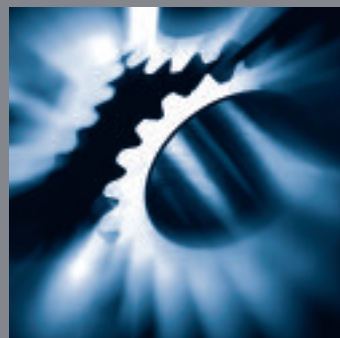
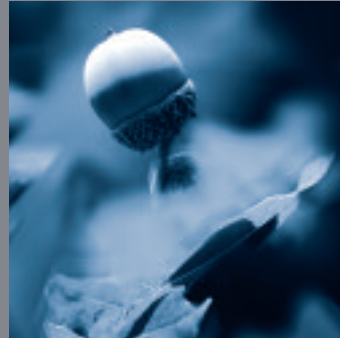
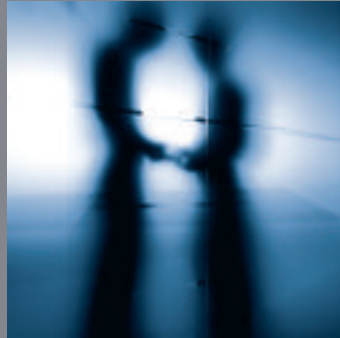


re^o Report

F&C Investments

2nd Quarter 2007



In this issue...

- US executive pay: Nasty surprises as new disclosure rules start to bite
- F&C says 'non' to unequal voting rights at **Danone, Schneider Electric** and **Total**
- F&C's handy guide to carbon offsetting
- Biodiversity and the bottom line: after extractives, food, construction and forestry
- The biofuels dilemma: protecting the climate without damaging it too much
- Conflict diamonds, dirty gold: human rights, environment and jewellery
- Junior mining companies: are they behaving?
- Utilities in the hot seat: national champions, energy security and climate

F&C
Investments

Expect excellence

Our philosophy

reo[®] stands for responsible engagement overlay

The objective of reo[®] is to use the influence that F&C has through the share ownership of its clients to encourage investee companies to enhance their business performance by adopting better corporate governance, social, and environmental practices. F&C believes that it can better serve its clients, and

protect the value of their shareholdings, through sustained and constructive dialogue with companies as well as the judicious and transparent use of its votes, thereby ensuring that companies respond prudently to the emerging expectations of shareholders and other stakeholders.

Why this report?

Our obligations to you

F&C represents you: we have been appointed either to manage your pensions and investments, or to represent your interests to the companies in which you are a shareholder, even if your portfolio is managed by other fund managers.

As your representative, we have important obligations to you. These are to be vigilant about how companies 1) plan their future growth with the capital you have entrusted to them; 2) manage and minimise business risks; and 3) protect financial returns over the long term.

What does this mean in practice?

This means that as your representative, we take the time to communicate our concerns to the managers of the companies in your portfolios. It also means that we expect full transparency from companies, so that we know what is being done with the money you have invested with them.

In addition, where F&C is your fund manager, this means exercising our voting rights – **your** voting

rights – at the annual and extraordinary shareholders' meetings of over 3,000 companies around the world.

Transparency: It cuts both ways

If we expect transparency from companies, you should expect no less from us: we believe that as investors, you are entitled to know what company managers are doing in your name with the money entrusted to them. At F&C, we take this responsibility very seriously. With this quarterly report, we outline how we have asked questions and spoken up in your name to ensure that companies are made aware of the concerns of their shareholders.

What could we do better?

We hope we have accurately reflected your concerns about good governance, environmental responsibility and the protection of basic employment and human rights.

Still, we want to be sure we get it right.

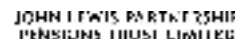
An electronic copy of this report can be found at: www.fandc.com/governance

Feedback: Your money listens

Your input is valuable to us. Thank you for telling us how your money should talk. Please mark your comments 'reo report feedback', and e-mail them to eve.crush@fandc.com

Or send to: Eve Crush, Governance & Sustainable Investment, F&C Management Limited, Exchange House, Primrose Street, London EC2A 2NY

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Introduction

As the 2007 peak voting season draws to a close, much attention has centred on US executive pay, where a series of headline-grabbing packages in 2006 have finally triggered tough new disclosure rules. F&C has been at the forefront of calls for clearer reporting and greater accountability to shareholders, and is pressing hard for the introduction of a UK-style 'Say on Pay' advisory vote. Some US companies are bowing to the inevitable, others are dragging their feet, as this report highlights. Meanwhile, F&C continues its efforts to secure one share/one vote in France and better disclosure in Greece.

Moving to Africa, we turn the spotlight on the jewellery industry, as gold and diamond miners and retailers face the twin challenges of 'conflict diamonds' and

environmental pollution. F&C has led the way since 2003 by pressing for robust practices from mine to shop window. Meanwhile, our brand new report entitled *Do You Know What Junior is Doing?* examines the behaviour of smaller, fly-below-the-radar mining companies, and highlights how these may be storing up problems for the future.

This report also features an update on F&C pioneering work on biodiversity, as we broaden our coverage from the extractives to construction, food and timber, and highlights F&C's new guide to the do's and don'ts of carbon offsetting. Finally, we take a look at the controversial Utilities sector, as it walks a tightrope between energy security, economic nationalism and climate protection.



Karina Litvack – Director,
Head of Governance &
Sustainable Investment,
F&C Management Limited

Engagement programmes

Governance



Corporate Governance & Voting

6-8

Social



Focus on Jewellery Industry

12-13

Environment



Focus on Carbon Offsetting

9

Sector Focus



Focus on Utilities

14-15



Focus on Biodiversity

10-11

Companies featured in this report

Corporate Governance & Voting

pages 6-8

Company	Countries	Company	Countries	Company	Countries	Company	Countries
Aetna	US	Bristol-Myers Squibb	US	ConocoPhillips	US	EMC	US
Home Depot	US	Occidental Petroleum	US	Schneider Electric	FR	Verizon	US
Aflac	US	Citigroup	US	Costco	US	ExxonMobil	US
Ingersoll Rand	US	Progressive	US	Target	US	Wal-Mart	US
Applied Materials	US	Coca-Cola Hellenic Bottling	GR	Danone	FR	Hellenic Telecommunications Organisation	GR
Intel	US	Public Power Corporation of Greece	GR	Time Warner	US		
Bank of America	US	Colgate-Palmolive	US	Eastman Kodak	US		
Motorola	US	Schering-Plough	US	Total	FR		

