing in the production of commercial aluminum windows, doors, storefronts, and curtain wall products. Sales and shipments varied from as small as a single door and window to contracts to supply aluminum framing and glass curtain walls for entire buildings.[1] AWC was well known for the quality and design of its products as well as its competitive prices.

According to Alex's father, there was no issue:

> Son, in all my years running this company, never once has anyone from Toronto come poking around my business. As long as the politicians in Toronto knew that I was providing honest work to the local community, no one ever bothered me. I don't see how anything has changed. Work translates into votes, and, given the government's poor economic performance, the last thing they want to do is to shut us down. They'd be hanging themselves, especially with the number of businesses that have shut down in our area over the past year.
>
> Those regulations will only be applied to the big companies like General Electric and General Motors, not to small operations like ours. They know you don't have the money to buy all that fancy air cleaning stuff, and furthermore, they don't expect you to buy it. They know that compared to the large companies, the amount of stuff you pump out into the air doesn't have much effect on the environment. Case in point, Alex: do you ever read in the newspaper about a small company being fined for polluting the environment? Never, it's always the 'big guys.'

How could Alex argue with that logic? His father had run the company successfully for 40 years, before retiring due to health problems, and handing over day-to-day management to Alex the previous year. Still, there was something that made Alex feel uneasy about ignoring the issue altogether.

AWC Inc.

Since its founding in 1950, AWC Inc. had grown and prospered. Many of the people working in the company in 1992 were the children of the first employees Alex's father had hired back in 1950. AWC was more than a company, it was a family. As Shirley Jenkins, Director, Design Engineering, explained:

> I came to work here in 1962 as an engineer. Over the years AWC has helped me to provide a comfortable life for my family. When my children were going to university, AWC always made sure there was work for them over the summer months. AWC treats all its employees this way. It's not uncommon to see the workforce increase by 10 to 15 people between May and August. This may not be unusual for Northern Telecom, but for a company of 100 employees it's quite something.

Sandeep Sharma, a production line manager, added:

> I've been working in the plant since 1952. The company has always sponsored one or two teams in the local hockey and basketball leagues. Recently, they've started sponsoring a local soccer team as well. And, anytime anyone has a problem—you know, financially—AWC is there to help them out, and the company doesn't make you feel embarrassed or ashamed about it. It's no wonder people take such pride in their work. I've seen people rework entire orders without being told to do so, just because they aren't satisfied with the quality of the final product. We just don't want to see the company name going on anything that isn't perfect. I might add that what we consider less than acceptable quality, our competitors sell as 'top' quality.

Of the 100 people employed by the company, 45 were production workers and 55 were office staff. The office staff consisted of 25 engineers who worked closely with customers from the design-proposal stage through quoting and on to the final installation. The company found that design and product performance were critical to success in this market, and that the best way of achieving this was through a force of competent and capable engineers supported by committed, skilled and quality-conscious production workers.

Aluminum Fabrication Industry

Aluminum is a relatively easy product to work with and is suitable for numerous applications. Aluminum fabrication does not require heavy machinery and production is often handled on a one-shift basis. (There is no need to run the equipment 24 hours a day to maximize use of expensive equipment, as is the case with steel fabrication.) AWC purchased aluminum of various alloys and with various finishes in 20 and 24-foot lengths, cut the lengths to size, and machined and assembled them. AWC employed different assembly methods including: corner bracket, tie-rod, and welding. Finished products were shipped completely assembled or as pre-machined, ready-to-assemble components.

As a result of the minimal costs required to set up an aluminum fabrication operation, AWC had 37 competitors in southwestern Ontario alone. This number did not include the 15 suppliers of extruded[2] aluminum, some of whom also manufactured door and window products.

Most of the contracts received by AWC were awarded through a competitive bidding process. Very often these contracts were for standard products, although configuration and usage differed. Price, and sometimes distance from the supplier, were the only factors distinguishing one operation from another. Yet, even for these contracts, it was essential for AWC's engineers to work closely with a customer in order to determine the specifics of a particular project to ensure that the product met performance standards including air and water infiltration and structural requirements. The quotation also needed to be competitive, and at the same time profitable, for AWC. Because of the number of projects the company was involved with at any one time at the bidding, design or installation phase, the company required its large engineering force and its large office staff. Competition for these contracts was fierce, and had become even more so as a result of the construction slow-down in southwestern Ontario over the 1989–1991 period. Alex explained:

> Since the late 1980s, competition for contracts has become incredibly fierce. Whereas before you could expect to earn five to seven per cent profit on a contract, today we're lucky to get three per cent. And the recession, at least in the construction industry, shows no signs of recovery for at least the next three years.

There were also some "custom" contracts. These were rare and occurred only when an architect's drawings called for a specific product that was available exclusively through a particular fabricator. To secure such a "specification" was a time-consuming, costly process and rarely occurred unsolicited, although the rewards could be significant. AWC had earned profits of up to 20 per cent on such contracts.

The industry had seen many other recent changes. Alex commented:

> Over the past five years I have witnessed many changes in the industry. One third of my competitors have gone out of business, while others have joined together to spread their overhead costs over a larger volume. Profits in the industry are minimal. On average, they are approximately three per cent. To survive, I've had to reduce my workforce through attrition, although I may soon be forced to lay off employees. This is not something that I've done easily, nor did I do it without a lot of deliberation and heartache. When any of my employees leave, even if it is through attrition, I feel like I'm firing my own mother.
>
> The construction industry, the major client for our product, has been devastated by the recent recession. Although there has been a shake-out in the aluminum fabricating industry, we have survived, but only by drastically cutting our prices, margins and profits and increasing our efficiency.
>
> The bulk of our fabrication costs are labour costs and engineering overhead. We cannot at this time afford any increase in these costs, unless we wish to jeopardize the business. But if we're to remain competitive in the industry, we can't lay off engineers. They are our future.
>
> The Canada-U.S. Free Trade Agreement has threatened to increase the competitiveness in the aluminum fabrication industry. The reduction in tariffs will allow large U.S. fabricators with lower cost structures to enter the Canadian market and offer lower priced products of equal quality. I see this as the beginning of the end of Canadian aluminum fabricators.

AWC and Aluminum Fabrication

Recently, AWC had introduced a superior door design for general purpose use. This had resulted in a significant increase in the company's sales of commercial aluminum doors and the need for high volume production. Not only was the new product more attractive in terms of price and ease of assembly, but it also offered equal or superior performance to comparable products. The door was designed and fabricated using a tie-rod assembly.

When the door was intended for heavy use areas, for example, the entrance way to a shopping mall, the door assembly would need to be reinforced by a stronger welded-corner design that required a greater time in the production process, specifically on the welding line. This design enhancement was a requirement in many orders.

The AWC welding line was used for existing products, but not on a full-time basis. To meet the production demands for the new door product, the welding line was now being used full-time, and, depending on the volume of product flowing through the plant, very often required a second shift.

The problem with a second shift on the welding line was twofold. Alex commented:

> If we move to a second shift on the welding line, we need to find someone who is capable of supervising it on the second shift. Not only does this cost extra money, but also, finding someone qualified to supervise the line will be difficult. I know this because it took us six months to find the supervisor we have at present. And even then, she required additional training. The second problem with a second shift is that AWC will be required to pay a shift premium to the six people who operate the line. This will increase costs. As well, the output of the night shift will have to be stacked all over the floor of the plant. We have no easily accessible storage area.
>
> One option is to install a second welding line. We could then have the existing supervisor assume responsibility for both welding lines. This would save a shift premium and reduce work in progress inventory. On the other hand, the equipment for a second line would cost $75,000.

The Toronto Trade Show

At a recent trade show that he had attended in Toronto, Alex had visited a booth set up by the

Ontario Ministry of the Environment. The booth was staffed by various government representatives. Among other information, they provided an overview of various aluminum fabrication processes and the harmful by-products of each. In addition, the government representatives outlined the various regulations concerning the emissions of various substances into the air, and they outlined the penalties for failing to comply with the regulations.

Of particular interest to Alex was the discussion that centred around welding. The welding process for aluminum produced various fumes composed of toxic and environmentally harmful metal particles and metal oxides. The law was quite specific: releasing high concentrations of these particles into the internal work environment or outside the plant was forbidden, and was punishable by fines of up to $400,000 per day. According to Ministry of the Environment and Ministry of Labour studies, even in small concentrations, these particles had been proven to be responsible for serious respiratory damage and, in some cases, cancer after long-term exposure.

As one government representative put it, "Inhaling these particles is more harmful than smoking a package of cigarettes a day."

Alex was puzzled by this last comment:

> We've been welding for years and have never vented the fumes from the plant. To date we've received no complaints. I wonder how sound these studies really are. After all, if the stuff really is harmful, Dad would never have let us work in the plant as kids. In fact, I've been in and out of that plant for almost 40 years, and look at me, no problems.
>
> Sure, the welding line has never been used as much as we are using it to meet the demand for our new product, but then maybe all we need to do is cut a hole in the ceiling of the plant and let more fresh air than usual in to mix and dilute that other stuff.

While at the trade show, Alex had also visited a booth set up by a company that specialized in ventilation emission control systems. He had taken advantage of this opportunity to do some research on systems that, if installed, would ensure that AWC did not contravene existing environmental legislation.

Emission Control Systems

If AWC were to install an emissions control system, it had a choice of two different types of emission control. The first was an exhaust system that would vent fumes outside the plant. While an exhaust system that vented the fumes to the outside was by far the cheaper of the two options, Alex had determined that the system would cost approximately $240,000. Although it satisfied Ministry of Labour occupational health and safety regulations, this system merely moved the problem from inside the plant to outside the plant. If AWC simply used the ventilation system, it would be subject to Ministry of the Environment regulations concerning external emissions of by-products. According to the regulations, AWC would be required to obtain a Certificate of Approval from the Ministry of the Environment for its industrial exhaust system. The Ministry of the Environment would require an air quality impact study be conducted on neighbouring property owners, and based on the results, would decide whether to approve AWC's exhaust system.

Alex continued:

> I couldn't believe it when I first heard about that requirement. I mean, my neighbour out here in the industrial park is a ready-mix concrete plant. They throw more dust and gunk into the air in one week than we could produce in a lifetime.

The second, and more expensive alternative, was to install a recirculating filtration system. Alex had determined the cost of the system AWC required would be $400,000. This system would take the air from the welding station, run it through a set of electrostatic filters, and expel it back into the plant. While these filters would not require approval from the Ministry of the Environment to operate, as they were not releasing the air to the outside of the building, the system would have to be approved by the Ministry of Labour, Department of Occupational Health and Safety.

There was an additional requirement for this system. The filters in a recirculating system had to be cleaned once a month to function effectively. The cleaner was a proprietary substance which had no acceptable substitutes. The cleaner was also corrosive and caustic, and would require special employee training and protection from health and safety hazards. In addition, the cleaning process generated about two litres of toxic sludge that had to be disposed of as a hazardous material under Ministry of Environment waste disposal regulations.

AWC could not legally store this sludge on its plant site unless it was first licensed as a hazardous materials storage site, which would require expensive facilities and safety precautions. Neither could AWC legally haul the materials to an authorized storage or disposal site as AWC was not licensed to haul hazardous materials. Again, seeking such a license would require an investment in specialized equipment and training. Under the law, the only option open to AWC was to use the services of a licensed hazardous waste disposal company who would pick up and dispose of this material at a cost of $500 per trip. The fee was fixed; whether the shipment was one litre of sludge or 101 litres of sludge, AWC would be charged the same price. The hazardous waste disposal companies also insisted on testing the substance each time, at a charge of $200, before they would collect and dispose of it.

Alex concluded:

> I can't believe that the government creates all of these obstacles for us. They won't let us vent directly into the plant, and they won't let us vent directly outside the plant. They expect us to somehow 'clean' the air entirely. So, first they require us to put in equipment that creates the sludge, then they make it nearly impossible to dispose of it.

ENVIRONMENTAL REGULATIONS

Over the previous few years, the provincial government in Ontario had raised the profile of environmental issues in response to demands from various stakeholder groups and as part of their underlying belief that the government must regulate business to preserve the environment. The province had reviewed its environmental legislation and had increased the legal and economic deterrents for polluting. In particular, fines were substantially increased and new penalties, such as incarceration, were introduced. Under the new rules, company directors, managers, and employees could be held personally liable for regulatory infractions.

A furniture manufacturer in Cambridge had recently been charged for exhausting paint fumes and other harmful vapours, a by-product of their finishing process, into the air. In response to complaints from neighbours, the provincial government approached the firm to eliminate the problem. The recommendation of the province was that the company install a two-process system that consisted of an air scrubber and a filter that would capture by-products. The price tag for this new system was $1.25 million. The company responded by stating that they would rather relocate to the United States than incur the cost of compliance. Because the company refused to comply, the province took it to court. The company was subsequently fined $100,000 and the company's general manager was personally fined $25,000. The case was still in appeal.

Alex MacDonald had done some checking and had discovered that of the 1,000 companies who had been charged for emitting harmful substances into the external environment, only 250 had actually been prosecuted, of which only 100 were fined an average of $30,000 each. As well, of the 1,000 charges, only one person had been incarcerated. Alex estimated that all in all, over 50,000 companies were affected by the law and 70 to 80 per cent were probably in violation of it.

Alex knew that in his situation, the maximum penalty for the firm was a fine of $500,000. At the same time, he was also aware that he could personally be fined $25,000, and that any of his employees could be fined up to $25,000 for violating the health and safety legislation.

> In all the years that AWC has been in business, I can't remember having been visited by an environmental inspector, nor can I remember any of my competitors having been visited by an inspector, except perhaps for one or two of the larger operations like World Aluminum Industries.

> This explains why my large competitors have installed expensive air quality control equipment in their plants. This doesn't seem all that unusual though. After all, their plants are usually very prominent in the community, have multiple locations, and are unionized. As well, they are large, and by virtue of this fact, create a large amount of pollution that is highly visible.
>
> The government guys are always breathing down their backs; hell, if one of the guys gets a paper cut from his pay cheque, the union calls the health and safety guys in. I can also tell you that those big guys have been struggling lately; their costs are so high, and they are having a hard time getting profitable contracts in this recession.

