REPORT TO:	**SUPERANNUATION INVESTMENT SUB-COMMITTEE OF THE POLICY AND RESOURCES COMMITTEE - 19 NOVEMBER 2007**
REPORT ON:	**SOCIALLY RESPONSIBLE INVESTMENT - SIX MONTHLY REPORT**
REPORT BY:	**HEAD OF FINANCE**
REPORT NO:	**567-2007**

1 PURPOSE OF REPORT

This report reviews the progress by the Fund Managers regarding the positive engagement strategy approved by the Sub-Committee on 23 February 2000.

2 RECOMMENDATIONS

The Sub-Committee is asked to note the information contained within this report with regard to the activities of the Fund Managers during the six month period ended 30 September 2007.

3 INTRODUCTION

On 23 February 2000 the Sub-Committee approved a report prepared by Hymans Robertson, the Fund's consultants that the Fund should adopt a strategy of positive engagement with the companies in which it invests. The four action areas were identified as Employee Care, Human Rights, Sustainability and the Environment. This report reviews how the individual Fund Managers have implemented this.

4 ALLIANCE BERNSTEIN

Alliance Bernstein have specifically looked at BP. They have used these concerns to reduce their valuation of the company. This is shown at Appendix 1.

5 BAILLIE GIFFORD

A summary of recent engagement activity is shown at Appendix 2. This shows the wide range of topics covered and the diversity of companies approached.

6 FIDELITY

Fidelity's policy and recent engagement activity is shown at Appendix 3, together with two key issues they have identified - energy and water scarcity.

7 OVERALL CONCLUSION

The managers have continued to demonstrate a commitment to this activity and have addressed a wide variety of issues with companies.

8 POLICY IMPLICATIONS

This Report has been screened for any policy implications in respect of Sustainability, Strategic Environmental Assessment, Anti-Poverty, Equality Impact Assessment and Risk Management.

The Fund's policy on Socially Responsible Investment requires its investment managers to engage with companies on Sustainability and the Environment and Employee Care and Human Rights.

9 CONSULTATIONS

The Chief Executive, Depute Chief Executive (Support Services) and Depute Chief Executive (Finance) have been consulted in the preparation of this report.

10 BACKGROUND PAPERS

None.

MARJORY M STEWART
HEAD OF FINANCE **13 NOVEMBER 2007**

Company Engagement: BP - Looking Beyond Public Relations

BP Is Highly Rated by SRI Organizations…

- Self-acclaimed champion of responsible operations: not just "legal compliance" but meeting "universal standards of individual and collective behavior"
- Climate change
- Development
- Sustainability reporting

…but We Had Concerns

- Texas refinery explosion kills 15 (March 05)
- OSHA puts BP on safety watch list (April 05)
- Hurricane Dennis damages Thunder Horse facility, revealing design flaws (July 05)
- Pipeline spill at Prudhoe Bay (March 06)
- BP accused of manipulating propane prices (June 06)
- US Government investigates BP for manipulating crude oil prices (August 06)
- Prudhoe Bay oil field closed due to pipeline corrosion (August 06)

APPENDIX 1

We Adjusted Our BP Forecast to Reflect Actual Company Operations

Capital Expenditure

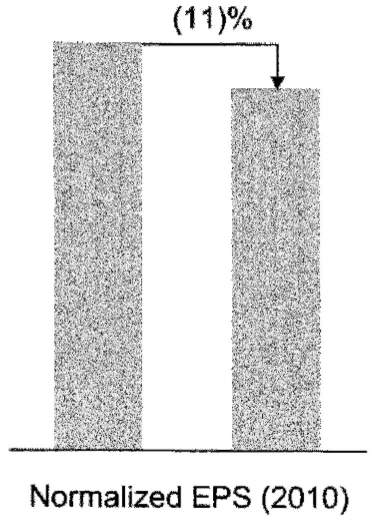
- Added US$500 million per year for US refineries
- Added US$500 million per year for other businesses (e.g., Prudhoe Bay)