Carbon Offsetting

page 9

Company	Countries	Company	Countries	Company	Countries	Company	Countries
BSkyB	UK	E.On	DE	Marks & Spencer	UK		
Prudential	UK	Silverjet	UK	Tesco	UK		

Environment Biodiversity

pages 10-11

Company	Countries	Company	Countries	Company	Countries	Company	Countries
Anglo American	UK	Prosafe	NO	Cheuk Nang	HK	Total	FR
Peter Hambro	UK	BP	UK	Sinopec	CN	ExxonMobil	US
Ascott Group	SG	Rio Tinto	UK	Chevron	US	Neste Oil	FI
Petrobras	BR	Brasil Ecodiesel	UK	Statoil	NO	Xstrata	UK
Balfour Beatty	UK	Royal Dutch Shell	UK	CNOOC	CN	Northern Foods	UK
Phaunos Timber Fund	UK	Burren Energy	UK	Taylor Woodrow	UK	Lafarge	FR
BG Group	UK	Scholastic	US	Creed Corp	JP		

Social Jewellery Industry

pages 12-13

Company	Countries	Company	Countries	Company	Countries	Company	Countries
Anglo American	UK	Nike		De Beers Group	UK	Target	
John Lewis Partnership		Bulgari	IT	Rio Tinto		Gap	US
AngloGold Ashanti	ZA	Peter Hambro		Debenhams	UK	Tiffany	
Newmont Mining Corporation		Costco	US	Signet		Home Retail Group	UK
BHP-Billiton	UK	Richemont		Federated Department Stores	US		

Sector Utilities

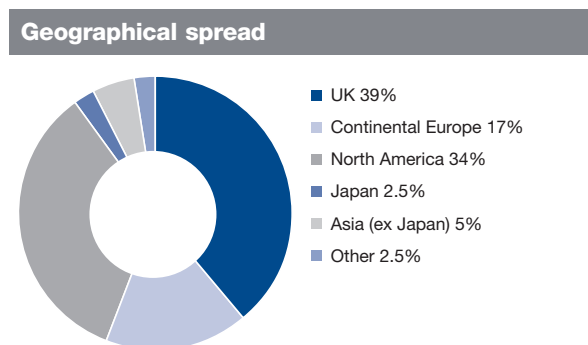
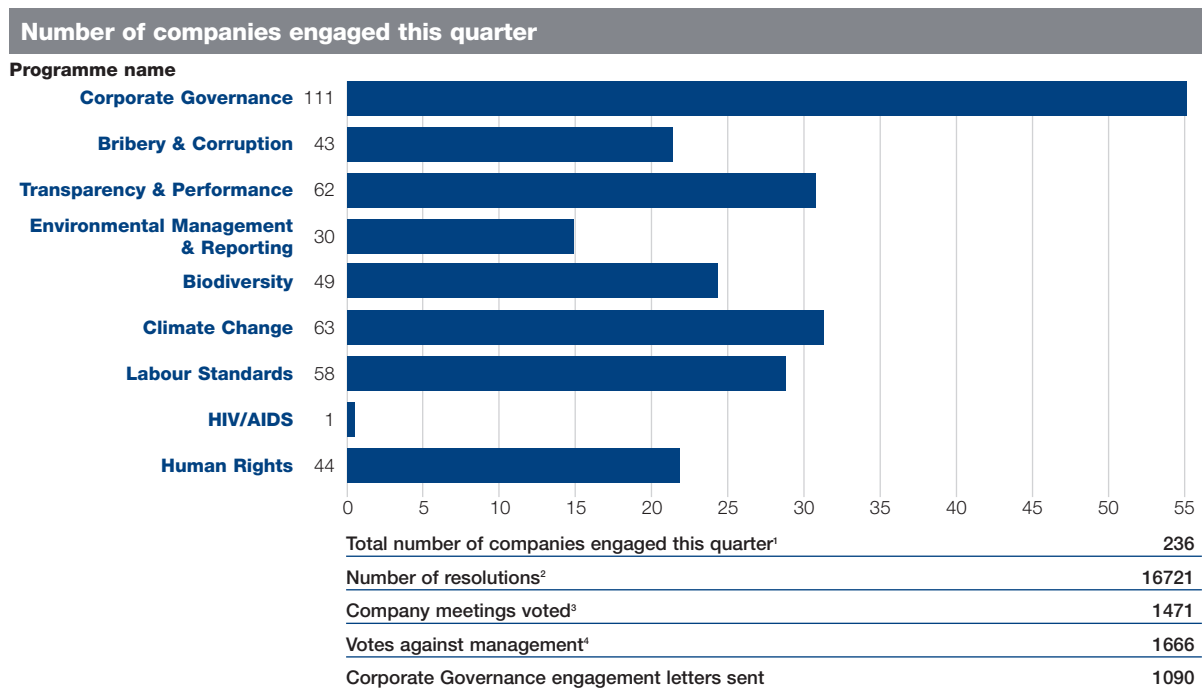
page 14

Company	Countries	Company	Countries	Company	Countries	Company	Countries
British Energy	UK	Iberdrola	ES	Endesa	ES	Southern Company	US
Gaz de France	FR	E.On	DE	Scottish and Southern Energy	UK	Energias de Portugal	PT
Duke Energy	US	RWE	DE	Enel	IT	Suez	FR

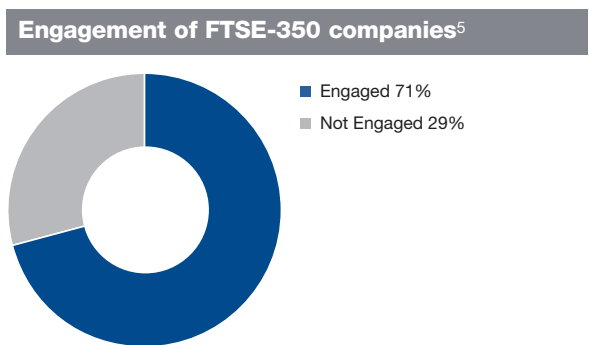
Activity report

F&C’s responsible engagement overlay is unique in the depth and breadth of its engagement, as the quarterly statistics below demonstrate. Key features are:

- A 15-person team of Governance & SRI specialists, allowing full monitoring of the portfolios for environmental, social and governance (ESG) risks and the capacity for in-depth and prolonged engagement with individual companies where necessary
- Global engagement – in all markets
- Comprehensive voting – F&C votes all of its clients’ shares worldwide, as well as publishing the voting record each month.