Alex figured that if there was a problem, someone would have said something by now.

One employee described the work environment:

> Sure, it's noisy and smelly in here, but hey, this is a factory after all. I work next to the welding line. Yes, sometimes I go home with a headache, but then so does my wife who works in an office. Who says the world is perfect? At least we have a job when many don't. And it's a good job at that.

Another employee commented about his experience at AWC:

> My dad worked here, I spent my university summers here, and Mr. MacDonald's dad even helped me get my engineering degree. I'm proud to work for this company and have a hand in designing what I think are the best damn aluminum doors and windows in the country.

The Decision

As Alex mulled over the estimates before him and his projected financial statements (Exhibits 1, 2 and 3), he began to become annoyed. AWC had been in business for more than 40 years and no one had complained. Furthermore, as his father had said: "We're running a factory, not a hospital operating room!" Alex added some additional thoughts about the firm:

Income Statement	*Actual 1990*	*1991*	*1992*	*1993*	*1994*
Sales	$3,535,118	3,623,496	3,732,201	3,844,167	3,959,492
Cost of Goods Sold	2,386,205	2,445,860	2,556,558	2,633,254	2,712,252
Gross Profit	1,148,913	1,177,636	1,175,643	1,210,913	1,247,240
Wages and Benefits	768,000	791,040	791,040	806,861	822,998
Advertising	40,000	42,860	42,860	42,860	42,860
Utilities	46,700	48,500	49,015	49,100	49,700
Insurance	10,000	10,000	10,000	10,000	10,000
Depreciation	28,945	28,945	28,945	28,945	28,945
Travel	77,000	80,000	82,700	83,400	84,400
Trade Shows	25,000	27,000	27,000	27,000	27,000
Executive Salary	100,000	100,000	100,000	100,000	100,000
Interest Expense	46,200	42,540	42,540	42,540	42,540
Total Expenses	1,141,845	1,170,885	1,174,100	1,190,706	1,208,443
Earnings Before Tax	7,068	6,751	1,543	20,207	38,797
Taxes	2,333	2,228	509	6,668	12,803
Net Income (Loss)	$4,736	4,523	1,034	13,539	25,994

Exhibit 1 Projected Income Statement 1991–1994 (no purchase of ventilation equipment)

Note: AWC charges engineering salaries to cost of goods sold.

Income Statement	*Actual 1990*	*1991*	*1992*	*1993*	*1994*
Sales	$3,535,118	3,623,496	3,732,201	3,844,167	3,959,492
Cost of Goods Sold	2,386,205	2,445,860	2,556,558	2,633,254	2,712,252
Gross Profit	1,148,913	1,177,636	1,175,643	1,210,913	1,247,240
Wages and Benefits	768,000	791,040	791,040	806,861	822,998
Advertising	40,000	42,860	42,860	42,860	42,860
Utilities	46,700	48,500	49,015	49,100	49,700
Insurance	10,000	10,000	10,000	10,000	10,000
Depreciation	28,945	28,945	58,945	58,945	58,945
Travel	77,000	80,000	82,700	83,400	84,400
Trade Shows	25,000	27,000	27,000	27,000	27,000
Executive Salary	100,000	100,000	100,000	100,000	100,000
Interest Expense	46,200	42,540	76,140	74,403	72,422
Total Expenses	1,141,845	1,170,885	1,237,700	1,252,569	1,268,325
Earnings Before Tax	7,068	6,751	(62,057)	(41,656)	(21,085)
Taxes	2,333	2,228	—	—	—
Net Income (Loss)	$4,736	4,523	(62,057)	(41,656)	(21,085)

Exhibit 2 Projected Income Statement 1991–1994 (purchase of $240,000 exhaust equipment)
Note: AWC charges engineering salaries to cost of goods sold.
Projections assume that equipment is installed for 1992.

Income Statement	*Actual 1990*	*1991*	*1992*	*1993*	*1994*
Sales	$3,535,118	3,623,496	3,732,201	3,844,167	3,959,492
Cost of Goods Sold	2,386,205	2,445,860	2,556,558	2,633,254	2,712,252
Gross Profit	1,148,913	1,177,636	1,175,643	1,210,913	1,247,240
Wages and Benefits	768,000	791,040	791,040	806,861	822,998
Advertising	40,000	42,860	42,860	42,860	42,860
Utilities	46,700	48,500	49,015	49,100	49,700
Insurance	10,000	10,000	10,000	10,000	10,000
Depreciation	28,945	28,945	78,945	78,945	78,945
Travel	77,000	80,000	82,700	83,400	84,400
Trade Shows	25,000	27,000	27,000	27,000	27,000
Executive Salary	100,000	100,000	100,000	100,000	100,000
Waste Disposal	—	—	8,400	8,400	8,400
Interest Expense	46,200	42,540	98,540	95,642	92,338
Total Expenses	1,141,845	1,170,885	1,288,500	1,302,208	1,316,641
Earnings Before Tax	7,068	6,751	(112,857)	(91,295)	(69,401)
Taxes	2,333	2,228	—	—	—
Net Income (Loss)	$4,736	4,523	(112,857)	(91,295)	(69,401)

Exhibit 3 Projected Income Statement 1991–1994 (purchase of $400,000 air recirculation equipment)
Note: AWC charges engineering salaries to cost of goods sold.
Projections assume that equipment is installed for 1992.

> My dad, mom, sister, and brother have all worked in the company. We started out as kids coming in on the weekends and helping to clean things up, or watch Dad draw up estimates for customers. I still have some of Dad's original staff here, and some of their children work here. Just like my Dad did, I help my employees send their kids to college when they need help.
>
> I went to school and studied business administration, but you know, I hated shuffling paper. This is where my heart is; this is where I'm happiest making things. When Dad was forced to retire early, I was glad to jump in. We build things here—if the boys on Bay Street are so smart, how come so many firms are in trouble? Just look at the real estate developers. How come we keep reading about all of these large businesses that keep screwing up because they tried to become so-called financial conglomerates? All they do is shuffle paper and push buttons on computers, but without people like us who actually create things, those guys would have zip!
>
> Before people go to work for the government, they should spend some time in the real world! They complain about our lack of competitiveness, about the job drain and the brain drain. Then they slam the working person and their employer with taxes, taxes, and more taxes, and with more and more of the same damned regulations that tie me in red tape anytime I want to do something. And then they wonder why firms are moving out of this province and setting up shop in Mexico!

Alex reviewed the figures in front of him. To comply with the provincial environmental regulations would be financially devastating for AWC and would lead to 100 people becoming unemployed. Alex reasoned that such an argument would suffice in explaining to the provincial environment officials why AWC might decide not to comply with the regulations. And after all, what were the chances of being caught? Alex leaned back in his chair, realizing that resolving his dilemma would not be easy.

NOTES

1. A curtain wall is the visible exterior glass envelope of a high-rise building, commonly consisting of glass windows and panels in an aluminum frame. The frames are generally suspended from mounting brackets built onto the structure of the building.
2. Aluminum extrusion is the process whereby aluminum ingots are heated and shaped into various sizes and lengths. The resulting extruded products are sold to fabricators who use them in making various products including doors and window frames.

ETHICAL FUNDS—THE STEVENSONS' DEBATE

Craig Gilchrist

Dana Gruber

Ron Wirick

 Version: (A) 1998–10–07

> *People make compromises every time they choose a mutual fund. Investors are always making a choice as to what their special needs are. If ethical investing is important, you can do it and still achieve above-average returns.*
>
> —Larry Lunn, Co-Manager of the Ethical Growth Fund[1]

By providing the tools to put money at the service of local communities, disadvantaged people and the environment, ethical investment can help to build a new economy based on human needs without rejecting investors' personal goals of security and happiness.

—Eugene Ellman, The 1998 Canadian Ethical Money Guide[2]

If you could make an investment that would yield 50 per cent or more return for less risk, would you take it? . . . What if you found out that, while technically legal, it involved child pornography?

—John Montgomery, President of Bridgeway Social Responsibility Portfolio[3]

Ian, I agree that it would be nice to feel like we're 'doing good' with our money, but I'm just not sure that I'm willing to sacrifice the returns that we could make if we were open to investing in all possible funds.

Ian Stevenson understood that his wife, Beth, was concerned that they might be foregoing a better return by investing their money in a socially responsible mutual fund; however, he felt very strongly that ethical investing was the right thing for them to do. He was convinced by his own research that they would not be jeopardizing any potential returns. In their late twenties, and after their first few years of marriage, the Stevensons were fortunate enough to have no substantial debt, and had managed to save approximately C$20,000 that they were interested in investing in the equity portion of their portfolio.

Ian pressed his position,

> I just don't feel right about making money from companies whose policies I disapprove of. I'm concerned about supporting companies that are involved in producing arms, nuclear power or unsafe products. Aren't you uneasy at all about investing in companies that use child labor or operate sweat shops? How about companies that test their products on animals?

> All of these issues concern me, too, Ian! But we've worked hard for our savings and we have to be practical. I want our investment to provide us with some extra money for something down the road. I know that you've told me that these funds can perform as well as other, 'more conventional' funds, but I'm worried that some industries might be avoided. Wouldn't that hurt our diversification? And another thing, if the managers of these funds are spending all their time monitoring these ethical corporations, when do they have time to worry about the companies financial performance and prospects for the future?

Principles of Ethical Investing

Socially responsible investing, or ethical investing, described the placement of money in mutual funds, stocks, bonds or other securities and investments, that were screened to reflect moral, environmental, social, and political values. Many supporters suggested that a better way of articulating the ethical investing concept was to say that socially responsible investors accepted the responsibility for the impact of their investments and their financial decisions.

Ethical investors wanted to have their money build a future that was congruent with their beliefs and values. Each person had their own individual concerns and ideas about what constituted 'ethical behaviour'; however, there were some concerns that widespread and were common to many. By examining investments based on specified issues of concern, fund managers determined which corporations were acceptable and desirable to invest in. This screening process could be administered in two different ways: positive and negative screening. Positive screening involved choosing those companies that focused on 'doing good,' while negative screening involved eliminating those companies that were deemed in some way to be harmful to society. Fund managers focused on either type of screening to varying degrees, but each fund would be based on some identified selection criteria. Exhibit 1 outlines common criteria that were used by a majority of ethical funds to determine whether an investment was ethical or not. Nearly 90 per cent of socially responsible investment funds were managed with at least three or more screens.[4]

The Emergence of Ethical Investing

Shareholders became increasingly aware of their potential for influence, as well as their ability to hold companies responsible for their activities. As a result, some investors became more discerning with their investments and more actively involved in communicating their positions in regard to company developments, management and operating practices.

In the United States, as of 1998, there were over 160 mutual funds based on particular social or environmental criteria, amounting to assets greater than US$1 trillion. Ethical funds accounted for approximately nine per cent of the US$13.7 trillion of assets invested under professional management in the U.S., at the end of 1997.[5]

In Canada, 15 ethical mutual funds were offered by five different mutual fund companies: Ethical Funds Inc., Clean Environment Mutual Funds, Fiducie Desjardins, Investors Group and Working Opportunity Fund.[6]

Criteria	*Identify*	*Avoid*
Environment	Positive programs, such as pollution prevention	Major polluters, nuclear power operators
Employer Relations	Positive labor relations and benefits, strong equal employment opportunity	Companies with records of discrimination or aggressive anti-union activity
Product	Safe, beneficial products	Tobacco, alcohol, gambling, unsafe products
Weapons/Military		Companies with significant weapons production, or arms trade
Human Rights	Companies that surpass international and local standards	Companies that fail to meet international conventions, or practise child labor
Community	Responsible corporate citizens	Financial institutions that discriminate in lending
Animal Welfare	Companies reducing animal testing	Companies lacking standards for humane treatment of animals
Equality	Companies that support all races, religions, sexes, and	Companies that discriminate against any individual sexual orientation

Exhibit 1 Common Investment Screens

Available funds represented the full range of mutual fund categories; including Canadian, International, North American, and Pacific Rim equities, as well as Canadian balanced funds, Canadian and International bond funds, Canadian money market, and Canadian small capitalization companies. Although ethical funds were becoming increasingly popular in Canada, representing close to C$3 billion[7] they only represented less than one per cent of the C$300 billion in total investment.[8] For example, Investors Group had more than C$33 billion in assets and less than one per cent of it, or C$300 million, was invested in their ethical fund, the Investors Summa Fund.[9]

There were at least two U.S. indices that existed that were based on socially responsible securities; the Good Dow and the Domini 400 Social Index. The Good Dow was the longest-running socially responsible index, created in the late 1970s by Good Money, Inc. Between 1976 and 1994, the Good Dow had an average annual return of 12.4 per cent versus 7.7 per cent for the Dow Jones Industrial Average.[10]

Kinder, Lyndenberg, Domini & Co. created the Domini 400 Social Index (DSI) for the purpose of studying how social criteria affected investment performance. Since May 1990, it had been the benchmark for measuring the performance of socially screened portfolios. Modelled on the S&P 500, the DSI was a market capitalization-weighted common stock index. Since its inception, it had outperformed the S&P 500 on a total return basis and on a risk-adjusted basis. Exhibit 2 illustrates the performance of the DSI