Production

- Reduced throughput from Texas City by 200,000 bpd in 2006 and 130,000 bpd in 2007
- Eliminated volumes for Atlantis and Thunderhorse for 2006 through 2008

Long term earnings

- Reduced normalized EPS an additional 6% to account for further outages and problems



BHP Billiton (UK)

For a global mining company, the management of environmental, social and governance (ESG) issues is integral to all aspects of the business. With the continuing growth and therefore increasing energy and mineral requirements of India and China, there are significant pressures and incentives for companies to increase production to keep pace with demand. BHP Billiton is very aware of the importance of managing its ESG risks and has extensive reporting covering all facets of the issues. We met the CFO when he was in Edinburgh and he confirmed that regardless of the pressures to increase exploration and production that ESG management remains a priority. This company manages its ESG risk in accordance with best practise and we will continue to review it to ensure this remains the case.

Greggs

It is not unusual for a mid-cap UK company to have limited disclosure on environmental, social or governance issues and for Greggs there are two areas where we believe there is room for increased disclosure. Firstly, on aspects of the 'explain' component of the Combined Code's 'comply or explain', and, secondly, with regard to food safety and health & safety. We met the MD to discuss these two points.

The Combined Code suggests that the independence of a non-executive director (NED) should be re-considered after 9 years and a board should articulate why a NED who has served on the board for longer than 9 years remains 'independent'. Greggs' Senior Independent NED has served on the board for 26 years. On enquiry, the MD explained that he brings a different perspective to the board, views the business as an investor, and adds a robustness to board debates. We are considerably more satisfied with this explanation than the one provided in the annual report and have encouraged this level of explanation in next years annual report.

Food safety and health & safety are described at being at the forefront of how the company operates but no further information is disclosed about how they are incorporated. The MD acknowledged that these two issues were very significant management issues and that they are taken very seriously. We will continue to engage with the company on this issue as there is scope for them to disclose their policies and management practices. We would note however that although there is little disclosure about the policies, the performance in this area appears to be good as to date, there have not been any customer health scares.

Royal Bank of Scotland Group

Reputation for an international bank is imperative for its continued growth and profitability. The integration of corporate responsibility (CR) principles into the Group's business operations is an important component of reputation management and, when successful, can enhance business opportunities and minimise reputational risks.

RBS has been improving its CR function and the governance structures around policy implementation for a couple of years, and this year there has been significant improvement.

Following a stakeholder survey in 2006 which identified the key CR issues (which included financial crime, lending practises, financial inclusion and project finance), the importance and commercial value of CR was identified and reported to the board. This has increased board recognition of the role CR has in maintaining and improving customers' perceptions of the company. In addition, with increased Board support, integration of CR throughout the Group is more likely to occur more quickly. We are pleased to see this and have highlighted to the company that currently the CR policies and reporting are predominantly UK focused. The CR Manager agreed with this analysis and confirmed that an objective for 2007/08 is to internationalise the CR function. We look forward to the results.

Standard Chartered

Standard Chartered places considerable emphasis on the importance of managing its sustainability issues, making it one of their differentiating values. Not only is this apparent when analysing the company but was also very evident when we met the Chairman earlier this year. Having this backing from the Board is important but ensuring the policies are implemented by every employee is equally important. This is where ensuring the communication channels, the training programmes and monitoring of the policy implementation is essential to ensure the policies have an impact on the ground and are not just policy statements published on the website. We met the Senior Manager responsible for Sustainability Reporting and Governance to try to get an insight as to how all the policy statements are implemented throughout the group, in all businesses and geographies.

We have been very impressed with the energy and enthusiasm Standard Chartered has shown towards sustainability; the company has provided us with numerous examples of their sustainability and employee engagement programmes and the measurable benefit the company receives from thoroughly implementing and reviewing its sustainability policies.

We continue to be impressed with Standard Chartered's approach and commitment to sustainability.