This table shows the domicile of companies that have been engaged by F&C in the last quarter.



This table shows the proportion of the FTSE-350 Index, by market capitalisation, engaged by F&C in the last quarter.

1 Companies may have been engaged on more than one issue
 2 Companies may have been engaged on more than one issue
 3 i.e. company meetings for which F&C has issued voting instructions
 4 Votes against management or abstentions
 5 by market capitalisation



Corporate Governance & Voting

Our objectives

- Ensure high standards of corporate governance in line with F&C Corporate Governance Guidelines with a focus on:
 - Board structure and composition
 - Remuneration
 - Appropriate internal controls and risk management systems
- Issue voting instruction on 100% of shares held.

Voting activity report

This table sets out the scale of voting for the past quarter. It is important to note that several votes in favour of management mask detailed dialogue, where, following compromise or mutual persuasion, we elected to support management.

Voting to date	Number	%
Total number of Meetings	1471	
Number of countries in which we voted	52	
Number of resolutions	16721	
Total votes for management	13072	78
Votes against management	1666	10
Abstentions	896	5
No vote	1087	7

Analysis of votes

Issue	% for	% against	% abstain	% no vote
Routine business	78	2	7	13
Directors and governance structure	77	10	9	4
Capital	76	12	2	10
Mergers/reorg	84	0	13	6
Remuneration	75	7	13	5
Anti take-over	33	67	0	0
Others	84	5	3	8

Shareholder resolutions number of votes for or against management

	for	against	abstain
	31	55	14

Engagement by F&C

Let the sun shine in: better disclosure of U.S. executive pay

Thanks to new rules from the US Securities and Exchange Commission (SEC) – encouraged by F&C in 2006 – investors received substantially more information about remuneration for 2007 voting. Many companies such as **Aetna**, **Progressive** and **Applied Materials** followed the spirit as well as the letter of the new rules and provided informative and comprehensive disclosure – including the performance targets used to award pay. **ExxonMobil** embraced the new “plain English” requirement, translating a formerly dense compensation report into accessible language, although its refusal to set specific performance hurdles for senior executives may lead to overpayment and remains a concern.

Retiring in style... as shareholders foot the bill

New disclosure rules yielded some unwelcome surprises – even by stratospheric American standards. For instance, we learned that the CEO of **ConocoPhillips** had amassed \$58 million in pension savings, rounded off by an additional \$42 million in deferred compensation. **Bank of America's** CEO accrued almost \$50 million in pension and \$34 million in deferred compensation. While compensation committees insist that such benefits are dictated by competitive pressures, the new disclosure standards also revealed that Bank of America's main rival, **Citigroup**, awarded its CEO a far more modest \$24 million, of which only \$2 million was pension accruals and the rest was deferred compensation. Escalating pension payouts this year prompted us to

withhold votes from some compensation committee chairmen. As always, we are following up with letters.

Getting it right: aligning pay with performance

Disclosure also resulted in some pleasant surprises, including data storage giant **EMC**, who deserves the F&C award for "most improved remuneration" in 2007. EMC surprised us with a highly transparent compensation report and took important steps to address head-on the concerns that F&C has raised for several years. The directors passed up the regulatory loophole that permits keeping performance targets confidential, disclosing historical data and some forward-looking targets that determine cash and equity awards as we requested. It also added new notes to its formerly one-note song sheet by rewarding executives for other performance achievements beyond earnings per share. While overly generous change-of-control provisions remain a concern, F&C appreciated the EMC board's responsiveness to its shareholders.

Unintended consequences: Does disclosure trigger an "arms race" on CEO pay?

Not if investors can hold management to account for their pay policies. F&C continues to oppose compensation committee chairmen and members when pay is out of line with performance. This voting policy seems to be catching on: for several years, F&C had opposed the compensation committee at **Occidental Petroleum** a serial and egregious over-payer. This year, a whopping 35% of voting shareholders opposed committee members, up from only 20% in 2006. But voting against committee chairmen and members has so far proved inadequate to the task of reigning in pay. Therefore, in 2007, investors filed over 60 shareholder proposals asking companies to give shareholders a vote on the compensation committee's report. For two years, F&C has written to all its US holdings encouraging them to adopt these so-called "say on pay" practices. In the UK, Netherlands and Australia, such advisory votes have encouraged substantive dialogue between directors and investors. They also provide directors with ammunition to resist unreasonable demands by powerful CEOs. In 2007, we supported all these resolutions, including proposals that passed with majority support at **Ingersoll Rand**, **Motorola** and **Verizon**.

Interestingly, some companies aren't opposing "say on pay" blindly. In a surprising move, insurer **Aflac** quickly agreed to introduce an advisory vote on pay effective 2009. And leading companies, including **Pfizer**, **Colgate-Palmolive** and **Schering-Plough**, have joined with F&C and other international investors in a working group to consider how advisory voting might be adapted to a US context. We look forward to a public meeting in July to present our findings. Nevertheless, companies may have missed their window for voluntary action: the US House of Representatives recently passed legislation requiring a "say on pay" vote at each company's annual meeting. F&C and other international investors wrote to the SEC to support such a standard, which would bring the US in line with global best practice and asked the US Senate to take up the bill.

“Some U.S. investors also say the process is less intrusive than resorting to other means to express frustration, such as by voting against the board directors who have arranged a CEO's pay package. With a non-binding vote, shareholders would have a "more specific and accurate place on the proxy to communicate concerns over pay," according to Elizabeth McGeeveran, a vice president at investment firm F&C Asset Management.”

Wall Street Journal, "House Votes to Give Shareholders Nonbinding Vote on Executive Pay," 20 April 2007

Beware the Claw!

F&C remains concerned about big payouts based on performance metrics that later prove inaccurate when companies restate their financials. F&C asks companies to ensure that executive contracts are written to allow performance-based equity and cash awards to be 'clawed back' – not just from executives whose direct errors led to restatements, but potentially from senior leadership as a whole, should the board deem this appropriate. In 2007, **Time Warner** introduced a limited claw back policy following detailed engagement with F&C. **Intel** and insurance company **Progressive** did even better, with far-reaching new policies that give the board substantial latitude to reclaim erroneous bonuses. However, we were disappointed that **Bristol-Myers Squibb** and **Eastman Kodak** continued with their more limited approach despite our engagement.