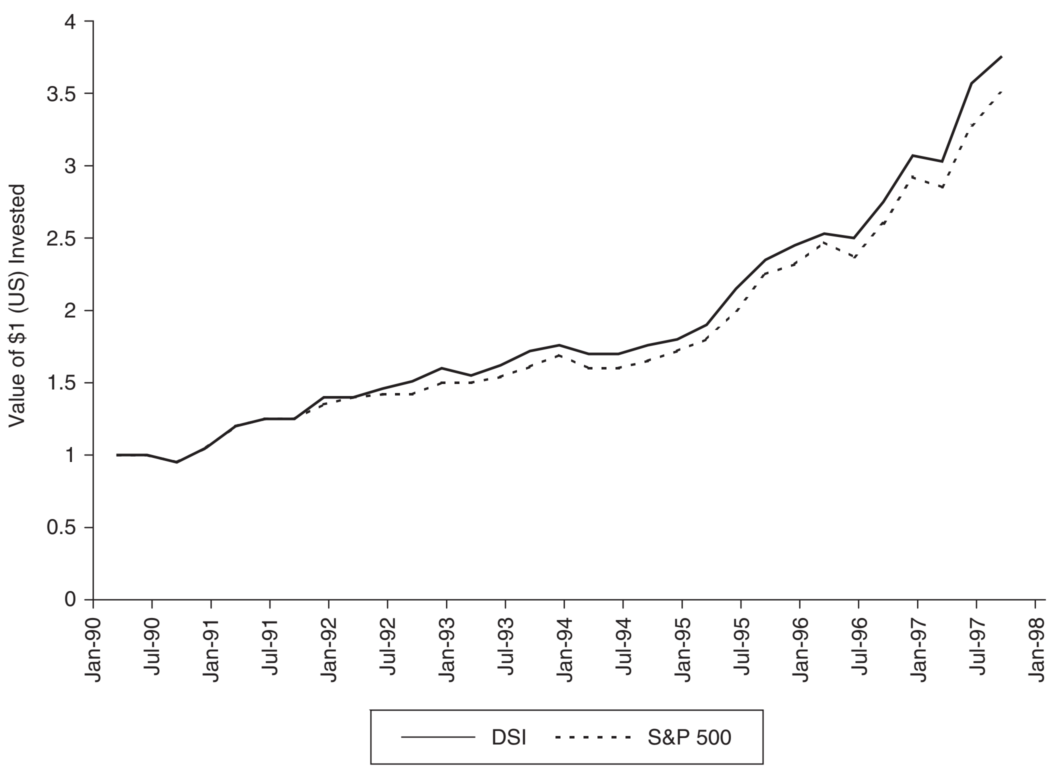

Exhibit 2 Domini 400 Social Index Performance

Source: Graph is approximated from http://www.kld.com against the S&P 500 since May 1990. About half of the stocks on the S&P 500 passed the ethical screen and were chosen for the DSI, and 150 other stocks were selected to round out the 400 that made up the index. The DSI had a very low turnover of about six to eight per cent, roughly in line with the S&P 500.[11]

Performance of Ethical Funds

Reviews about ethical fund performance in Canada and the U.S. have been mixed. Proponents maintained that ethical investments could perform as well as conventional investments and in some cases better. While the stocks listed in the Domini 400 Index had grown by more than 302 per cent in terms of their stock prices, for the year ended December 31, 1997, the S&P 500 had increased by only 262 per cent for the same period.[12] Exhibit 3 outlines the investment performance of 23 popular U.S.-owned and eight Canadian-owned ethical equity funds. These 31 funds can be benchmarked against the Median Canadian Diversified Equity Fund, Domini 400, MSCI World, TSE 300 and S&P 500.

One major concern with ethical funds was the fear of higher management expense ratios to cover the additional effort spent selecting and monitoring 'ethical companies.' High management expense ratios reduced the amount of return to an investor. Exhibit 3 displays the management expense ratios and sales fees (loads) for the 31 popular funds mentioned earlier.

The diversity among funds, in relation to their composition and screening criteria, often made it difficult to compare the financial performance of certain funds. Funds with limited screening might have been considered with other traditional mutual funds, making the distinction between ethical funds and conventional funds vague. Exhibit 4 illustrates the variety of criteria different ethical funds used to screen their investment selections.

Canadian Ethical Funds

Ethical Funds Inc.

Ethical Funds Inc. was Canada's largest group of socially responsible mutual funds. The group offered eight different funds, and included screens for industrial relations, racial equality, tobacco, military production, nuclear energy and environmental practices.

All funds were based upon their 'Ethical Principles,' which were created through a consultative process involving the public, unitholders and a special advisory council on ethics. Their selection process involved first selecting investments with excellent growth potential, and then applying a 'best-of-sector' approach. This involved picking the best companies in a sector based on predetermined criteria. It was owned and controlled by the Canadian credit union system and was available to Canadian residents only. The distributor of Ethical Funds Inc. was Credential Asset Management Inc., a subsidiary of Credit Union Central of Canada. Credit Union Central of Canada (Canadian Central) was the national trade association and central finance facility for credit unions in Canada.

Ethical Funds Inc. offered Canada's largest ethical fund, the Ethical Growth Fund (Exhibit 5). This fund had over C$818 million in assets, as of April 30, 1998. It was launched in 1986 by its administrator, Vancouver City Savings Credit Union (VanCity), and was Canada's first fund of its kind.[13] It invested in the common stock of Canadian corporations with medium-to-large market capitalization.

The Ethical North American Equity Fund (Exhibit 6), had over C$181 million of assets, as of April 30, 1998. Fund manager, Cynthia Frick argued that she, "can easily find well-performing proxies for the firms that are off limits."[14] She used a bottom-up strategy for her stock selection, and constantly rebalanced the fund, turning over its value by 125 per cent each year.

Fund Name*	Assets ($M)	Annual Average Return 1 Year	3 Year	5 Year	10 Year	Load	Exp. Ratio
Canadian-Owned Equity Funds (CAN$)							
Ethical Growth	$818.96	26.88%	23.38%	16.86%	12.57%	—	2.10%
Ethical Special Equity	$96.70	21.12%	18.26%	N/A	N/A	—	2.71%
Ethical North American Equity	$181.18	55.14%	37.33%	24.45%	14.78%	—	2.47%
Investors Summa	$465.30	39.53%	27.53%	18.44%	12.21%	Both	2.48%
Clean Environment Equity	$283.53	45.89%	30.98%	22.11%	N/A	Optional	2.88%
Clean Environment International Equity	$32.38	53.05%	28.53%	N/A	N/A	Optional	2.77%
Desjardins Environment	$141.88	30.40%	22.04%	16.18%	N/A	—	2.08%
Working Opportunity	$196.07	6.56%	7.31%	5.22%	N/A	—	3.30%
Canadian Average	$277.00	34.82%	24.42%	17.21%	13.19%	—	2.60%
US-Owned Equity Funds (US$)							
Ariel Appreciation Fund	$236.10	48.23%	29.71%	19.75%	N/A	—	1.33%
Ariel Growth Fund	$194.90	47.19%	28.81%	18.92%	14.75%	—	1.25%
Bridgeway Fund Social Responsibility Portfolio	$1.10	41.33%	26.99%	N/A	N/A	—	1.50%
Calvert Capital Accumulation Fund	$70.50	48.73%	25.69%	N/A	N/A	4.75%	1.96%
Calvert Social Investment Fund Equity Portfolio	$166.70	30.53%	23.33%	12.65%	11.39%	4.75%	1.21%
Citizens Emerging Growth Portfolio	$87.00	49.51%	27.97%	N/A	N/A	—	2.01%
Citizens Index Fund - Retail	$318.00	45.31%	32.56%	N/A	N/A	—	1.59%
Delaware Quantum Fund	$41.50	46.04%	N/A	N/A	N/A	4.75%	1.50%
DEVCAP Shared Return Fund	$7.20	39.22%	30.24%	21.15%	N/A	—	1.75%
Domini Social Equity Fund	$397.50	40.59%	31.79%	22.49%	N/A	—	0.98%
Dreyfus Third Century Fund	$899.70	40.48%	31.79%	20.03%	16.55%	—	1.03%
Green Century Equity Fund	$12.80	40.28%	31.46%	21.94%	N/A	—	1.50%
Meyers Pride Value Fund	$3.10	32.46%	N/A	N/A	N/A	—	1.95%
MMA Praxis-Growth Fund	$132.00	37.70%	26.16%	N/A	N/A	—	1.75%
Neuberger & Berman Socially Responsive Fund	$93.90	39.47%	28.46%	N/A	N/A	—	1.48%
New Alternatives Fund	$41.00	25.40%	15.10%	10.00%	N/A	4.75%	1.15%
Noah Fund	$1.80	37.40%	N/A	N/A	N/A	—	1.42%
Parnassus Fund	$366.90	34.92%	14.88%	15.32%	14.58%	3.50%	1.11%
Pax World Growth Fund	$7.30	5.80%	N/A	N/A	N/A	2.50%	1.49%
Rightime Social Awareness Fund	$13.70	22.99%	19.74%	12.70%	N/A	4.75%	2.35%
Security Social Awareness Fund	$12.90	37.33%	N/A	N/A	N/A	5.75%	0.67%
Total Return Utilities Fund	$11.20	42.00%	N/A	N/A	N/A	—	1.80%
Women's Pro-Conscious Equity Mutual Fund	$7.00	43.09%	25.13%	N/A	N/A	—	1.50%
US Average	$135.82	38.09%	26.46%	17.50%	14.32%	1.54%	1.49%
Benchmarks							
Median Can Diversified Equity Fund (CAN$)	$54.20	22.90%	20.00%	14.50%	10.30%	N/A	2.33%
Domini Social Index 400 (US$)		43.07%	34.05%	24.30%	N/A		
Msci World (CAN$)		32.55%	21.77%	19.02%	13.06%		
TSE 300 (CAN$)		30.35%	23.85%	17.65%	11.82%		
S&P 500 (CAN$)		44.36%	34.20%	26.09%	20.66%		
S&P 500 (US$)		41.06%	31.96%	23.23%	18.91%		

Exhibit 3 Historical Ethical Fund Equity Performance

Source: Canadian funds found at http://www.globefund.com (May 29, 1998)

U.S. funds found at http://www.socialinvest.org/sriguide/mfpc.htm (May 29, 1998)

*All information is for the period ending April 30, 1998.

*Fund Name**	*Environment*	*Labour/Employment*	*Products/Service*	*Defense/Weapons*	*ALC./Tob./Gambling*	*Animal Testing*	*Human Rights/Equality*	*Other*
Canadian-Owned Equity Funds								
Ethical Growth	X	X	X	X	X		X	
Ethical Special Equity	X	X	X	X	X		X	
Ethical North American Equity	X	X	X	X	X		X	
Investors Summa	X		X	X	X		X	
lean Environment Equity	X		X					X
Clean Environment International Equity	X		X					X
Desjardins Environment	X		X					X
U.S. - Owned Equity Funds								
Ariel Appreciation Fund	X			X	X			
Ariel Growth Fund	X			X	X			
Bridgeway Fund Social Responsibility Portfolio	X	X	X	X	X	X	X	
Calvert Capital Accumulation Fund	X	X		X	X			
Calvert Social Investment Fund Equity Portfolio	X	X	X	X	X	X	X	
Citizens Emerging Growth Portfolio	X	X	X	X	X	X	X	
Citizens Index Fund - Retail	X	X	X	X	X	X	X	
DEVCAP Shared Return Fund	X	X	X	X	X			
Domini Social Equity Fund	X	X	X	X	X		X	
Dreyfus Third Century Fund	X	X	X	X	X		X	X
Green Century Equity Fund	X	X	X	X	X		X	
Meyers Pride Value Fund		X						X
MMA Praxis-Growth Fund	X	X	X	X	X		X	
Neuberger & Berman Socially Responsive Fund	X	X	X	X	X		X	X
New Alternatives Fund	X	X	X	X	X	X		
Parnassus Fund	X	X	X	X	X		X	
Pax World Growth Fund	X	X	X	X	X			
Rightime Social Awareness Fund	X	X	X	X	X			
Security Social Awareness Fund	X	X	X	X	X		X	
Total Return Utilities Fund	X		X	X	X	X		
Women's Pro-Conscious Equity Mutual Fund	X	X	X	X	X	X	X	

Exhibit 4 Investment Screening Criteria

Source: All information on Canadian-owned funds was complied from the case writers research
All information on U.S.-owned funds was found at http://www.coopamerica.org/mfsc.htm
*All information was last updated on September 30, 1996.

Fund Profile - Ethical Growth Fund

Fund Sponsor:	Ethical Funds Inc.
Portfolio Manager:	Ethical Funds Inc.
Inception Date:	Jan-86
Total Assets:	$818.96 Million
Sales Fee Type:	No Load
Mgmt Expense Ratio:	2.10%
Fund Type:	Canadian Equity
Globe 5 Year Rating:	A+
RRSP Eligibility:	Yes
Min. Initial Investment:	$500.00

Top Holdings (as of March 31, 1998):

Bank of Nova Scotia	4.80%
Magna International Inc	4.60%
Royal Bank of Canada	4.40%
Canadian National Railway Co	4.10%
Suncor Energy Inc	3.80%
Abitibi-Consolidated Inc	2.80%
Bank of Montreal	2.80%
Geac Computer Ltd	2.80%
Laidlaw Inc	2.80%
Nova Corp	2.70%

Returns (as of April 30, 1998):

	Fund	*Index**
1 Year	26.88%	30.35%
3 Year	23.38%	23.85%
5 Year	16.86%	17.65%
10 Year	12.57%	11.82%
3 Year Risk	12.41	12.16
3 Year Beta	0.99	1.00

*Index refers to TSE 300 Total Return

Sector Weightings (as of March 31, 1998):

Financial Services	14.50%
Oil and Gas	12.80%
Industrial Products	11.50%
Transport and Environment	7.40%
Others	5.50%
Gold and Precious Metals	4.30%
Paper and Forest	3.80%
Metals and Minerals	3.70%
Communication and Media	2.30%
Utilities	2.30%

Investment Objective:

The investment objective of this Fund is to maximize long-term capital return by investing in a diversified portfolio consisting primarily of shares of Canadian corporations. The assets of the Fund may from time to time, however, be placed in different classes of assets such as short-term investments, bonds, and debentures.

Exhibit 5 Ethical Growth Fund

Source: http://www.globefund.com (May 29, 1998)

*All figures are in Canadian dollars (C$).