Taylor Nelson Sofres

We were invited to participate in the remuneration consultation at market research firm Taylor Nelson Sofres (TNS). We consider this to be an opportunity to ensure that the interests of management and shareholders are aligned. The proposed changes in director remuneration focused on the annual bonus and the long term incentive plan. Two changes have been made to the annual bonus which we welcome. Firstly, part of the bonus awarded will now be deferred for two years. Secondly, financial performance conditions for the bonus have also been stretched. The significant change made to the long term incentive plan was that TNS have undertaken to review performance targets annually, this ensures that performance conditions remain stretching, are linked into business cycles, and in line with consensus estimates. This ensures that the interests of management and shareholders are aligned to meet the objectives of the company across a longer term horizon.

Teva Pharmaceutical Industries

Teva Pharmaceutical is principally focussed on the development, production and marketing of generic drugs although it also has some branded niche products of its own. Originating from Israel, it has expanded internationally and now generates most of its sales in US and Europe. Given this history, we expected its disclosure on environmental, social and governance (ESG) issues to have increased as it expanded, to incorporate best practice principles and processes. This has not happened; there is very little ESG policy disclosure and no information about implementation, monitoring or performance. We spoke to the Investor Relations Director and discovered that responsibility for ESG issues lie with the regional offices and are therefore not a centralised function. We do not believe that this is a reason for not having any disclosure and have

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Fidelity's policy on Corporate Social Responsibility

- Fidelity believes that high standards of corporate social responsibility (CSR) make good business sense and have the potential to protect and enhance investment returns. Consequently, our investment process takes social, environmental and ethical issues into account when, in our view, these have a material impact on either investment risk or return.
- We recognise and support the view that social, environmental and ethical best practice should be encouraged as long as the potential for financial return is not reduced. We favour companies committed to high standards of CSR and to the principles of sustainable development.
- We do not screen out companies from our investment universe purely on the grounds of poor social, environmental or ethical performance. Instead, we adopt a positive engagement approach whereby we discuss these issues with the management of the companies in which we invest on behalf of our clients. We use the information gathered during these meetings both to inform our investment decisions and also to encourage company management to improve procedures and attitudes. We strongly believe that this is the most effective way to improve the attitude of business towards CSR.

Fidelity's four-stage process for CSR analysis & engagement

1. The CSR Analyst identifies engagement priorities, typically focusing on companies where we perceive that environmental, social and ethical issues could have a material impact on shareholder value. These engagement priorities are discussed with the relevant research analysts.
2. Background research is undertaken on specific issues through dialogue with brokers and other interested parties (such as non-governmental organisations).
3. CSR Analyst holds dedicated CSR meetings with companies.
4. The findings from the meeting are reviewed by the CSR Analyst and research analyst and future engagement objectives agreed.

Recent company engagement Note: We have been in contact with the companies listed below to discuss environmental, social and ethical issues, either through face-to-face meetings, by teleconference or in writing.

Company	Country	Corporate Responsibility Strategy	Environmental Management & Climate Change	Responsible Product Stewardship	Workplace	Human Rights
Acciona	Spain		•	•		
Anglo American	UK	•	•	•	•	•
Areva	France		•	•	•	
AstraZeneca	Sweden	•	•	•	•	
BP	UK		•	•		
Clipper Windpower	UK		•	•		
EDF	France		•	•	•	
Fortum	Finland		•	•		
Gamesa	Spain		•	•		
Geberit	Switzerland		•	•		
Kingspan	Ireland		•	•		
[illegible]	The Netherlands		•	•		
[illegible]	Germany		•	•		
Rio Tinto	UK		•	•		
Saint Gobain	France	•	•	•	•	
[illegible]	India		•	•		
Veolia Environnement	France	•	•	•	•	
Vestas	Denmark		•	•		
Xstrata	UK	•	•	•	•	•

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Issue: The Global Energy Challenge