Votes of no-confidence: whose company is it anyway?

Some US directors appear to view their shareholders as a nuisance rather than as the owners of the company to whom they are accountable. In 2007, F&C joined other investors in withholding votes from **ExxonMobil** director Michael Boskin. Despite chairing the 'Public Issues Committee', Professor Boskin steadfastly refuses to meet with major shareholder groups to discuss the company's climate change strategy. We also withheld from the Audit Committee Chairman at **Wal-Mart**, Roland Hernandez, whose pledge to open a dialogue with shareholders on labour standards violations proved an empty promise. And we continued our practice of withholding support from directors at companies who refuse to implement shareholder proposals that have been passed by majority support, such as discount retailer **Costco**. F&C also voiced its concern to **Target** for the second year because its directors do not attend the annual meeting to hear directly from the shareholders they purportedly represent. We had raised this same concern at corporate governance "bad boy" **Home Depot** in 2006, and were pleasantly surprised this year to see the company issue a public apology for last year's annual meeting: the event had been marred by investor anger over another outsized package for then-CEO Robert Nardelli, the failure of directors to turn up, and a gag order on investor questions. The annual meeting debacle set the stage for Mr. Nardelli's later ouster, albeit with a \$200 million golden goodbye, leaving Home

Depot's share price at 6% below its 2000 level. But the Nardelli affair also seems to have marked a low point in US pay practices that F&C hopes has jolted both shareholders and directors out of their complacency and moved the debate onto a more constructive path.

“Prof Boskin appears to have misread the mood of the shareholders base,” said Karina Litvack, director of governance and sustainable investment at F&C. “A substantial proportion think climate change is vitally important for ExxonMobil and expects to have access to the board member tasked with dealing with this issue.”

Financial Times, “Investors demand Exxon board shake-up”, 23 May 2007

Corporate Governance in Europe

F&C says ‘non’ to unequal voting rights in France

F&C continued its campaign to pull down the corporate barricades that prevent shareholders from voting their full holdings at French company meetings. In its sixth year, our efforts continued to gather momentum as we worked in partnership with French activist investor PhiTrust to file shareholder proposals to remove voting caps at **Danone**, **Schneider Electric** and **Total**. The proposal had strong support at the first two companies with 29% and 34%, respectively and won unequivocal majority support at Total. Unfortunately, 55% of voting shareholders is not enough to meet the supermajority requirements of French law that would have triggered the adoption of one share/one vote. As shareholder proposals are not in the local tradition, such unprecedented support for first-time resolutions sends an unambiguous signal that France's global companies must start playing by the global rules of good governance.

Greek tragedy: Poor disclosure triggers votes against management

Full and complete information is essential for casting informed votes. In markets where disclosure standards are poor, F&C is forced to abstain on a large number of management proposals. This has been particularly pronounced at Greek companies, where we abstained on amendments to the articles of incorporation at **Public Power Corporation of Greece**, and on the reports and accounts and the remuneration report at **Hellenic Telecommunications Organization**, simply because none of these reports had been published. In addition, we voted against the appointment of board members at **Coca-Cola Hellenic Bottling**, again because the actual names of the directors were unavailable. Often such key information is presented at the meeting itself, which prevents most shareholders from assessing it prior to voting. As usual, we will write to these companies to emphasise the need to provide sufficient information for shareholders to deliver meaningful votes, rather than forcing them into an all-or-nothing choice between giving the board a blank cheque and opposing it outright.



Focus on Carbon offsetting⁸

A fast-growing trend...

A growing number of companies – including F&C⁶ – are making use of “carbon offsets” as part of their environmental strategies. The financial services, media and travel industries have been at the front of the queue. Examples include the UK operations of **Royal & Sun Alliance**; **BSkyB**; and **Silverjet**, the first fully carbon-neutral airline. Retailers are also joining in, with **Marks & Spencer** committing to carbon neutrality by 2012.

...but also a controversial one

At the same time, questions are being raised about the integrity of offsetting schemes. There have been concerns about whether the use of offsetting reduces incentives to cut emissions – as it may encourage an attitude of “it doesn’t matter, it’s all being offset anyway”. And there have been accusations of malpractice in the voluntary offset market, with a Financial Times investigation claiming that some companies might be selling credits that do not exist.

F&C sets the standard

In response to these issues, F&C has published a briefing⁷ setting out the potential benefits as well as some of the pitfalls of offsetting, and setting out four steps to best practice in implementing an offsetting strategy. F&C has discussed its approach with companies including **Prudential**, **Marks & Spencer**, **Tesco**, **E.On** and **HSBC**. We also submitted a response to a UK government consultation on the subject, calling for greater standardisation of the voluntary offset market, but rejecting the idea that the government seal of approval should only be given to projects in the highly-regulated mandatory carbon markets⁸.

Step 1: Put systems in place to measure and monitor emissions

Effective measurement and monitoring systems are an essential first step in any energy management programme. This may require companies to put new systems in place to collect data accurately.

The scope of emissions also needs to be defined. Some companies will focus on emissions from their own operations – such as heat, electricity use, and business travel. They may choose to offset all these emissions, making themselves “carbon neutral”⁹. For other companies, the focus will be on emissions from the products they sell to customers – such as flights, petrol, or car insurance. These companies may offer their customers the option to offset when they purchase the product.

Step 2: Seek emissions reductions wherever possible

Companies need to look systematically across their business, and identify cost-effective opportunities to cut energy use. There are numerous ways to do this, many of which both reduce emissions and save money by cutting the organisation’s energy bill. Examples might include installing motion sensors for lighting, using videoconferencing rather than travelling, and purchasing renewable power. Other options, such as installing solar panels or micro wind turbines, may be expensive relative to the cost of offsetting. But some companies may choose to go beyond purely what is cost-effective, perhaps because they wish to gain experience of using new technologies, or because it enhances their reputation.

Step 3: Offset what can’t be reduced

Once opportunities to reduce emissions have been taken up, the remainder can then be offset. Most companies will do this by paying one of a number of carbon providers, who will in turn use the money to fund emissions reduction projects. There is a wide choice of offset providers; the selection process can be daunting.