Clean Environment Mutual Funds

This was a Toronto based mutual fund company offering four funds that invested in companies reflecting the concept of sustainable development. These funds included: Clean Environment Equity, Clean Environment International Equity, Clean Environment Balanced and Clean Environment Income. Exhibits 7 and 8 profile the two equity funds in complete detail. President and lead portfolio manager, Ian Ihnatowycz, did not use negative screening, but rather, looked for companies offering unique solutions to today's problems: "We focus on the science underlying the products or service and only buy companies that meet our financial and sustainability criteria."[15] Many of these companies were involved with waste cleanup and were environmental leaders. Ironically, Ihnatowycz also stated, "We don't really consider ourselves ethical funds,"[16] explaining that their primary concern was simply to invest in companies committed to a strong ecological future.

Fund Profile - Ethical North American Equity Fund

Fund Sponsor:	Ethical Funds Inc.
Portfolio Manager:	Ethical Funds Inc.
Inception Date:	Sep-68
Total Assets:	$181.18 Million
Sales Fee Type:	No Load
Mgmt Expense Ratio:	2.47%
Fund Type:	U.S. Equity
Globe 5 Year Rating:	A+
RRSP Eligibility:	Foreign
Min. Initial Investment:	$500.00

Top Holdings (as of March 31, 1998):

	5.00%
Merck & Company Inc	5.00%
Lucent Technologies Inc	4.60%
Bristol-Myers Squibb Common	4.50%
Airtouch Communications	4.30%
Dell Computer Corp	4.20%
Mbna Corp	4.20%
Colgate Palmolive Co	4.00%
Campbell Soup Co	3.80%
Walt Disney Company	3.80%
Home Depot Inc	3.60%

Returns (as of April 30, 1998):

	Fund	*Index**
1 Year	55.14%	44.36%
3 Year	37.33%	34.20%
5 Year	24.45%	26.09%
10 Year	14.78%	20.66%
3 Year Risk	15.42	11.15
3 Year Beta	1.24	1.00

*Index refers to S&P 500 Composite (CAN$)

Sector Weightings (as of March 31, 1998):

Others	63.00%
Financial Services	20.50%
Consumer Products	9.20%
Transport and Environment	5.40%

Investment Objective:

The investment objective of this Fund is to maximize long-term capital return by investing in a diversified portfolio consisting primarily of North American stocks. The assets of the Fund may from time to time, however, be placed in different classes of assets such as bonds, money market securities and debentures.

Exhibit 6 Ethical North American Equity Fund

Source: http://www.globefund.com (May 29, 1998)

*All figures are in Canadian dollars (C$).

Investors Group

Investors Group, the largest mutual fund company in Canada, operated the Investors Summa Fund, profiled in Exhibit 9. The company's only social fund began in 1987 and in 1998 had over $465 million in assets. Fund manager, Allan Brown, also used a 'best-of-sector' approach to picking stocks.[17] After he selected his picks, they were screened for things such as alcohol, tobacco, gambling, military weapons, pornography, environmental issues and repressive regimes. Brown explained that his management team was open to all potential investment opportunities: "We do not exclude any sectors when picking stocks. We want to reward companies for being responsible and trying to improve their ethical standards."[18]

U.S. Ethical Funds

The concept of socially responsible investing has been around for quite awhile in the U.S.[19] The founder of The Pioneer Group, a religious man, used a "sin" test to screen out companies when he started his fund in 1928. There were 24 funds

Fund Profile

Fund Sponsor:	Clean Environment Mutual Funds
Portfolio Manager:	Acuity Investment Management
Inception Date:	Jan-92
Total Assets:	$283.53 Million
Sales Fee Type:	Optional
Mgmt Expense Ratio:	2.88%
Fund Type:	Canadian Equity
Globe 5 Year Rating:	A+
RRSP Eligibility:	Yes
Min. Initial Investment:	$500.00

Top Holdings (as of March 31, 1998):

Ati Technologies Inc	8.80%
Fairfax Financial Holdings Ltd	6.60%
Yogen Fruz World-Wide Inc	6.40%
Geac Computer Ltd	5.20%
Philip Services Corp	4.40%
American Eco Corp	4.00%
Cfm Majestic Inc	3.70%
Zenon Environmental Inc	3.60%
Optus Natural Gas Dist Income Fund	3.10%
Cinram International Inc	2.80%

Returns (as of April 30, 1998):

	Fund	*Index**
1 Year	45.89%	30.35%
3 Year	30.98%	23.85%
5 Year	22.11%	17.65%
10 Year	N/A	11.82%
3 Year Risk	11.70	12.16
3 Year Beta	0.75	1.00

Sector Weightings (as of March 31, 1998):

Industrial Products	37.00%
Transport and Environment	22.00%
Others	14.00%
Financial Services	11.00%
Consumer Products	10.00%
Communication and Media	3.00%
Metals and Minerals	3.00%

*Index refers to TSE 300 Total Return

Investment Objective:

The investment objective of this Fund is to maximize long-term capital appreciation. The Fund will seek to generate strong, reasonably reliable growth of capital over the long-term by investing in equity securities of companies that have outstanding potential for growth. To reduce risk the Fund will invest primarily in a broad selection of equity securities, convertibles and warrants. It is intended that under normal circumstances the Fund will be almost fully invested in these securities. In periods of unusual market conditions, a significant portion of the Fund's assets may be held in cash and cash equivalents.

Exhibit 7 Clean Environment Equity Fund

Source: http://www.globefund.com (May 29, 1998)

*All figures are in Canadian dollars (C$).

in this group, and in 1980, Pioneer added a South African screen. Methodists and Quakers started the Pax World Fund in the 1970s to avoid investments supporting the Vietnam War. The Dreyfus Corporation became the first traditional money-management house to add a socially screened fund in 1972, by developing the Dreyfus Third Century Fund. In addition to avoiding companies that did business in South Africa, the fund also chose to invest in companies that had records of good safety, health and environmental standards, as well as those that supported equal opportunity initiatives. In 1982, the Calvert Group offered both a mutual and a money market fund with a number of thorough social screens. The next few to follow were; the New Alternatives Fund, an energy fund; the Working Assets Money Fund;

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Fund Profile

Fund Sponsor:	Clean Environment Mutual Funds
Portfolio Manager:	Acuity Investment Management
Inception Date:	Nov-93
Total Assets:	$32.38 Million
Sales Fee Type:	Optional
Mgmt Expense Ratio:	2.77%
Fund Type:	International Equity
Globe 5 Year Rating:	N/A
RRSP Eligibility:	Foreign
Min. Initial Investment:	$500.00

Top Holdings (as of March 31, 1998):

Ati Technologies Inc	9.20%
Yogen Fruz World-Wide Inc	7.40%
Scaffold Connection Corp	7.20%
Fairfax Financial Holdings Ltd	6.00%
Dalsa Corp	5.40%
Geac Computer Ltd	5.00%
Open Text Corp	5.00%
Philip Services Corp	4.00%
Laidlaw Environmental Svcs Inc	3.90%
Thermo Electron Corp	2.20%

Returns (as of April 30, 1998):

	Fund	*Index**
1 Year	53.05%	32.55%
3 Year	28.53%	21.77%
5 Year	N/A	19.02%
10 Year	N/A	13.06%
3 Year Risk	13.71	10.47
3 Year Beta	0.54	1.00

*Index refers to MSCI World (CAN$)

Sector Weightings (as of March 31, 1998):

Industrial Products	42.00%
Transport and Environment	18.00%
Others	14.00%
Financial Services	9.00%
Consumer Products	9.00%
Metals and Minerals	5.00%
Communication and Media	2.00%
Utilities	1.00%

Investment Objective:

The investment objective of this Fund is to maximize long-term capital appreciation. The Fund will seek to generate strong, reasonably reliable growth of capital over the long-term by investing in equity securities of companies that have outstanding potential for growth and are located primarily outside of Canada. To reduce risk the Fund will invest primarily in a broad selection of equity securities, convertibles and warrants. It is intended that under normal circumstances the Fund will be almost fully invested in these securities. In periods of unusual market conditions, a significant portion of the Fund's assets may be held in cash and cash equivalents.

Exhibit 8 Clean Environment International Equity Fund

Source: http://www.globefund.com (May 29, 1998)

*All figures are in Canadian dollars (C$).

the Amana Mutual Funds Trust, offering a Muslim screen; and the Ariel Growth Fund, designed by an African-American financial firm. After the mid-1980s, the development of these funds took off, particularly, a trend toward environmentally friendly investment vehicles, and those supporting workers' rights. In 1998, the number of socially responsible funds was growing at a steady pace as investors continued to demand more options within the ethical investing category. Exhibit 10 displays the growth of ethical funds within the U.S. from 1982 to 1997.

The Calvert Group

The Calvert Group provided a large family of funds, which included seven equity funds. Two of these funds, the Calvert Capital Accumulation Fund A, and the Calvert Social Investment Fund Equity Portfolio A, are detailed in Exhibits 11

Fund Profile

Fund Sponsor:	Investors Group
Portfolio Manager:	I.G. Investment Management Ltd.
Inception Date:	Jan-87
Total Assets:	$465.30 Million
Sales Fee Type:	Both
Mgmt Expense Ratio:	2.48%
Fund Type:	Canadian Equity
Globe 5 Year Rating:	A+
RRSP Eligibility:	Yes
Min. Initial Investment:	$1,000.00

Top Holdings (as of March 31, 1998):

Bank Of Montreal	6.70%
Royal Bank Of Canada	3.80%
Toronto Dominion Bank	3.80%
Cibc Common	3.70%
Yogen Fruz World-Wide Inc	3.00%
Nokia Corp	2.90%
Petro-Canada	2.50%
Aflac Inc	2.10%
Edperbrascan Corp	2.10%
Boardwalk Equities Inc	2.00%

Returns (as of April 30, 1998):

	Fund	*Index**
1 Year	39.53%	30.35%
3 Year	27.53%	23.85%
5 Year	18.44%	17.65%
10 Year	12.21%	11.82%
3 Year Risk	10.09	12.16
3 Year Beta	0.75	1.00

*Index refers to TSE 300 Total Return

Sector Weightings (as of March 31, 1998):

Financial Services	24.30%
Industrial Products	14.40%
Consumer Products	9.50%
Real Estate and Construction	7.00%
Oil and Gas	6.50%
Merchandising	4.90%
Utilities	4.80%
Communication and Media	4.10%
Transport and Environment	4.00%
Gold and Precious Metals	3.30%

Investment Objective:

The Fund's principle objective is long-term capital growth with moderate income generation. The Fund intends to invest primarily in common shares of Canadian corporations. In addition, investments other than common shares and securities convertible into common shares like rights and warrants will be included in the Fund's portfolio where such investments provide a valuable supplement to the Fund's holdings. These investments may include, but are not limited to, preferred shares and interest bearing investments such as bonds and money market instruments like commercial paper issued by corporations and government issued treasury bills. The Fund may invest in companies which are socially responsible and have adopted progressive standards and practices illustrative of an awareness towards economic, social and environmental issues.

Exhibit 9 Investors Summa Fund

Source: http://www.globefund.com (May 29, 1998)

*All figures are in Canadian dollars (C$).

and 12, respectively. Created in 1982, The Calvert Social Investment Funds, employed a group of social researchers to conduct a 'social audit' to determine the impact of a prospective investment. Using many of the same criteria as other similar funds, this fund focused on choosing stocks that supported the 'quality of life.' Investments in these funds included household names like; Microsoft, Hewlett-Packard, Disney, Kellogg, Polaroid, BankAmerica and Whirlpool. Financially attractive investment opportunities were identified first, and then examined to determine the suitability of their inclusion in these funds.

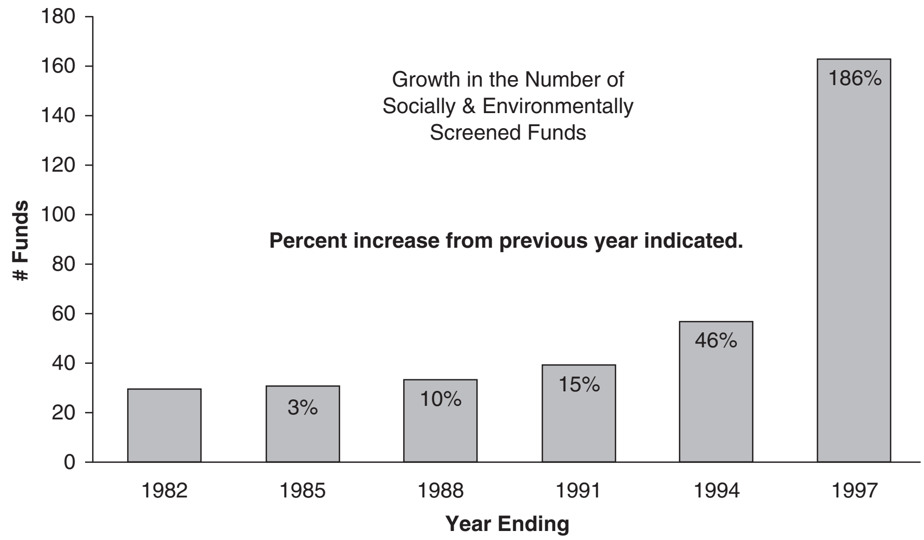

Exhibit 10 Growth Of U.S. Ethical Funds

Source: http://www.goodmoney.com/fundsgrow.htm

Fund Profile			
Fund Sponsor:	Calvert Group	**Top Holdings:**	
Portfolio Manager:	Eddie Brown		
Inception Date:	Oct-94	Home Depot Inc	4.47%
Total Assets:	$70.50 Million	Cisco Sys Inc	4.25%
Max. Sales Fee:	4.75%	Cardinal Health Inc	3.95%
Mgmt Expense Ratio:	1.96%	Carnival Corp	3.88%
Fund Type:	U.S. Equity	Chase Manhattan Corp	3.65%
RRSP Eligibility:	Foreign	Autozone Inc	3.43%
Min. Initial Investment:	$2,000.00	Price T Rowe & Associates	3.20%
Category:	Mid Cap (MID)	Networks Assocs Inc	3.06%
		Alza Corp Del	2.95%
		Mcn Energy Group Inc	2.95%
Returns (as of April 30, 1998):			
1 Year	48.73%	**Sector Weightings:**	
3 Year	25.69%		
5 Year	N/A	Utilities	24.53%
10 Year	N/A	Cap. Goods & Tech.	21.81%
Beta	1.35	Consumer Non-Cyclicals	16.23%
		Finance	16.10%
		Consumer Cyclicals	10.05%
		Basic Industries	4.91%
		Miscellaneous	3.43%
		Transportation	2.95%