Background: Power generation accounts for about one quarter of global greenhouse gas (GHG) emissions and this will be further exacerbated as global energy demands grow by as much as 60% over the next 25 years. Two thirds of this increase will come from developing countries, as a result of increased urbanisation and living standards. Zero growth is not the answer to the energy challenge and climate change, as energy is a vital input to economic growth and poverty reduction.
There are currently four potential solutions for reducing CO2 from power generation – nuclear, 'clean coal', renewable energy sources and energy efficiency. This quarter, we undertook a review of each of these areas to identify CSR issues and investment opportunities for each, and to assess their growth prospects. Fidelity's CSR Analyst was joined in this analysis by two Equity Analysts covering Coal and Renewable Energy (Solar & Wind), with the output presented to the European and North American investment teams.

Company Engagement: Coal is a fossil fuel that currently provides 40% of the world's electricity, with reserves that are abundant, affordable and widely available geographically. Yet, in general terms, coal generation emits twice as much carbon as a gas-fired electric-generation plant. In addition to CO2, the combustion process of coal releases sulphur dioxide (SO2), nitrogen oxides (NOx) and mercury (Hg). It is the dirtiest form of electricity generation and therefore does not fit well into today's climate change world.

Yet the environmental credentials of coal versus gas or other fossil fuels are often of little relevance in new-build decisions when there are significant domestic coal resources available at low cost and soaring electric-generation demand. In 2005 alone, China added 70,000MW of new capacity, predominantly coal-fired. The industrialisation of the East has already gripped the financial world in the form of global commodities as China's thirst for resources has caused shortages around the world. Yet the next step – continuing to provide the necessary resources and dealing with the consequences in terms of climate change – is often not reviewed within equity analysis. The International Energy Agency forecasts that the dominant role of fossil fuels will see little change over the next 20 years. What is likely to change is that the balance between the three main fossil fuels – oil, gas, coal. Coal's role as a primary energy provider is going to increase as China, India and Russia go through their industrialisation process – thus putting significant pressure on global CO2 emissions.

There is a growing need to develop clean coal technology to deal with these consequences. Currently, the most efficient way to reduce carbon emissions from the generation process is the replacement of old capacity with new state-of-the-art technology. The next generation of supercritical pulverised coal plants and integrated gasification combined cycles (IGCC), which boost efficiency and reduce emissions, are beginning to be built around the world. Here in Europe, this technological development is also timely as nearly 30% of existing generating capacity is now more than 30 years old; this will rise to 70% by 2020. Many European countries will need new electric-generation plants by the beginning of the next decade.
In the longer term, the technology to separate carbon in the power-generation process is still at the test phase. The technology is available, but can lead to an overall efficiency loss of about 10-15% - this does not seem very significant but is infact equivalent to almost all the improvement that has been made in power-generation technology over the last 20-30 years. In terms of the storage of CO2 – either under water or land in appropriate geological formations - there are a number of pilot projects in operation. However, current carbon capture & storage (CCS) projects have an experimental character, rather than aiming at operating on a large industrial scale any time soon. Our analysis of costs (currently the major obstacle, although as with any new technology is expected to reduce over time) indicates it will not be a viable option until after 2015.

However, the need for clean coal as an important solution to climate change is likely to increase. Assuming that market-based solutions remain the preferred method to lead the transition to low-carbon economies in Europe, for electricity generators it will mean that long-term power prices are unlikely to fall, and carbon prices will rise to a level necessary to incentivise clean coal technology. For European utilities, this means that the power-price story, which has already been one of the major share drivers over the past four years, could be prolonged. This improved environmental outlook for coal is also a positive for the diversified miners Xstrata, Anglo American and Rio Tinto.