Companies should seek to ensure that the emissions reductions they are paying for are real, verifiable and sustainable. This means being confident in the checks and controls in place at the provider in question. F&C’s Guide to Carbon Offsetting includes a checklist of questions that companies can ask potential offset providers.

Step 4: Publicise what you do, and track progress

Companies should tell their staff about their strategy to reduce and offset emissions, and encourage them to play a role by considering how they can save energy in the workplace. Public reporting is also important; F&C encourages companies to report on how successful they have been in cutting emissions in their Annual Report or Corporate Social Responsibility report.

“Companies and individuals rushing to go green have been spending millions on “carbon credit” projects that yield few if any environmental benefits.”

Financial Times, “Industry caught in carbon ‘smokescreen’”, 25 April 2007

⁶ See press release of 3 April 2007, available at www.fandc.com

⁷ See Publications in our Governance and Sustainable Investment site at www.fandc.com

⁸ See Submissions in our Governance and Sustainable Investment site at www.fandc.com

⁹ “Carbon neutral” is a registered trademark of the Carbon Neutral Company.



Focus on Biodiversity

Our objectives

Encourage all companies where biodiversity is a material risk to adopt a biodiversity policy and define and implement a process for managing biodiversity impacts

Background: increased awareness

The term 'biodiversity' has gained increasing prominence in business circles of late – in stark contrast with four years ago, when few companies displayed much sign of awareness, much less understanding, of its significance. For example, in a 2003 survey conducted by F&C, 83% of companies did not know where their palm oil originated, despite widespread criticism that procuring palm oil from unsustainable sources was responsible for extensive deforestation in south-east Asia¹⁰.

In the last two years, virtually all major extractive companies have recognised biodiversity as a significant risk factor, and the middle tier of the sector is beginning to follow – along with food retailers and the construction industry. The number of FTSE 100 companies with a biodiversity policy has increased each year for the past three years. However, implementation is another matter: F&C's research suggests that most companies lack a strategic approach to biodiversity and find it difficult to integrate biodiversity into their standard environmental management systems – resulting in late action or neglect of important environmental factors.

New standards

One sign of increased awareness is that key standard-setting organisations have started to develop globally-recognised indicators. These include a biodiversity working group set up by the UNEP Finance Initiative, guidelines on biodiversity reporting produced by the Global Reporting Initiative and best-practice guidance from the mining industry trade body the International Council for Metals and Mining (ICMM).

Ecosystem services: why they matter

An important development has been for companies to interpret their biodiversity risks in the context of 'ecosystem services' – such as stable water and agricultural supplies. Many companies are dependent on such services, and so are potentially vulnerable to the mismanagement of biodiversity by others and the increasing impact on ecosystems of climate change. Other companies can play a key role in either enhancing or damaging the biodiversity that underpins such services, but are often unaware of this – risking regulatory intervention or a backlash from civil society and the media.

Engagement by F&C

The investment case: Where biodiversity hits the bottom line

By influencing access to land, relations with regulators and stability of supplies from natural products, biodiversity can have a direct impact on a company's performance – as recently highlighted by record prices for palm oil. F&C first drew attention to biodiversity in 2004 with its research report

'Is biodiversity a material risk for companies', which highlighted the nine most vulnerable industry sectors and seven different types of biodiversity risk. Since then, F&C's focus has been on the five of the highest-risk areas: the oil & gas, mining, forestry, construction and food sectors – with a more recent concentration on biofuels.

The first half of 2007 has seen F&C research 98 companies based in Europe, North and South America and Asia to assess biodiversity risks. For those that operate in the highest-risk sectors, including food producers **Northern Foods**, forestry investors the **Phaunos Timber Fund**, German retailer **Metro** and publishers Woongjin **ThinkBig** and **Scholastic**, F&C has asked that they provide details of how they address biodiversity, and pressed for clear policies and management systems where these were lacking.

The extractive sectors: High impact, mixed performance
Of all sectors, extractives present the clearest example of how biodiversity can directly affect strategy and ultimately shareholder value. As oil reserves and mineral rights become ever scarcer, projects are increasingly to be found in or near protected or ecologically-sensitive areas – so a company's ability to secure access by demonstrating high environmental standards becomes an important factor in its financial success.

F&C considers that companies with a better track record in biodiversity management are likely to gain greater or faster access to reserves and suffer fewer delays in project development. However, performance is very mixed in the extractive sectors. A recent F&C report¹¹ highlights the fact that few if any smaller companies have systems in place to assess or manage biodiversity, even when they are in long-term corporate relationships with larger companies that do have such policies. In addition, oil services companies and those from emerging markets tend to be very weak in this area.

In addition to long-standing dialogue¹² with **BP**, **Royal Dutch Shell**, **ExxonMobil**, **Chevron**, **Total**, **BG Group**, **Rio Tinto**, **Anglo American** and **Xstrata**, recent engagement has focussed on companies that have a lower public profile, yet still face biodiversity-related risks. These include oil services company **Prosafe**, mining companies **Peter Hambro** and **Lonmin**, mid-sized oil companies **Burren Energy** and **Woodside Petroleum**, and fast-growing emerging players Petrobras of Brazil and **SINOPEC** and **CNOOC** of China. In general, the mid-sized mining companies have been more aware of biodiversity risks than their oil industry counterparts, but overall, awareness levels and action among smaller companies significantly trails the oil and mining majors.

We said...

“We do not feel that BP’s public policy statements adequately address this current debate on protected areas.... This raises concerns that BP may be disadvantaged through not being the ‘operator of choice’ when seeking to operate in protected or ecologically sensitive areas.”

Extract of letter from F&C Asset Management to Chief Executive of BP, 30 March 2004.

They said...

“The ERNP [Environmental Requirements for New Projects] originated in work commissioned by the group chief executive in 2004 around sensitive areas...A key stakeholder in the process was F&C Asset Management, an institutional shareholder, which provided the original environmental challenge to BP in 2004.”

Extract from BP’s 2006 Sustainability Report

We said...

“The new requirements bring much greater clarity about how BP intends to operate in or near ecologically-sensitive areas. They are not perfect, but ... should give reassurance to investors that BP understands the emerging risks associated with biodiversity and ecosystem management. However, the challenge will be in implementation. In the light of recent performance, BP needs to convince its critics that in a company of such size, it is able to turn good headquarters’ policies into effective operational practice.”