Exhibit 11 Calvert Capital Accumulation Fund A

Source: http://www.findafund.com (May 30, 1998)
http://www.socialinvest.org/sriguide/mfpc.htm (May 29, 1998)
*All figures are in U.S. dollars (US$)

Fund Profile

Fund Sponsor:	Calvert Group	**Top Holdings:**	
Portfolio Manager:	Loomis Sayles & Co.		
Inception Date:	Aug-87	Sbc Communications Inc	5.02%
Total Assets:	$166.70 Million	Albertsons Inc	3.78%
Max. Sales Fee:	4.75%	Computer Assoc Intl Inc	3.73%
Mgmt Expense Ratio:	1.21%	Federated Dept Stores	3.72%
Fund Type:	U.S. Equity	General Nutrition Cos	3.56%
RRSP Eligibility:	Foreign	American Greetings Corp	3.42%
Min. Initial Investment:	$1,000.00	Dover Corp	3.20%
Category:	Growth - Domestic (GRD)	Symantec Corp	2.98%
		Ameritech Corp	2.95%
		Black & Decker Corp	2.93%
Returns (as of April 30, 1998):			
1 Year	30.53%	**Sector Weightings:**	
3 Year	23.33%		
5 Year	12.65%	Cap. Goods & Tech.	17.99%
10 Year	11.39%	Utilities	13.81%
Beta	0.93	Consumer Non-Cyclicals	13.67%
		Consumer Cyclicals	12.85%
		Basic Industries	12.41%
		Finance	10.01%
		Transportation	9.27%
		Miscellaneous	8.37%
		Energy	1.63%

Exhibit 12 Calvert Social Investment Fund Equity Portfolio A

Source: http://www.findafund.com (May 30, 1998)

http://www.socialinvest.org/sriguide/mfpc.htm (May 29, 1998)

*All figures are in U.S. dollars (US$).

Management stayed actively involved with the companies it had selected. Company management was engaged in dialogue with each corporation, sending numerous letters and holding meetings. When necessary, resolutions were voted on at annual shareholder meetings, at which time participants could elect to divest. In this way, Calvert representatives acted as advocates for higher social and environmental practices.

The Dreyfus Corporation

The Dreyfus Corporation was one of the oldest and largest mutual fund companies in the U.S. It was primarily an investment adviser or administrator for more than 150 mutual fund portfolios. The Dreyfus Third Century Fund (Exhibit 13) was a capital growth oriented fund concerned with the enhancement of the quality of life in America. As of April 30, 1998, net assets were nearly US$900 million and the one-year return was 40.48 per cent. The fund screened for investments that did not involve weapons, alcohol, tobacco, gambling or unsafe products. The fund also looked for companies with good environmental practices and labor relations.

Domini Social Investments

Domini Social Investments offered two socially responsible investment products; the

Fund Profile

Fund Sponsor:	The Dreyfus Corporation	**Top Holdings:**	
Portfolio Manager:	Maceo K. Sloan		
Inception Date:	Mar-72	Federal Natl Mtg Assn	3.56%
Total Assets:	$899.70 Million	Colgate Palmolive Co	3.33%
Max. Sales Fee:	No Load	Cisco Sys Inc	3.31%
Mgmt Expense Ratio:	1.03%	Merck & Co Inc	3.25%
Fund Type:	U.S. Equity	Bmc Software Inc	3.20%
RRSP Eligibility:	Foreign	Medtronic Inc	3.13%
Min. Initial Investment:	$2,500.00	Bristol Myers Squibb Co	2.96%
Category:	Growth - Domestic (GRD)	Guidant Corp	2.92%
		Allstate Corp	2.69%
		Sunamerica Inc	2.66%
Returns (as of April 30, 1998):			
1 Year	40.48%	**Sector Weightings:**	
3 Year	31.79%		
5 Year	20.03%	Finance	23.06%
10 Year	16.55%	Consumer Non-Cyclicals	20.29%
Beta	1.11	Cap. Goods & Tech.	20.21%
		Basic Industries	13.00%
		Utilities	11.30%
		Transportation	5.09%
		Energy	3.60%
		Consumer Cyclicals	3.46%

Exhibit 13 Dreyfus Third Century Fund

Source: http://www.findafund.com (May 30, 1998)

http://www.socialinvest.org/sriguide/mfpc.htm (May 29, 1998)

*All figures are in U.S. dollars (US$).

Domini Social Equity Fund (Exhibit 14), and the Domini Money Market Account. The Domini Social Equity Fund sought to provide long-term capital appreciation from a diversified equity portfolio of socially screened companies. The fund was an index fund, which held the 400 stocks that make up the Domini Social Index. Although the fund sought to match the index, its performance typically fell short by a small percentage due to operating costs. The fund included companies with records of good community involvement, the environment, employee relations and hiring practices. It also avoided those companies involved with alcohol, tobacco, gambling, nuclear power and weapons contracting. The social objectives of the fund were advanced by proxy voting, by filing shareholder resolutions and by maintaining constant communication with the chosen corporations.

Praxis Funds

Ranked in the top one-third of U.S. mutual funds in 1997, the four-year-old Praxis Funds was considering moving north to become Canada's first religiously based mutual fund. This group included three funds; an international fund, a growth fund and an income fund. These funds used a variety of Mennonite screens to sort out nondesirables, and looked for corporations involved in health care, housing, food and education.[20] As of April 30, 1998, the MMA

Fund Profile - Domini Social Equity Fund			
Fund Sponsor:	Kinder, Lyndenberg, Domini & Co.	**Top Holdings:**	
Portfolio Manager:	Team Managed		
Inception Date:	Jun-91		
Total Assets:	$397.50 Million		
Max. Sales Fee:	No Load		Not available
Mgmt Expense Ratio:	0.98%		
Fund Type:	U.S. Equity		
RRSP Eligibility:	Foreign		
Min. Initial Investment:	$1,000.00		
Category:	Growth - Domestic (GRD)		
Returns (as of April 30, 1998):			
1 Year	40.59%	**Sector Weightings:**	
3 Year	31.79%		
5 Year	22.49%		
10 Year	N/A		
Beta	1.04		Not available

Exhibit 14 Domini Social Equity Fund

Source: http://www.findafund.com (May 30, 1998)

http://www.socialinvest.org/sriguide/mfpc.htm (May 29, 1998)

*All figures are in U.S. dollars (US$).

Praxis-Growth Fund (Exhibit 15) had assets totalling US$132 million.

Ethical Funds—The Debate

As a fairly new investment practice, ethical investing was still undergoing a great deal of research and debate regarding its ultimate impact, as well as the level of returns and relative performance.

It was argued that an obvious benefit for a company with a public image of being environmentally friendly, or 'ethical,' was the resulting public goodwill, which had the potential to boost profits. Another argument in favor of ethical screening was that ethical companies might be more efficient. These companies could be expected to produce less waste, to have a more motivated and productive workforce, and to avoid law suits and bad publicity. Ethical firms also had established new industries or technologies that redesigned processes, used alternative techniques, preserved, reduced and recycled materials, and reduced pollution.

Ethical investments were sometimes based on smaller sized companies for two reasons. First, many large companies were eliminated because of their poor social records or unacceptable practices. Second, many small and emerging companies were those identified for their conscientious developments and re-engineered processes. Smaller companies often provided more room for potential growth, as well as adaptability to political and social changes. On the other hand, smaller firms were often more sensitive to economic swings.

The most common argument against ethical investing was that by applying screens to stock selection, fund managers were constrained in picking securities and could not choose stocks that would yield the highest returns. Diversification objectives could be impaired if a manager was limited to certain stocks and not others.

Fund Profile - MMA Praxis-Growth Fund

Fund Sponsor:	Mennonite Mutual Aid	**Top Holdings:**	
Portfolio Manager:	Keith Yoder		
Inception Date:	Jan-94	Thomas & Betts Corp	3.75%
Total Assets:	$132 Million	Sbc Communications Inc	3.68%
Max. Sales Fee:	No Load	Alza Corp Del	3.64%
Mgmt Expense Ratio:	1.75%	Boston Scientific Inc	3.59%
Fund Type:	U.S. Equity	Williams Cos Inc Del	3.46%
RRSP Eligibility:	Foreign	Albertsons Inc	3.33%
Min. Initial Investment:	$500.00	First Data Corp	2.93%
Category:	Growth - Domestic (GRD)	Johnson & Johnson	2.91%
		Deere & Co	2.90%
		Lowes Cos Inc	2.85%
Returns (as of April 30, 1998):			
1 Year	37.70%	**Sector Weightings:**	
3 Year	26.16%		
5 Year	N/A	Consumer Non-Cyclicals	25.10%
10 Year	N/A	Utilities	17.08%
Beta	0.79	Finance	17.07%
		Transportation	10.82%
		Basic Industries	8.48%
		Energy	7.22%
		Consumer Cyclicals	4.38%
		Miscellaneous	4.05%
		Cap. Goods & Tech.	3.86%
		Non U.S.	1.93%

Exhibit 15 MMA Praxis-Growth Fund

Source: http://www.findafund.com (May 30, 1998)

http://www.socialinvest.org/sriguide/mfpc.htm (May 29, 1998)

*All figures are in U.S. dollars (US$)

Another common concern of suspicious investors related to the level of research and monitoring required to select and manage an ethical fund. This additional effort could come with a price tag attached in the form of higher management expense ratios. Given the extra work required of ethical fund managers, there was also concern that they might lose sight of the financial outlook for each company, while finding themselves wrapped up in ethical debates and controversial discussion.

Some critics were particularly worried about the additional risk created by potential ethical crises. Top-rated ethical companies could be downgraded in anticipation of bad publicity relating to an accident, debatable practice, or destructive product. Investors could lose money, if an 'ethical' company came under heavy investigation. Most ethical funds would sell off the same company under such circumstances, accentuating the drop in share price.

Investors that chose socially responsible funds wanted their money to form part of a solution and to be a catalyst for social change. Critics complained that these funds did not actually advance the causes they supported because mutual funds themselves did not affect the value of a company. The transfer of shares of stock in the open market, it has been argued, did not help or hinder a company's ability to raise additional capital. There was no question, however, that when investors worked together with other concerned parties, such as socially-aware consumers, unions, religious organizations and social activists, change could happen. The South African experience of the end of apartheid was used as an example of what could be accomplished. By refusing to support the South African economy, social groups, political groups and investors were able to instigate substantial change.

The Stevensons—The Debate Continues

We know in our complex economic system it's impossible to be absolutely pure. We do our best, but we recognize there are always grey areas.

—John Liechy,
President of Praxis Funds[21]

If they were to go ahead with making an ethical equity investment, the next decision for Ian and Beth Stevenson would be to determine which companies to invest with, and which fund would best meet their objectives. Ian had already gathered some information to help them with their decisions. Exhibits 5 to 9 outline the Canadian-owned funds, and Exhibits 10 to 15 outline the U.S.-owned funds that they could select from. Exhibits 16 and 17 break down the top 15 holdings of the S&P 500 and TSE 300, respectively.

Beth looked confused and turned to Ian,

> It does sound as though these funds offer comparable returns, but I still have a number of questions. What about RRSP eligibility? And what if we determine that a U.S. fund is the best choice? If we are going to call ourselves ethical investors, is it ethical for us to invest in another country's companies rather than our own?
>
> Besides, I am not even sure what I consider to be ethical. It's true that a company like Walt Disney Co. has an excellent reputation as an employer, but what about some of the violence in the movies they produce?[22] Or what about nuclear power plants? A significant portion of our electricity is nuclear power generated, but it is extremely destructive to the environment, not to mention dangerous. Or what about Microsoft? They're a great company and many funds carry the company in their portfolio, but what about all the anti-competition law suits that are pending? Should we avoid these things, or are some things a necessary evil?

Top 15 Company Weights (as of April 30, 1998)	
General Electric Common	3.2%
Microsoft Corp Common	2.5%
Coca Cola Co Common	2.2%
Exxon Corp Common	2.1%
Pfizer Inc Common Cum Rts	1.7%
Merck & Co Inc Common	1.6%
Intel Corp Common	1.5%
Royal Dutch Pete Nlg1.25 (ny Regd)	1.4%
Wal-Mart Stores Inc Common	1.3%
Ibm Common	1.3%
Procter & Gamble Co Common	1.3%
Bristol Myers Squibb Common	1.2%
Lucent Technologies Common	1.1%
AT&T Corp Common	1.1%
Johnson & Johnson Common	1.1%

Exhibit 16 S&P 500

Source: 1998 Portfolio Analytics Limited (Pal Trak).

Top 15 Company Weights (as of April 30, 1998)	
Bce Inc Common	6.3%
Royal Bk Cda Common	4.3%
Northern Telecom Ltd Common	3.6%
CIBC Common	3.4%
Bank of Montreal Common	3.3%
Toronto Dominion Bk Common	3.1%
Bank of Nova Scotia Common	3.1%
Cdn Pacific Ltd Common	2.3%
Seagram Common	2.2%
Barrick Gold Corp Common	1.9%
Alcan Aluminium Common	1.7%
Newcourt Credit Grp Common	1.6%
Bombardier Inc Class B Sub Vtg	1.6%
Canadian Natl Ry Co Common	1.3%
Magna Intl Inc Class A Sv	1.2%

Exhibit 17 TSE 300

Source: 1998 Portfolio Analytics Limited (Pal Trak).

Ian nodded in agreement with his wife; there were still a number of things to consider before they made an investment. He couldn't ignore the feeling, however, that they should be using their money to help create a future that they could be comfortable with, both financially and socially.