The key benefits of nuclear power are that it is a low-carbon energy source that is cost competitive relative to conventional fuels. Nuclear fuel derived from one tonne of naturally occurring uranium can produce more than 40,000 megawatt-hours (MWhe) of electricity. This is equivalent to burning 16,000 tonnes of coal or 80,000 barrels of oil. The 'clean' credentials of nuclear power are based on the fact that it is one of the least carbon-intensive technologies, with greenhouse gas emissions only amounting to approximately 9.2 to 20.9kg CO2 /MWh, compared to 385kg to 1242kg CO2 for fossil fuel and 9.2kg-278kg CO2/MWh for renewable energy sources.

The key barriers to nuclear growth are public and political acceptance, because of safety concerns and issues remaining about the disposal of radioactive waste. The industry's new generation of reactors, designed and to be built by Areva, Toshiba-Westinghouse and General Electric, have significantly improved efficiency (which, in turn, reduces waste) and safety performance. For example, Areva outlined to us its passive safety-related systems that use naturally occurring forces such as gravity, natural circulation and condensation, which activate without the need for human intervention. However, a key outstanding issue facing the nuclear power industry is the development of a final, high level waste (HLW) disposal method. Nuclear waste is normally classified as low-level, intermediate or high-level according to the amount and type of radioactivity. In Europe, the HLW is vitrified, which involves heating the waste strongly to produce a dry powder that is incorporated into Pyrex glass to immobilise the waste. This is then sealed into corrosion-resistant metals, and this will ultimately be stored in burial sites with stable rock structures deep underground. However, long-term HLW repositories have yet to be identified, and public opinion is likely to remain controversial until these are operational.

Acceptance of nuclear power varies in Europe by country: those actively pursuing new builds include Finland and France; countries considering new nuclear plants include the UK; while those opposing new build and considering plant closures are Germany & Spain. Overall, life extensions (adding 10-20 years to the lifetime of current nuclear plants via technological upgrades) are less controversial than new builds and are estimated by UBS to have a positive NPV for utilities of nearly 40% the value of a new plant. EDF and Fortum are the utility companies most likely to receive life extensions to their nuclear fleet in the future.

There is a positive political environment for nuclear power in China and significant plans underway for new build capacity. Yet there are some security-of-supply obstacles in that country. Uranium is a reliable fuel source with significant reserves balanced across the globe, although the primarily supply is from Australia, Canada and Kazakhstan. However, only 1% of worldwide uranium reserves are in China, where there is the greatest energy demand growth, while – as noted – coal is an abundant national resource. Coal-fired power plants will therefore continue to be the major source of electric-power generation in China.

Renewable energy has become an increasing focus over the last couple of decades, as environmental concerns have risen up the political agenda. The major barriers to renewable energy have historically been cost and practicality (especially scalability). Rising energy prices and, at the same time, more efficient technologies have seen the relative cost dynamics of certain renewable energies improve dramatically over recent

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Issue: The Global Energy Challenge (continued)

years. Yet, although a very popular topic, renewables, such as solar and wind, are growing from a very small base, currently only providing 0.4% of world energy demand. There also remains a significant diversity in the economic position of the different renewable technologies. Wind and hydro are cost competitive today; solar power, although a fast-developing technology, remains a niche solution rather than a wide application power-generation solution for today. Wind energy has been the fastest-growing renewable solution, and the market has grown strongly over the last twelve years, with a CAGR of 33% since 1992. Despite this growth, wind power accounted for only 0.3% of global electricity generation in 2005 and the International Energy Agency (IEA) expects this to reach 4% by 2030. Our renewables Industry Review evaluated the competitiveness of Vestas, Suzlon, Gamesa, Clipper Wind, Nordex and Acciona in relation to this growth scenario.

Finally, it is possible to reduce GHG emissions by implementing energy efficiency; saving energy is one of the easiest ways to reduce costs and emissions. Buildings account for over 40% of the EU's energy consumption, and so offer the largest single potential for energy efficiency. According to research undertaken by the EU Commission, one-fifth of the present energy consumption and up to 30-45 million tonnes of CO_2 a year could be saved by 2010 by applying more ambitious energy-saving standards to new buildings and when refurbishing existing buildings. The Energy Performance of Buildings Directive (EPBD) and the Energy Saving Directive (ESD) are being applied in order to achieve this. We expect the additional requirements under the EPBD and, this quarter, reviewed with Kingspan how it expects to benefit from the resulting increase in demand for insulation products. A company with diverse building activities that has particularly strong exposure to energy and emissions issues is Saint Gobain. The company noted to us that about 25% of its sales from products and distribution services is directly linked to generating energy savings in buildings.