Extract from BP’s 2006 Sustainability Report, quoting F&C Asset Management

UK-based construction companies appear generally aware of biodiversity, although most still have very embryonic strategies and none have yet turned this awareness into a competitive advantage when bidding for projects, permits or land. Overall, construction companies fall well short of the best practices displayed by the best of the extractive and utility companies. F&C has recently engaged several UK-based construction and building supply companies to encourage a more strategic and comprehensive approach, full integration of biodiversity into other environmental management processes and better disclosure. These include **Hanson, Balfour Beatty, Taylor Woodrow, Wolseley and Marshalls.**

F&C has also started to engage companies based in Asia, where standards are very poor but land development can often have a significant impact on biodiversity. Companies engaged include **Ascott Group, Creed Corp, Cheuk Nang** and **Wheelock Properties.**

Biofuels

The growth in the biofuels industry has focused global attention not only on the competing demands of food and fuel production, but also increasingly on the need to protect biodiversity as a key element of securing the benefits of biofuels in tackling climate change. F&C has taken a strong public policy stance in favour of biofuels, but has called on governments to establish mandatory standards for sustainable sourcing of feedstocks.

Overall, F&C recommends that biofuels companies have full traceability for their feedstock, and join or help to form industry initiatives to promote and facilitate sustainable sourcing of feedstocks – much as we recommend food companies have traceability and support sustainable sourcing for palm and other vegetable oils. Biofuels companies engaged by F&C are located worldwide and range in size from small start-ups to divisions of the oil majors – which are often leading sector-wide sustainability initiatives. They include **Brasil Ecodiesel, Verbio, Neste Oil, Total, Shell, BP** and **Statoil.**

Construction & building materials

Without access to land, there is no construction, and so biodiversity-related delays in, or denials of, permits and approvals are another area in which business can grind to a halt for lack of good practice. Even a completed project can leave lasting damage to a company’s reputation as it seeks new land and new projects. But this direct effect at the site of construction is only the beginning: of growing concern are the indirect biodiversity effects inherent in the building materials used in company supply chains. Sustainable sourcing is becoming increasingly important as the market grows throughout the world for public-private partnership projects, in which governments are starting to set stricter guidelines for sustainable procurement. Examples include governments specifying certified wood products¹³ for fencing, hoarding and structural woods and finishes, and requiring aggregates such as gravel to be sustainably sourced.

We said...

“We consider that the long-term sustainability of the biofuels industry depends on robust environmental credentials. Certain types of biofuels, for example those produced at the expense of important carbon sinks or biodiversity, may result in long-term problems, rather than solutions for climate change. F&C views positively the UK Government’s decision to move, in the long term, towards a system under which only biofuels that meet minimum sustainability standards are encouraged and eligible for renewable transport fuel certificates under the RTFO.”

Extract from F&C Asset Management’s submission to the UK Department of Transport’s consultation on the Draft Renewable Transport Fuels Obligation Order, May 2007



Focus on Jewellery Industry

Our objectives

- Promote responsible product stewardship and effective industry initiatives that apply throughout the jewellery product life cycle:
- **Retailers:** encourage adoption of a supply chain policy, robust monitoring, supplier engagement and clear communication to consumers.
- **Mining companies:** encourage strong practices in environmental, social and governance practices within mining operations.

“Our objective is to promote responsible ethical, social and environmental practices throughout the diamond and gold jewellery supply chain, from mine to retail.”

Council for Responsible Jewellery Practices’ Mission Statement

“A voluntary system will not bring the necessary change within the diamond industry”

Amnesty International and Global Witness, Financial Times, 29 May 2007

Introduction: the consumer awakens

Thanks in part to the Hollywood film *Blood Diamond*, consumer concern about poor practices in the jewellery industry is reaching new heights. Public attention is focused on the companies that mine, process, trade and retail diamonds and gold, because of their possible contribution to financing conflict in Africa, and causing human rights and environmental abuses. Over time, consumer trust in jewellery brands could suffer a perception of poor practices. But the jewellery market is complex and fragmented, involving many sectors: exploration, mining, trading, cutting and polishing, jewellery manufacture and retail. No one sector or company can single-handedly create the change in business practice that is needed to bring an end to abuses; industry-wide coordination is required. For instance, consumer-facing brands risk the greatest damage, especially prominent luxury brands, but these companies can do little to reassure their customers without good practice by industry players further up their supply chain. Self-regulation through voluntary good practice is a start, but human rights campaigners will not trust this until there is clear evidence that companies are acting in line with their public commitments.

Engagement by F&C

F&C has encouraged companies to work together to improve practices throughout the entire jewellery product life cycle, from mine to shop window. Since F&C’s initial engagement with companies in 2003, companies have made individual progress and a new industry body has been established to promote good practice, The Council for Responsible Jewellery Practices (CRJP). Its 60 member companies aim to maintain consumer confidence in the jewellery industry.

Nevertheless, F&C remains concerned by patchy implementation of the industry initiatives. We have highlighted to industry bodies that prompt and consistent implementation is critical to the effectiveness of voluntary initiatives. To address these challenges, F&C has focused on retail and mining, two key links in the supply chain that tend to be listed companies. Here, we have pressed companies to tackle the risks associated with high-risk jewellery products, including diamond, gold and other minerals.

Key issues facing the jewellery industry

Blood Diamond – a thing of the past?

“Blood” or “conflict” diamonds are rough diamonds sold to provide revenues for rebel movements, indirectly financing conflict in Africa. Despite industry efforts to prevent trade in such diamonds, they continue to make their way into the markets, putting at risk consumer confidence in the jewellery industry and therefore its long-term success.

F&C has called on retailers publicly to support the Kimberley Process – but most importantly of all, has insisted they provide clear evidence that this commitment extends right down the supply chain, by establishing strong tracking and monitoring systems. F&C has also recommended that retailers communicate clearly their practices to consumers and policy makers. **Signet** (which owns **Kay Jewellers, Jared, H Samuel** and **Ernest Jones**), **Bulgari, Tiffany, Richemont** (owner of **Cartier**) and **Home Retail Group** (owner of **Argos**) have all improved their practices, while **The John Lewis Partnership** and US low-cost retailer **Target** have pledged to improve practices going forward. However, F&C still awaits responses from US retailers **Costco** and **Federated Department Stores**. In the meantime, following F&C’s recommendations, mining company **Rio Tinto** has launched its diamond stewardship programme, focussing on working with consumers and policy makers to raise awareness of the issues associated with diamond sourcing and production.