Notes

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The Rent-to-Own Industry

Doug Schuler

Gerry Keim

 Version: (A) 2004–11–23

Rhonda Ward[1] was devastated as she read her morning paper on September 22, 1993. As director of public and governmental affairs for the Association of Progressive Rental Organizations, the main trade association for the rent-to-own (RTO) industry, she was in charge of monitoring events concerning the industry, providing information to the public, following the regulatory events and planning governmental lobbying strategies. Ward knew, sipping her coffee, that today's article in the *Wall Street Journal* would pose challenges for her in the days and months to come.

The Rent-to-Own Industry

RTO was a $4 billion-dollar industry in 1993. There were about 7,500 stores across the United States that rented furniture, appliances, electronic goods and similar products to over 3.5 million households. The industry experienced rapid growth in the early and mid-1980s, but this rate had slowed over the past five years.

About 70 per cent of the firms in the RTO industry were small, either being single shops or part of a group of five or fewer shops. But there were also large companies involved in the RTO business; approximately 20 firms were responsible for about 60 per cent of the industry sales.[2] Rent-A-Center was the largest company, with over 1,000 stores and about $600 million in revenues in 1992. Exhibit 1 lists the principal RTO companies in the United States.

The service that RTO firms offered is the rental of a consumer good, with some option of ownership. This arrangement is similar to the British hire-purchase agreement, traditionally used as a way for lower middle class individuals to finance purchases of consumer goods. Typically, rentals were weekly, bimonthly and monthly, with weekly being the most popular. Customers did not incur debt upon renting the product, they simply "pay as they go." If consumers do not desire the product, they can return it to the RTO firm with no obligation. For people who desired the use of, for example, a large screen television for a week or a month, a RTO transaction may be more convenient than buying. Industry surveys indicated that 75 per cent of customers did not pursue ownership (although industry critics state that this figure is misleading because of rewritten rental contracts. The critics estimate that about 60 per cent of RTO customers pursue ownership.[3]), returning the rented item in less than four months.[4] Additionally, the RTO companies would deliver and install the product, repair it if necessary, and provided a loaner or replace the product if a repair cannot be made.[5]

Company	*Annual Sales*	*Employees*
Rent-A-Center	$600 M	5,000
RTO, Inc.	160 M	800
Aaron's Rentals, Inc.	145 M	1,400
REMCO American, Inc.	70 M	500
Colortyme	60 M	37
DEF Investments, Inc.	43 M	560
UCR, Inc.	36 M	540
WBC Holding, Inc.	30 M	295
Action TV & Appliance Rental	21 M	225
Racord, Inc.	12 M	160

Exhibit 1 Principal Rent-To-Own Companies in the United States, 1993

Source: David L. Ramp. Report on Dominant National and Regional Rent-to-Own Dealers in the United States. Submitted to the U.S. House of Representatives, Committee on Banking, Finance & Urban Affairs. April 6, 1993.

Note: This list does not include Magic Rentals, a subsidiary of Transamerica, which has about 300 stores nationwide, and had assets valued by Transamerica of $141.2 million at 1991.

But customers paid a price for these options. If the total amount of the payments required for ownership was summed, the annual effective interest rates typically exceeded 100 per cent and could be as high as 200 per cent to 300 per cent. For example, at Rent-A-Center, a television that had a suggested retail price of $299 had a rental price of $11.70 per week for 78 weeks and totalled $920.10 to own, an effective annual interest rate of 200 per cent.[6] See Exhibit 2 for a sample of rental rates. The promise of ownership could be costly. Says industry critic Congressman Henry Gonzalez (Democrat-Texas), "Through rent-to-own, a poor woman pays $1,200 for a $400 television set that a rich man can buy on credit for $450."[7] Furthermore, many of these customers are often educationally disadvantaged and may not fully understand the terms of the rental.[8]

An RTO store calculated a monthly balance on rent (BOR). The BOR was the monthly average of the number of units rented. A typical RTO store would have 500 to 600 units rented, with a range of 50 to over 3,000 units in a few stores in large cities. The average income per unit was between

$55 and $60 per unit per month. This was slightly lower than the figure in the mid-1980s, when $60 to $62 was the average income per unit. Theft of inventory was a problem for RTO stores; about 12 per cent of a rental dealer's inventory could be expected to be stolen each year.[9]

The most typical goods rented are: 1) furniture (30 per cent of total units on rent); 2) appliances (24 per cent); 3) TVs (19 per cent); 4) VCRs (11 per cent); and stereos (nine per cent). Other items rented include jewelry, pagers, home entertainment centres, exercise equipment and air conditioners, among others.

The industry claimed that it does not prey on the poor.[10] According to the industry, a typical customer of a RTO firm is an unmarried, single mother of two earning $20,000, or a newly married couple under the age of 35 with one or no children, and a median income of $30,000.[11] Critics state that these figures are highly inflated and that the poor and nearly-poor make up the vast majority of RTO customers.[12] Furthermore, according to Walter Gates, chairman and CEO of Thorn EMI Rental Americas, the real family income for the rental-purchase segment's core customers has and would continue to shrink in the foreseeable future.[13] The average renter would spend $1,075 annually for rental products.[14] Most of the customers lived near the RTO store; the industry's trade association estimated that 80 per cent of a store's business would be done with customers who live within a three-to-five-mile radius of the store.[15]

At most RTO operations there was a limited, if any, credit check. Rent-A-Center simply verified the residence given, the source of income and contacted one or two of the six references a customer is required to provide.[16] See Exhibit 3 for a typical RTO application.

The Wall Street Journal Article[17]

The *Journal's* article was a sweeping indictment of the RTO industry, through the investigation of the industry's largest player, Rent-A-Center, a subsidiary of Thorn-EMI PLC. Rent-A-Center is the largest player in the RTO industry and is Thorn's most profitable subsidiary and its largest contributor to operating profit.

Much of Rent-A-Center's growth comes from high pressure sales. "Upselling," which involves talking customers into more than they had originally wanted to rent, and aggressive closing tactics are commonplace. Scrambling to meet ambitious sales targets, employees routinely encourage unsophisticated buyers to rent more goods than they can afford. Says a former store manager, "Even if a customer can't afford it and you know it and they know it, we'll rent to them anyway." Sales pressures are particularly intense during holidays and around welfare-cheque day.

Despite the healthy profits made in renters fulfiling contracts (see the section above and Exhibit 2), this is not where Rent-A-Center

	New/Used	*Cash Price*	*Pmt/Period*	*No. Pmts.*	*Total Pmts.*	*Est. APR*
Product						
Washing Machine	Used	$150	$40.00	18	$720.00	315%
Refrigerator	New	$862	$22.99	78	$1,793.22	185%
TV	New	$550	$42.99	18	$773.82	46%
TV	Used	$200	$12.99	52	$675.48	323%
Refrigerator	Used	$700	$20.00	78	$1,560.00	125%

Exhibit 2 Sample Rates of Rent-to-Own

Source: U.S. Public Interest Research Group, Rent-to-Own Survey, 1993.

REMCO

The Goaheadandgetit Store.

FOR OFFICE USE ONLY

Date ________________ Time ____________ am / pm

Del. Date ______________________________

Del. Time ______________________________

Taken By ______________________________

Verified By # 1: __________ Verified By # 2I __________

Cust. Code ______________________________

Prod. Code ______________________________

Rates Quoted Mo. ____________ Wk. ____________

Terms ______________________________

Unit # ______________________________

CHECK ALL THAT APPLY

☐ **NEW** ☐ **MONTHLY** ☐ **PHONE-IN**

☐ **RENTAL RETURN** ☐ **WEEKLY** ☐ **WALK-IN**

DELIVERY/INSTALLATION INSTRUCTIONS

Rent ____________

Del. & Proc. ____________

Waiver ____________

Total C.O.D. ____________

Next Due Date ____________

Key Map # ____________

DELIVERY INSTRUCTIONS

Employment Code: ☐ Blue Collar ☐ White Collar ☐ Medical ☐ Domestic ☐ Sales ☐ Clerical ☐ Unemployment

Residence: ☐ Renting ☐ Own Home

Marital Status: ☐ Married ☐ Single

Race: ☐ White ☐ Black ☐ Hispanic ☐ Other

Sex: ☐ Male ☐ Female

Age: ________________

Monthly Income: ☐ 1 = less than $700 ☐ 2 = $701-1,000 ☐ 3 = $1,001-1,250 ☐ 4 = $1,251-1,666 ☐ 5 = $1,667-2,000 ☐ 6 = $2,001-2,500 ☐ 7 = $2,501 +

How Ordered: ☐ 1 = TV ☐ 2 = Radio ☐ 3 = Yellow Pages ☐ 4 = Flyers ☐ 5 = Other

Customer Type: ☐ 1 = New ☐ 2 = Repeat Customer ☐ 3 = Referral

Waiver: ☐ Yes ☐ No

Promo Code: AC = Advo Coupon CN = Store Coupon DM = Direct Mail FL = Flyer GV = Grapevine MA = Mailer NP = Newspaper RF = Referral Freetime RA = Radio TV = Television

SMOOTH START

My name is ________________ I'd like to ask you a few questions about the services Remco has provided you so far:

Product:

Did we . . .

- Deliver your product? ☐ YES ☐ NO
- Do it on time? ☐ YES ☐ NO
- Have it clean and in good working order? ☐ YES ☐ NO
- Give you the Owner's Manual? ☐ YES ☐ NO
- Give you the Accessories? ☐ YES ☐ NO
- Demonstrate the product? ☐ YES ☐ NO

Other:

Did we: . . .

- Explain the Agreement? ☐ YES ☐ NO
- Satisfy you with our services ☐ YES ☐ NO
- Do you have any questions? ☐ YES ☐ NO

Again, my name is ________________. and I really appreciate you doing business with us. Should you have any questions, or need anything else, please call me at ________________. We'll be happy to help you in any way that we can.

Actions Needed: ______________________________

Actions Taken: ______________________________

Date: ________________ Call made by: ________________

NOTES

Exhibit 3 Sample Rent-to-Own Application makes most of its profits. The big money is made in repossession: items that are rented, repossessed and then re-rented, can really make a lot of money for Rent-A-Center: in California, a $179 VCR brought in over $5,000 in a five year period. It is estimated that three out of four Rent-A-Center customers have items repossessed.

Given the tremendous profit potential, the "repo-man" is a regular part of Rent-A-Center's strategy: they will use phone calls, door knocking and intimidation to repossess items. Allegations of physical and psychological abuse are rampant. One Rent-A-Center employee dressed up in a Cookie Monster outfit on Halloween night, knocked on the door of a customer, and when they opened the door, barged into the house to repossess the rented merchandise. Reports were made of "couch payments," illicit sexual favors solicited by Rent-A-Center employees in exchange for a rental obligation. Rent-A-Center also fully employs the legal system to get liens on its delinquent customers' pay cheques, alimony or welfare cheques.

For low-income customers, however, Rent-A-Center has tremendous appeal. The chain gives them immediate use of brand name merchandise with no future obligations and the weekly payments are usually less than $20. Many of the customers are unemployed and on governmental assistance and are usually denied more traditional credit sources. As one store-owner put it, "They can't get a Sears card."

A similar industry tale comes from *Forbes*[18] in 1987: Many of Rent-A-Center's poor customers understand they're getting poorer. But given their financial standing, the point is academic. "Sure, you can get stuff for a lot cheaper if you've got the money outright," said customer Vernon Smith, a 26-year-old garbage truck driver in Wichita. But the father of three doesn't have the money. Why not just save $9.95 a week for 25 weeks and then go pay cash for a television set? With a sigh of resignation, Smith explained that he wanted the merchandise immediately and he didn't want anybody hassling him about creditworthiness.

Enter Henry Gonzalez

While the sensationalized stories from the *Journal* brought tremendous public attention on the industry, the RTO industry had been under the watchful eye of House Banking Committee Chairman Henry Gonzalez for some time (see Exhibit 4). In March of 1993, Gonzalez called for hearings on the RTO industry, which were attended by industry representatives, state governments and consumer advocates.

Gonzalez introduced H.R. 3136, the "Rent-to-own Protection Act," into the House Committee on Banking on September 27, 1993, only five days after the *Journal's* article. This legislation would classify rent-to-own transactions as credit sales. The bill started with the findings of the March hearings on the industry, in which Gonzalez noted that RTO firms targeted low income and minority neighborhoods, that the majority of customers who entered RTO contracts did so as a means of financing their purchase, and that there existed a lack of disclosure on payment and collection practices and no protection for consumers similar to retail installment sales laws at the state and federal levels.

The most important aspect of the Gonzalez bill was its specification of a limit on the interest rate which an RTO firm could charge (Section 1004). Credit sales were regulated by the federal and state governments, and most states had capped interest rates at about 20 per cent maximum per year. In general, the limit of interest depended upon the maximum allowed by state usury laws on installment sales plus a reasonable markup for some of the services that the RTO firms performed for their customers. Furthermore, the bill made RTO transactions comply with federal credit laws, including the Truth in Lending Act, the Equal Credit Opportunity Act, the Fair Debt Collection Practices Act, and the Fair Credit Reporting Act.

The Gonzalez bill also put a prohibition upon aggressive repossession techniques and made violations subject to fine. Additionally, the bill

Democrats	*Republicans*	*Independent*
Kennedy (Chair-Subcommittee) Gonzalez (Chair-Committee) LaRocco Gutierrez Rush Roybal-Allard Barrett Furse Velazquez Wynn Fields Watt Hinchey Kanjorski Flake Waters Maloney Deutsch	McCandless Castle King Pryce Linder Knollenberg Bereuter Thomas Lazio Grams Bachus Huffington	Sanders

Exhibit 4 Membership of the U.S. House Of Representatives Committee on Banking, Finance & Urban Affairs, Subcommittee on Consumer Credit and Insurance (1993)

Source: Commerce Clearing House, Inc. September, 24, 1993.

required full disclosure of terms such as the cash price, the total amount of payments required for ownership and all additional costs and fees.

Parallel legislation was introduced by Senators Metzenbaum (Democrat-Ohio) and Durenberger (Republican-Minnesota) in the Senate (as Section 1566) on October 19, 1993.