Future Engagement Objectives: The link-up of these reviews on Coal, Nuclear and Renewables (and Energy Efficiency in Q1 2007) as solutions to Climate Change provided valuable analysis and recommendations for investment decisions. It represented an important milestone regarding how our CSR research can add value to the performance of the portfolios we manage. Our CSR Analyst will continue to provide input to potential new investment areas arising from environmental and social issues. As our efforts gather momentum, it is anticipated that this research will move from a separate function to an integral part of the research undertaken by all of our equity analysts when there are environmental and social issues that are material to performance.

Issue: Global Water Scarcity

Background: Water scarcity is a growing crisis that affects most of the world, although problems are most acute in the world's poorest countries. By 2025, 1.8 billion people will live in areas with water scarcity. Water contamination is also an issue and, again, is particularly pressing in developing countries, where as much as 75% of all industrial waste and 90-95% of sewage is discharged into surface waters without any treatment. China faces the worst water-crisis scenario, and will spend over $87 billion by the end of 2010 to improve water supply and sanitation.

The water theme is an area of ongoing CSR research and engagement to identify opportunities arising from companies that assist in addressing this important global issue. In Q1 2007, we looked at solutions to enhance the supply of water, such as desalination (the conversion of seawater into a purified and drinkable form). This quarter, our CSR research looked at challenges and solutions to reduce demand, as we believe more efficient use of water will differentiate companies competitively.

Company Engagement: The industrial sector currently consumes approximately a quarter of the world's available water resources, with volumes varying depending on the industry, the different types of production, and the technology used in the industrial process. Water management is therefore an important CSR performance issue, and not only for manufacturing industries. Indeed, high-tech industries, often mistakenly perceived as being 'clean', can be the most water-dependent and water-damaging sectors. For example, each 300mm silicon wafer (computer) chip produced requires 8,622 litres of de-ionized freshwater. Water is also of strategic importance to companies due to the rapid globalisation of many supply chains. In most countries the state owns the water rights and provides licenses or allocations for supply. In times of drought or of water crisis, governments designate domestic use as a top priority, followed by agriculture, for reasons relating to food security. Industry is often the last priority, which increases business risk. For AstraZeneca, water is essential in the production and manufacture of raw ingredients and chemicals in its pharmaceutical production. Of the company's 29 manufacturing facilities, nine are located in countries with water resources listed as 'highly stressed' or 'medium stressed'. The company provided us with an overview of its ongoing programme to minimise water usage, not only within its own activities (ensuring adequate supplies and limiting waste and pollution) but also assisting local communities with this challenge in order to ensure the long-term success of its business. At the same time, a significant service industry has developed to assist with this water-management challenge. Nalco Company outlined to us its growth as a provider of integrated water treatment and process-improvement services for industry. Veolia Environnement has an unparalleled know-how, global reach and experience in this area; the company provided an overview of its business in designing and building technological water systems for government and industry. Veolia manages municipal contracts in 14 provinces, serving approximately 18 million inhabitants in China.

Finally, our water-scarcity research does not only focus on developing countries. The Swiss company Geberit is on the water 'watch list' of the CSR Analyst, as a provider of ecologically efficient sanitary systems and piping solutions. Geberit realised and included the water-saving potential of its product development at an early stage, for example introducing as early as 1996 a dual-flush technology that reduced water usage by as much as 60%. In the case of a family of four, this corresponds to approximately 40,000 litres of water or 200 full bathtubs per year.

Future Engagement Objectives: We will continue our review of the water issue and solutions.