Managing community relations from the start

Although the retail price of gold and diamond jewellery is relatively high, local communities around the mines have historically derived little benefit, and in some cases their welfare has been compromised by mining activities. F&C has engaged the major mining companies on this issue, calling for transparent community relations and systems for minimising disruption; **Anglo American, BHP-Billiton** and **Rio Tinto** have since developed policies for effective community outreach and consultation.

The Kimberley Process was launched in 2003 as an international, government-run diamond certification scheme to eliminate trade in conflict diamonds. In parallel, the diamond industry established self-regulation, whereby suppliers must provide retailers with warranty statements on invoices, indicating the source of diamonds. Four years on, serious weaknesses have become apparent, including poor government controls and lacklustre company compliance, leading to conflict diamonds being falsely certified as conflict-free. F&C considers that The Kimberley Process may yet be effective, but only if governments and industry step up efforts rapidly. We have recommended companies to establish tighter sourcing controls and monitoring.

During 2006, F&C turned its attention to other companies, namely 'junior' gold and diamond producers. Following F&C's engagement, **Peter Hambro**, a gold producer based in Russia and listed in the UK, has developed policies addressing community consultation and local development. Recognising the role increasingly played by 'juniors' in exploration on behalf of the majors, F&C published a report entitled *Do You Know What Junior is Doing?*¹⁴, which calls on the majors to ensure that their ESG policies encompass all operations, including joint-ventures. We are pleased that **Anglo American**, a major platinum producer and partial owner of some of the largest diamond and gold miners, has disclosed how its human rights and community management policies apply to its joint ventures at all stages of mine development.

Do You Know What Junior is Doing?, a new F&C report on the environmental, social and governance challenges facing joint-ventures in the mining sector, highlights the dangers of failing to address such issues as biodiversity and community relations from the earliest stages of mine development. The study analyses the gaps in how mining majors apply their ESG systems to independently-managed operations, and recommends a way forward.

Jewellery sector: Polishing up its act

A significant concern to local communities has been the environmental degradation caused by diamond and gold extraction, which F&C has encouraged the industry to address:

- In line with F&C's recommendations, **Peter Hambro** has developed clear and transparent systems for the use and clean-up of cyanide in gold extraction. Cyanide use has attracted harsh NGO and media criticism because of the ground and water pollution it can cause. F&C has

also encouraged **AngloGold Ashanti** to manage its impacts on biodiversity and ecosystem services, and welcomes the company's recent commitment to address the issue.

- While the mining industry has the highest direct environmental impacts of any element in the jewellery production chain, retailers can influence practices through their purchasing and monitoring standards. F&C has recommended retailers **Tiffany** and **Signet** work with suppliers to improve environmental practices; both have indicated they will do so.

Improving labour standards

Allegations of child and forced labour, as well as health and safety problems, common throughout the supply chain, can likewise harm jewellers' brands. F&C has highlighted these risks to retailers, recommending they commit publicly to upholding established international standards, the ILO Core Conventions, and check supplier compliance. **Signet**, **Debenhams** and **Home Retail Group** have indicated this is underway. We have also recommend retailers publicly disclose the results of supplier audits; presently only Home Retail Group does so.

Bringing the links of the chain together: effective industry approaches

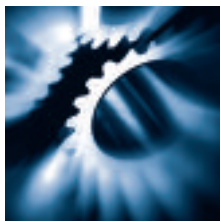
In addition to engaging companies one by one, F&C has contributed actively to the Council for Responsible Jewellery Practices' principles and code of practices. We welcome the Council's decision to adopt F&C's recommendation that the code reference relevant ILO Core Conventions and require robust third-party monitoring.

F&C has encouraged companies to join the new Council for Responsible Jewellery Practices. Following our engagement, retailers **Signet**, **Cartier** (owned by **Richemont**) and **Bulgari** have joined the Council, while **Argos** (owned by **Home Retail Group**) is seeking to join it. F&C also commends the following mining companies for joining: **AngloGold Ashanti**, **BHP Billiton**, **De Beers Group**, **Newmont Mining Corporation** and **Rio Tinto**.

Next Steps

Going forward, F&C will continue to engage the jewellery industry to improve product stewardship, asking for:

- Strong supply chain management and performance reporting by retailers;
- Investment in stable, transparent relations with communities surrounding diamond and gold mines;
- Membership in the Council on Responsible Jewellery Practices;
- Inclusion of biodiversity and corruption on the agenda of industry associations such as the Council on Responsible Jewellery Practices; and
- Development of industry-wide systems to address similar challenges posed by other gemstones, such as emeralds from Burma and Colombia.



Focus on Utilities

Our objectives

- Encourage companies to identify and manage environmental, social and governance issues that may influence relations with regulatory authorities who grant licenses and often control prices.
- Ensure that companies have identified the risks and opportunities of the trend towards increasing curbs on CO₂ and encourage them to develop a strategy to manage these risks.
- Press for Shareholder rights to be respected in this highly-politicised sector.

Engagement by F&C

Utilities: A political flashpoint

The utilities sector has always been at the heart of conflicting political pressures. But now, with concerns over security of supply and climate change joining the list of concerns, the heat is really on. Utilities now face increased demands from consumers, governments and regulators to curb greenhouse gas emissions, ensure security of supply, liberalise their operations, and keep power prices low.

Within this complex market, utilities need to carve out a path to sustainable long-term performance.

F&C's engagement objectives

F&C's engagement has been focused on three key areas: climate change, bribery and corruption and shareholder rights.

Climate Change: Ultimately, F&C believes that the utility companies who will succeed in the future are those best able to make the transition to lower carbon intensity. F&C encourages companies to develop transparent, forward-thinking strategies to adapt to a carbon-constrained world.

Bribery and Corruption: Due to the highly regulated and politicised nature of the utilities industry, companies in the sector are vulnerable to accusations of undue influence and bribery and corruption. F&C has encouraged companies to develop comprehensive policies and whistle-blowing systems to address bribery and corruption.

Shareholder Rights: The political minefield of cross-border mergers and acquisitions has often meant that shareholder rights have been overlooked. F&C actively lobbies for enhanced shareholder rights, both directly with issuers and at EU level. F&C believes that enhanced shareholder rights lead to greater management accountability and enhanced shareholder value in the long-term.