The Consumer Credit System and Government Regulation

Consumer Credit

Banks, finance companies, credit unions, savings institutions, and retailers provide the majority of consumer credit. Almost 50 per cent of consumer loans are provided through banks and about 20 per cent through credit companies.[19]

A bank makes money by making loans to "good" customers. Of course, choosing good customers is not easy. Therefore, a priori, banks will screen potential borrowers with a number of criteria. Typically, banks will ask about employment, residence, and credit history. Exhibit 5 contains a consumer credit application from a major bank. The bank will "score" the applicant; enough satisfactory responses and the bank will judge that the applicant has the probability of making good on the loan. Applicants below the benchmark are denied loans.

Theoretically, a bank will make a loan to any individual if it correctly knows the risk profile of the applicant. A low risk individual will pay a relatively low interest rate, while a higher risk individual will pay a higher interest rate. If the bank can judge the situation correctly, it can make profits. However, banks generally will not make high-interest loans because they expect that it encourages very risky applicants.

Empirically, this seems to be the case. While the banking system provides credit to millions of customers, many individuals cannot qualify for credit through these channels. Manufacturer estimates indicate that about one third of the adult American population does not have

APPENDIX 4
Sample Bank Application for a Consumer Credit Loan

Consumer Loan Application

PLEASE TELL US ABOUT YOUR LOAN REQUEST

☐ AUTO ☐ NEW PURCHASE PRICE$ ________
☐ BOAT ☐ USED DOWN PAYMENT$ _________
☐ OTHER ________________________________
☐ SECURED ☐ UNSECURED

☐ INDIVIDUAL APPLICATION
☐ JOINT APPLICATION

DAY OF MONTH PREFERRED FOR PAYMENT (Circle One) 1 6 11 16

REPAYMENT TERM PREFERRED 21 26

SPECIFIC PURPOSE COLLATERAL (IF SECURED)

AMOUNT REQUESTED $

ONEPLUS ☐ YES ☐ NO

WHERE DID YOU HERE ABOUT US? ☐ TV ☐ BILLBOARD ☐ DIRECT MAIL ☐ NEWSPAPER/MAGAZINE ☐ RADIO ☐ FRIEND/RELATIVE ☐ OTHER SPECIFY________________________________

YOURSELF

NAME(FIRST, MIDDLE, LAST) | BIRTHDATE | SOCIAL SECURITY NO. | U.S. CITIZEN OR RESIDENT ALIEN ☐ YES ☐ NO | ☐ UNMARRIED* ☐ MARRIED ☐ SEPARATED

ADDRESS (STREET, APT, #) | CITY | STATE | ZIP | ☐ OWN ☐ LIVE W/RELATIVES ☐ RENT ☐ OTHER SPECIFY ____________

HOME PHONE NO. | YEARS/MONTHS AT PRESENT ADDRESS | MONTHLY RENT OR PAYMENT | PREVIOUS ADDRESS (IF CURRENT IS LESS THAN 2 YRS.)

NAME AND ADDRESS OF NEAREST RELATIVE NOT AT YOUR ADDRESS | RELATION TO YOU | RELATIVES PHONE NO.

NAME AND ADDRESS OF YOUR EMPLOYER (IF APPLICABLE, INDICATE: STUDENT, RETIRED, HOMEMAKER, ETC.) | TYPE OF BUSINESS | BUSINESS PHONE NO.

POSITION/TITLE | LENGTH OF EMPLOYMENT | GROSS SALARY ☐ ANNUALLY ☐ MONTHLY ☐ WEEKLY

NAME & ADDRESS OF PREVIOUS EMPLOYER (IF CURRENT IS LESS THAN 2 YRS.) | POSITION/TITLE | LENGTH OF EMPLOYMENT

SOURCES OF OTHER INCOME AND MONTHLY AMOUNTS**

*Includes single, divorced and widowed.
**OPTIONAL: Alimony, child support, or separate maintenance Income need not be revealed if you do not wish to have it considered as a basis for repaying this obligation.
If revealed, indicate if received under: ☐ Court Order ☐ Written Agreement ☐ Oral Understanding

YOUR BANKING RELATIONSHIPS CHECK ALL THAT APPLY

DO YOU HAVE A BANK ACCOUNT?
☐ CHECKING ☐ SAVINGS ☐ OTHER SPECIFY: ____________________

OTHER FINANCIAL INSTITUTIONS? SPECIFY: ______________________
☐ CHECKING ☐ SAVINGS ☐ OTHER SPECIFY: ______________________

YOUR CREDIT REFERENCES CHECK ALL THAT APPLY

☐ MAJOR CREDIT CARDS (MASTERCARD, VISA, AMEX, DINER'S DISCOVER, ETC.)
☐ RETAIL STORES (SEARS, MONTGOMERY, ETC.)
☐ GAS & OTHER CARDS
☐ MANUFACTURER'S FINANCE COMPANY LOANS (GMAC, FORD, ETC.)
☐ OTHER FINANCE COMPANY LOANS (BENEFICIAL, TRANSAMERICA, ETC.)
☐ LOANS & OTHER INDEBTEDNESS* (PLEASE PROVIDE DETAILS BELOW)

*DETAILS FOR LOANS & OTHER INDEBTEDNESS (INCLUDE ALIMONY/CHILD SUPPORT)

BANK/CREDITOR	TYPE OF LOAN	MONTHLY AMOUNT	BALANCE

ALL APPLICANTS

☐ YES, I AUTHORIZE BANK NA TO AUTOMATICALLY DEBIT THE LISTED DEPOSIT ACCOUNT EACH MONTH IN THE AMOUNT OF THE PAYMENT DUE.
DEPOSIT ACCT. NO. ______________________________

HAVE YOU DECLARED BANKRUPTCY, OR HAS AN INVOLUNTARY PETITION BEEN FILED AGAINST YOU IN THE LAST 10 YEARS? ☐ YES ☐ NO

DO YOU HAVE ANY OUTSTANDING JUDGMENTS, OR PENDING LAW SUITS AGAINST YOU? ☐ YES ☐ NO

WOULD YOU LIKE CREDIT LIFE INSURANCE ON YOUR LOAN?
☐ NO ☐ YES IF YES, WOULD YOU LIKE ACCIDENT AND HEALTH INSURANCE ON YOUR LOAN?
☐ NO ☐ YES

DO YOU GUARANTEE/CO-SIGN ANY DEBT NOT SHOWN ABOVE?
☐ NO ☐ YES IF YES, DESCRIBE.
____

ARE YOU AN OFFICER, DIRECTOR, OR PRINCIPAL SHAREHOLDER OF ANY BANK?
☐ NO ☐ YES IF YES, WHAT BANK?

In applying for this loan, I/we certify that the statements contained herein are true and that I/we have filled out this loan application in sufficient detail that it will not be misleading. The Bank is authorized to obtain any information it anoms necessary for the review of my/our application. I agree that if anything artier before the Bank makes this loan which changes any of my statements, I will promptly tell the Bank. The Bank may request a credit report on me. If the Bank reviews, renews or contends my loan, the Bank may request a new credit report without telling me. I agree to pay any thing, then search, appraisal, or survey loans included by the bank on my behalf in furtherance of this applilcation request.

APPLICANT SIGNATURE | DATE | CO-APPLICANT SIGNATURE (IF APPLICABLE) | DATE

Exhibit 5 Sample Bank Application for a Consumer Credit Loan credit.[20] Some are new in the market or have used up all available credit, while others are deemed too risky for any credit.

Credit Sales and Governmental Regulations

The Truth-in-Lending Act[21] was a federal law that covered credit sales, including certain leases (although not RTO contracts). Passed in 1968, the statute was Congress' most comprehensive effort to guarantee the accurate and meaningful disclosure of the costs of consumer credit and thereby to enable consumers to make informed choices in the credit market.[22] The Act generally required disclosures of the costs and terms of the loan, including such things as interest rates, grace periods for collections and repossession rights. It was administered and enforced by the Federal Trade Commission.

The Consumer Leasing Act required disclosures to consumers in certain lease transactions involving personal property and a lease term that exceeded four months. It also fell under the governance of the Federal Trade Commission.

Most credit sales are governed by state laws, which are generally more substantive and restrictive on leases than federal laws.[23] States have usury laws, disclosure laws, credit insurance laws, and default, repossession and resale laws. States also provide limited protections to consumers through Articles 9 and 2A of the Uniform Commercial Code.[24] The state usury laws set a maximum rate which a financial institution may charge per annually for a consumer credit loan. These interest rates differ across states and through time, but generally do not exceed 25 per cent. States generally have installment sales laws or consumer credit codes that parallel the "contracts to pay" language of the federal Truth-in-Lending Law.[25]

Consumer groups have challenged the classification of RTO as non-consumer credit in state and federal courts. The RTO industry has prevailed in the vast majority of these cases. In one of the most recent rulings, a Federal District Court jury in St. Paul, Minnesota, decided in March of 1992 that these contracts were not credit sales, and thus are not covered by credit laws.[26]

State Regulation of the RTO Industry

Currently, the RTO industry is regulated in 34 states. Michigan enacted the first RTO statute in 1984. In every state except Pennsylvania, the RTO transaction has been defined not to constitute a consumer credit sale under state retail instalment statutes or consumer credit codes.[27] The state regulations merely require certain disclosures and do not put a ceiling on interest rates (except in Pennsylvania). Typical state legislation includes disclosure of the weekly cost of an item, the number of payments required for ownership, the total cost to the consumer at the end of an agreement and a description of the goods. Most of these state regulations were supported by the RTO industry. Such state legislation has forced some of the sleaziest firms out of the industry for non-compliance.[28]

In Pennsylvania, RTO transactions are included under the state's installment sale law, which requires the merchant to state a cash price for the item and limits interest charges to 18 per cent. However, an investigation by the state's Attorney General found that this law has not been fully effective; RTO firms have evaded the state law by changing the "nominal" payment for ownership at the end of the lease or using a system of "disappearing payments," in which an individual pays a small rental amount, i.e., $1 per month, ad infinitum.[29] Thus, even in "regulated" Pennsylvania, effective annual interest rates from 82 per cent to 265 per cent can be found.[30]

The Larocco Bill

In spite of imposed legislations, the RTO industry was not shunning Congressional politics completely. After an unsuccessful attempt at federal regulation in 1992,[31] Congressman Larry LaRocco (Democrat-Idaho) introduced H.R. 2803, the "Rental-Purchase Reform Act of 1993" (LaRocco Bill), to the Committee on Banking, Finance and Urban Affairs in the summer of 1993. The LaRocco Bill basically spread the pro-RTO industry state disclosure requirements to the Federal level.

The stated purposes of the bill were: 1) To assure meaningful disclosure of the terms of rental-purchase agreements, including the disclosure of all costs to consumers under those agreements; 2) to regulate collection practices; and 3) to provide certain substantive rights to consumers under rental purchase agreements (Section 1002). Commercial rentals were exempt.

The LaRocco bill distinguished between rental-purchase and credit sales. Rental-purchase agreements provide the use of personal property for an initial period of four months or less, are automatically renewable with each payment, and permit but do not obligate the consumer to become owner of the property (Section 1002. Definitions 8A).

The types of disclosures which the RTO firm must make to the consumer, in writing and at the time of rental, involved: 1) the amount of the initial rental payment, including any fees or taxes at the inception, 2) the amount and timing of each payment; 3) the total number and total dollar amount of rental payments and other charges necessary to acquire ownership of the property; 4) a statement that the owner would not own the property until the consumer had made the total dollar amount necessary to acquire ownership; 5) a statement as to whether the rental item was new or used; 6) a statement of the manufacturer's suggested retail price of the item and the cash price for which the property was available from the RTO firm for sale; 7) a clear statement of the terms of the option to purchase contract (Section 1006).

Additionally, the LaRocco Bill specified certain consumer rights with late payments (a seven-day grace period), with returned rental goods and with substantial payment (60 percent) of the total dollar amount necessary to acquire ownership of the rental good. The conduct for collection practices of RTO firms was also covered in the bill. Certain advertising disclosures were also mandated by this bill.

A Political Decision

At January 31, 1994, Rhonda Ward had to assess the situation. The Gonzalez/Metzenbaum bills were well under way in the House and the Senate. The LaRocco bill was sitting in the Banking Committee's Subcommittee on Consumer Credit and Insurance since August, 1993. The furor over the *Journal's* article had subsided, but had not gone away. Furthermore, for some consumer advocates, disclosures were not enough. Margot Saunders, managing attorney for the Washington office of the National Consumer Law Center stated: "This problem is about an industry targeting a segment of the population from whom they can charge outrageous prices."[32]

Ward had a number of issues to consider: 1) Did the public really know about the RTO industry? 2) Did the public really care about the RTO industry? 3) Did voters know about the RTO industry? 4) Were politicians focusing on this industry to protect the public interest? 5) Or was the self-interest of politicians the driving force for the Congressional hearings?

Ward also had to decide if the industry should mount a political campaign. If so, how should it be done? Her Association of Progressive Rental Organizations had political capabilities, but how should their resources be deployed most effectively? What possible alliances could be made? Should they use a Washington "hired gun" strategy or a grassroots approach? Should the battleground be in Congress or at the state level or in the courts?

None of these answers seemed evident. Still, the answers to these questions would help her understand the next steps that her Association of Progressive Rental Organizations should take.

Notes

1. This name has been disguised.
2. David L. Ramp. Report on Dominant National and Regional Rent-to-Own Dealers in the United States. Submitted to the U.S. House of Representatives, Committee on Banking, Finance & Urban Affairs. March 31, 1993.
3. See written testimony of David L. Ramp. U.S. House of Representatives, Committee on Banking, Finance & Urban Development. March 31, 1993. pp. 253–254.
4. Furniture/TODAY, August 23, 1993: p. 31. In the hearings by the U.S. House, Committee on Banking, Finance & Urban Affairs, the industry trade association stated that the average rental agreement is terminated in about 100 days.
5. Association of Progressive Rental Organizations. Various publications. 1993.
6. Wall Street Journal, September 22, 1993. p. A1(6).
7. Washington Post, April 4, 1993.
8. Washington Post, November 23, 1992: p. B5.
9. Written testimony of the Association of Progressive Rental Organizations, U.S. House Committee on Banking, Finance & Urban Affairs, March 24, 1993, p. 2.
10. Washington Monthly, October 1993, v. 25. p. 12 (4).
11. Washington Post, November 23, 1992, p. B5.
12. See Testimony of Ernest D. Preate, Jr., Attorney General of Pennsylvania, U.S. House of Representatives, Committee on Banking, Finance & Urban Affairs, March 31, 1993, pp. 99–113.
13. Furniture/TODAY, August 23, 1993: p. 2.
14. Association of Progressive Rental Organizations, 1993.
15. Association of Progressive Rental Organizations, November 1993, p. 3.
16. Critics state that the industry's claim of no credit check is false. For examples of credit checks, see testimony of David L. Ramp, before the U.S. House of Representatives, Committee on Banking, Finance & Urban Affairs, March 31, 1993, p. 249.
17. Alix M. Freedman. Peddling Dreams: A Marketing Giant Uses Its Sales Prowess To Profit From Poverty, Thorn EMI's Rental Centers Push Sofas, Rings, VCRs To the Poor at High Rates, Repos and 'Couch Payments,' Wall Street Journal, September 22, 1993, p. A1(6).
18. This paragraph was taken in full, from Forbes, May 19, 1987, p. 73.
19. Mona J. Gardner and Dixie L. Mills. Managing Financial Institutions: An Asset/Liability Approach. Second Edition, 1991, Chicago: Dryden Press, p. 404.
20. Association of Progressive Rental Organizations, Fact Sheet, November, 1993, p. 2
21. The Truth-in-Lending Act is found at 15 U.S.C. Sec. 1601 et seq.
22. James P. Nehf. Effective Regulation of Rent-to-Own Contracts, Ohio State Law Journal, Summer, 1991, Vol. 52.
23. See prepared statement of the Federal Trade Commission on RTO, before the House Banking, Finance & Urban Affairs Committee, March 31, 1993.
24. See James P. Nehf, *ob. cit.,* for a detailed explanation.
25. Association of Progressive Rental Organizations. RTO Legal Reference Index: Understanding the Rent-to-Own Industry, 1993.
26. John Hendren. State News Services, March 31, 1993.
27. Written testimony of the Association of Progressive Rental Organizations, U.S. House Committee on Banking, Finance & Urban Affairs, March 26, 1993.
28. Mike Hudson. Washington Monthly, October 1993, v. 24 p. 12 (4).
29. See testimony of Ernest D. Preate, Jr. Attorney General of Pennsylvania. Before the U.S. House Committee on Banking, Finance & Urban Affairs, March 31, 1993, pp. 112–113.
30. Washington Post, April 4, 1993.
31. Larry LaRocco (Democrat-Idaho) introduced the Lease Purchase Agreement Act, H.R. 4497, into the House in 1992. It was heard in the Consumer Affairs Subcommittee in June 1992, but did not make it out of committee. The bill mirrored the state level RTO regulations fairly closely.
32. Paul Kirby, State News Service, March 25, 1993.

PEMBINA PIPELINE CORPORATION

Ken Mark

Alexandra Hurst

 Version: (A) 2001–07–06

INTRODUCTION[1]

Patrick Walsh, president of Pembina Pipeline Corporation, was abruptly awakened by a telephone call from Jim Thomas, his operations manager. It was 4:30 a.m. on August 2, 2000, in downtown Calgary, Alberta, and Thomas had no time for pleasantries:

> Walsh, I just heard from one of our pipeline operators that our new Taylor-Prince George pipeline burst open this morning! Get up! We're leaking thousands of barrels of crude into a pristine salmon river. Our emergency response crews have started containment efforts but we're going to need much more help. What are we going to do next?

A wave of panic shook Walsh awake. Grabbing his car keys and the cellular phone, he scrambled into his Ford Explorer and began driving to Pembina's Calgary head office. Negotiating corners with one hand on the steering wheel, Walsh kept Thomas on the line:

> I want to know all the details of the spill now! Our first concern will be to contain the oil! I'll join you in a few minutes at the office and we'd better come up with something. Damn it, Thomas, we don't even have media relations people, much less a PR agency!

PEMBINA PIPELINE CORPORATION

Involved in the transportation of light crude oil, condensate and natural gas liquids in western Canada, Pembina Pipeline Corporation owned the Pembina Pipeline Income Fund (the Fund), a publicly traded Canadian income fund. This fund was established in 1997 to give the investing public the opportunity to participate in a stable, well-managed pipeline transportation entity that had provided high quality, reliable service to the Canadian oil and gas industry since the mid-1950s. The Fund was intended to provide unitholders with attractive long-term returns through its investment in Pembina, which had a mandate to efficiently operate its pipeline systems and actively seek expansion opportunities. The Fund paid cash distributions to unitholders on a monthly basis. The trust units traded on the Toronto Stock Exchange under the symbol PIF.UN.

Pembina's pipeline systems served a large geographic area with 7,500 kilometres of pipeline and related pumping and storage facilities. The systems were well positioned in the heart of western Canada's oil and natural gas production areas. There were four systems in total:

- Peace Pipeline System—Central Northwest Alberta
- Pembina Pipeline System—Central Southwest Alberta
- Bonnie Glen Pipeline System—Central South Alberta
- Wabasca Pipeline System—Northern Alberta

Collectively, Pembina's pipeline systems transported over 40 per cent of conventional light crude oil production in Western Canada.

OPERATIONS

Pembina's pipeline systems were maintained and operated by a dedicated group of field employees located in 10 field offices. Pembina's corporate head office was located in Calgary, Alberta where technical and administrative staff supported the pipeline operations. Through its pipeline, Pembina transported light crude oil, condensate and natural gas liquids. Virtually no heavy oil was transported on any of the Pembina systems, nor was Pembina a natural gas carrier. The company did not own the product it transported but, similar to a trucking company, it took custody of the product from when it entered the pipeline until it was delivered to the owners.

Pipelines and the materials used in them were designed, built and tested to high standards. When pipelines were properly maintained failures due to pipe breakdown were rare. Pembina had several maintenance programs in place to ensure line integrity. These were:

Internal Inspection Program

Internal inspection tools were designed to allow pipeline operators to measure the wall thickness along the pipe so that areas of metal loss could be located and repaired. These tools had been incorporated into Pembina's monitoring program, and pipeline systems were inspected on a rotating seven-to-eight-year-cycle. Pembina's pipeline systems, with the exception of the recently purchased Federated system, were last checked in 1998.

Hydrostatic Testing

Government regulations required new pipelines be filled with water and pressure tested to 125 per cent of their licensed maximum operating pressure before the lines could be put into service. The hydrotest was designed to reveal any structural weakness in the pipe or welds. Although not a regulatory requirement, all of the major pipelines in the Peace and Pembina System (built prior to 1970) had been hydrostatically retested. The first two phases of hydrostatic testing of the 16-inch mainline had been completed and confirmed the strength and quality of the pipe tested.

Bacterial Monitoring and Treatment

Pembina's pipeline systems employed programs of regular product sampling and testing for bacteria. Producers with excessive bacteria were required to treat their tanks with a biocide to kill the bacteria. Similarly, biocide was periodically shipped through pipelines to control and kill bacteria.

Cathodic Protection

Cathodic protection systems were used on steel pipelines to impress a small voltage on the pipe to help protect it from external corrosion. Every month, readings were taken on Pembina's pipelines to ensure that these systems were operating at effective levels. A complete cathodic protection survey was done annually in compliance with regulatory requirements and any necessary repairs or adjustments to the systems were made. Evaluation of the survey results provided important information on the condition of the pipeline coatings.

Expansion

Pembina intended to continue to expand its service through new battery and facilities connections, tie-ins to third-party pipelines, and expansion of Pembina's existing systems to service new oil- and gas-producing areas. Ongoing exploration and development activity by the producer community was expected to continue to fuel demand for pipeline service in the regions served by Pembina's pipeline systems, particularly on the Continental System operating in northwestern Oregon and northeastern Washington.

The most significant increase in throughputs on the Pembina System could potentially come from technology developments to improve the recovery of crude oil in the oil fields. It was estimated that only 21 per cent of initial crude oil in place was recoverable using present technology.

Pembina's management was actively reviewing potential acquisitions and believed that Pembina was very well positioned to take advantage of any favorable opportunities to acquire or otherwise expand Pembina's business.

Incident Control Mechanisms

While environmental incidents had never occurred on Pembina's pipeline systems, Pembina maintained insurance to provide coverage in relation to the ownership and operation of its pipeline assets. Property insurance coverage provided coverage on the property and equipment that was above-ground or that facilitated river crossings, with recovery based upon replacement costs. Business interruption insurance covered loss of income arising from specific property damage. The comprehensive general liability coverage provided coverage in actions by third parties. The latter coverage included Pembina's sudden and accidental pollution coverage, which specifically insured against certain claims for damage from pipeline leaks or spills.

The Pipeline Break

Thomas continued to feed more information to Walsh:

> At about 1:20 this morning, the pipeline break and subsequent spill of crude oil occurred at mile post 102.5 of the Federated Western Pipeline—the same pipeline company that we bought 12 hours ago.[2] The break released crude oil into the Pine River just upstream of Chetwynd, B.C.
>
> Our emergency response field team set up a control site half a mile downstream from the spill. A second control site was set further downstream at the creek's entry into the Pine as a precautionary measure, and a third control site beyond the town of Chetwynd is to be set up today.

When he heard that the spill had occurred near a small town and could threaten its water supply, Walsh knew that there was no stopping immediate media coverage. He let Thomas continue uninterrupted.

> We've set up vacuum facilities at each control site which are being manned right now, removing oil from the river. My guys are telling me that we'll lose as much as 6,300 barrels.[3] In the next hour, I'm going to set up a mobile lab to continuously test the water upstream from Chetwynd. I'll also contact district officials to inform residents along the Pine River of the situation and to put in guidelines to restrict their water usage.

At Pembina's Head Office

Walsh parked his car and ran up two flights of stairs to the office. Thomas and the crew of pipeline monitors were hovering over a computer screen detailing Pembina's network of pipelines. Walsh knew that he would need help in dealing with the media. Even if he were able to contact and retain a media relations firm, he realized that the initial press release would be his responsibility. Thomas exclaimed:

> We still do not know what caused the pipeline break, but I can tell you that we have between 70 to 80 people already onsite, beginning clean-up activities. They're using oil booms to stop the flow of oil and sponges to soak up what they can.

A map of the area was laid out on the table. Walsh could now clearly see the proximity of the town of Chetwynd to the spill. He knew that the health of the town and surrounding area would have to be his first priority. First, Pembina had to contain the oil spill.

It was 5 a.m. and daylight would break within the next two hours.

Notes

1. This case was written with public sources and the permission of Pembina Pipeline Corporation. Some facts have been altered.
2. The deal to purchase Federated was completed on July 31, 2000—see Exhibit 1.
3. This amount (6,300 barrels) was equivalent to one million cubic metres of oil.

NEWS RELEASE

Attention Business Editors:

Pembina Pipeline Corporation Completes Purchase of Federated Pipe Lines Ltd.

Not for distribution to United States Newswire Services or dissemination in the United States.

CALGARY, July 31 /CNW/ - Pembina Pipeline Income Fund (TSE-PIF.UN) announced today that its wholly-owned subsidiary Pembina Pipeline Corporation has successfully completed its purchase of 100% of the shares of Federated Pipe Lines Ltd. from Anderson Exploration Ltd.'s subsidiary, Home Oil Company Limited, and Imperial Oil Limited. In a related transaction, Pembina closed the purchase of the Cynthia Pipeline from Imperial on the same date.

Following the completion of this transaction, Pembina's combined pipeline network comprises roughly 7,000 kilometres of pipeline and related pumping and storage facilities and in 1999 transported 548,400 barrels per day of crude oil, condensate and natural gas liquids. The Federated acquisition entrenches Pembina's position as Canada's leading feeder pipeline transportation business. Total consideration paid by Pembina for the Federated shares was $340-million, including the assumption of Federated debt. A further $9-million was paid for the Cynthia pipeline. The transactions were financed utilizing a new $420-million syndicated credit facility arranged with a Canadian chartered bank.

Pembina is working toward the timely and orderly integration of the Pembina and Federated pipeline networks, and expects a seamless transition during the consolidation process. The combination of these considerable pipeline operations is expected to produce significant synergies and operating efficiencies which will provide substantial value for Pembina's customers and Unitholders of the Fund. Incremental cash flow generated by the acquired assets is expected to be sufficient to service the acquisition debt as well as fund an increase in the distribution payments to Unitholders of the Fund once the pipelines have been successfully integrated.

Pembina's purchase of the pipeline assets of the Western Facilities Fund for $40.3-million is scheduled to close in late August 2000 following approval by the Unitholders of Western.

The Pembina Pipeline Income Fund is a Canadian income fund engaged, through its wholly-owned subsidiary Pembina Pipeline Corporation, in the transportation of crude oil, condensate and natural gas liquids in Western Canada. Trust Units of the Fund trade on the Toronto Stock Exchange under the symbol PIF.UN.

This news release contains forward-looking statements that involve risks and uncertainties. Such information, although considered reasonable by Pembina at the time of preparation, may prove to be incorrect and actual results may differ materially from those anticipated in the statements made. For this purpose, any statements that are contained herein that are not statements of historical fact may be deemed to be forward-looking statements.

Such risks and uncertainties include, but are not limited to risks associated with operations, such as loss of market, regulatory matters, environmental risks, industry competition, and ability to access sufficient capital from internal and external sources.

This news release shall not constitute an offer to sell or the solicitation of an offer to buy securities in any jurisdiction. No securities of Pembina Pipeline Income Fund have been registered under the United States Securities Act of 1933, as amended, and such securities may not be offered or sold in the United States absent registration, or an applicable exemption from the registration requirements of such Act.

Exhibit 1 The Purchase of Federated Western Pipelines

Source: www.pembina.com December 29, 2000.