State meddling frustrates shareholders

Despite a push by the European Commission to liberalise energy markets, national governments have interfered to frustrate international mergers, or force domestic mergers, in an attempt to champion their domestic players. Germany's **E.ON** failed in its attempt to buy Spain's **Endesa** because the Spanish energy regulator blocked the bid using measures designed to prevent foreign takeovers.

Meanwhile, Italian Enel's attempt to buy France's **Suez** has been thwarted by the government's push to merge **Suez** with **Gaz de France**. This interference has frequently been to the detriment of shareholder rights by depriving sellers of opportunities to achieve the highest possible price.

F&C took action in the latter case, when the French government's action resulted in a (failed) offer for **Suez** that fell well short of shareholders' expectations and included no substantial takeover premium. The French government (and related parties), with by far the largest shareholding in the combined group, attempted to underpay for **Suez** using shareholder-unfriendly mechanisms such as golden shares. Along with a group of other investors, F&C wrote to the company to object to the terms of the merger and insist on an increase in the dividend paid to Suez shareholders.

F&C also remains concerned over governance structures that give certain shareholders, such as governments, disproportionate control over a company. F&C has actively lobbied for increased shareholder rights at EU level for a number of years. F&C has also participated in an EU consultation on the subject, calling for the abolition of shareblocking, greater ease for shareholders to table resolutions, and a policy of one share/one vote¹⁵.

We believe that robust shareholder rights allow shareholders to use their influence to promote good management and create value over the long term. This is of particular significance in the utilities sector, where, despite privatisation, historic government influence has the potential to damage minority shareholder rights.

Guarding against corruption

The utilities sector is highly regulated, and in many countries is subject to direct state intervention. The highly-politicised nature of the industry puts companies at risk of accusations of undue influence, including bribery and corruption. This can expose companies to legal and reputational damage resulting in fines, management disruption, and decreased ability to secure contracts. F&C has highlighted issues of bribery and corruption to utility companies for several years, encouraging companies such as **Suez** and **Endesa** to adopt the UN Global Compact's 10th principle against corruption. F&C has pressed utility companies to develop

robust systems to counter bribery and corruption, and recommends that they:

- Develop a comprehensive anti-bribery and corruption policy that includes reference to facilitation payments, third parties and political donations.
- Institute whistle-blowing procedures so employees can report policy violations or concerns

Recent allegations concerning inappropriate payments to politicians by German power generator **RWE**, as well as investigations into price-fixing activity, illustrate how the absence of anti-corruption systems can thrust a company into the spotlight. F&C had highlighted the risks associated with bribery and corruption back in 2004, at a time when **RWE** lacked such policies, well before any scandal had hit the headlines. F&C met the company on numerous occasions and encouraged it to develop a comprehensive policy covering facilitation payments, third parties, political donations, and whistleblowing procedures. Although the company could not prevent the damage from previous scandals, it has since implemented a comprehensive code of conduct, largely following F&C's recommendations. The code has been signed retrospectively for 2006 by all senior managers.

As EU turns up the heat, US warms to CO2 curbs

The recent G8 Summit in Germany is the latest reminder that climate change is now at the top of the political agenda. With power generation the single-largest source of global emissions, no sector will be more affected than utilities. F&C believes that utility companies must have a clear strategy on how they will adapt their business to a carbon-constrained world. Specifically, we encourage utility companies to:

- Develop a transparent forward-thinking strategy on adapting to a carbon-constrained world.
- Engage in the public policy debate to ensure that robust, predictable policy frameworks are put in place to tackle climate change.

F&C has had discussions on these issues with several companies including **Scottish and Southern Energy**, **British Energy**, **E.ON**, **RWE**, **Suez**, **Enel** and **Energias** de Portugal over the past year.

EU emission permits: Once bitten, twice shy

The first phase of the EU Emissions Trading Scheme had some perverse effects. Utility companies were handed out permits for free, yet most were able to pass on the additional CO2 cost into the price they charged customers. This resulted in windfall profits totalling an estimated €5bn annually¹⁶ for the utilities sector alone.

This time round, the EU scheme is toughening up. Future schemes will see far fewer permits allocated to the utilities, and we can expect a significant proportion to be sold by auction rather than given for free. That means that utilities with a heavy exposure to more carbon-intensive fuels, particularly coal and lignite, could be increasingly

disadvantaged. The trend towards tougher targets is similar in the US. With all the Democratic, and most of the Republican, Presidential candidates endorsing a national cap-and-trade scheme for emissions (as F&C has consistently argued for), it now seems inevitable that carbon curbs are the future; US utilities need to be thinking now about the regulatory risks that lie ahead.

The need for a clear and consistent public policy framework on climate change has been accepted by many business leaders across the globe. As well as being an active member itself, F&C has encouraged European utilities such as **Iberdrola**, **Enel** and **RWE** to join the EU Corporate Leaders' Group on Climate Change¹⁷. The group seeks to encourage the European Union to take a leadership position on climate change, by pushing for clear regulation to allow the necessary step change to a low-carbon economy. The group has been an active voice in the EU policy arena, with the CEOs of seventeen members meeting the President of the European Commission, Jose Manuel Barroso, to push for tighter emissions caps. In the US, F&C has been involved in investor group initiatives with companies such as **Duke Energy** and **Southern Company** to build consensus around the need for the US federal government to introduce mandatory restrictions on carbon.

What next?

The second half of 2007 promises to be another eventful year for the utilities sector, with the EU driving its dual agenda of liberalisation and climate change. The pressure for cross-border consolidation, and the resulting political controversies, are also likely to continue. F&C will continue to engage companies to ensure that the utility companies in which it invests are positioned to prosper in a carbon-constrained, yet liberalised and competitive, economy.

They said...

“70 or 80 percent of the executives in our industry think there will be carbon regulation [in the US]. In a sense, we're all building our business plans around the carbon scenario. The only issue is what the regulations will look like and when they'll be implemented.”

Paul Anderson CEO of US utility Duke Energy, interview with www.grist.com, 4 April 2007

¹⁶ Reuters, "EU Looks to Curb Utility Windfall Carbon Profits", May 4 2007

¹⁷ The EU Corporate Leaders' Group on Climate Change is a group of European and US companies who believe that there is a need for urgent government action on climate change, including the adoption of more stringent carbon caps. Details of previous activities of the group were reported in the Q4:2006 reo® report – see http://www.cpi.cam.ac.uk/bep/clgcc/eu_letter.htm


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Important information. All data is as at 30 June 2007 unless otherwise stated.

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