

Product liability, where does the buck stop?

Product liability is increasingly moving to the forefront of the corporate agenda. It raises a number of complex questions: To what extent is a company responsible for the social and environmental impacts of its products? What actions by a company are considered to be legally and morally acceptable ways of protecting against potential liability and protecting shareholder interests? We will address these issues in the following three examples.



Tobacco

Proven to be addictive and carcinogenic for some time now, tobacco is the classic product liability case.

Initially the response of tobacco companies was to refuse to publicly acknowledge the health issues of tobacco, argue against warning labels and controls on advertising, and pursue marketing strategies in developing countries.

The tactics used by tobacco companies to fight liability have led to increased regulation and control, and calls for tobacco producers to recoup the public health costs of smoking. Evidence that passive smoking has links to cancer has added a further dimension to the issue.

Asbestos

Asbestos-related liability, faced by CSR, James Hardie and others in the building industry, is an example of product liability which takes years to materialise.

CSR each year provides compensation and makes provision for their asbestos-related liabilities. The recent NSW Special Commission of Inquiry into James Hardie's asbestos liabilities reveals a different approach.

One of the focuses of the Inquiry was to consider the way James Hardie attempted to isolate and minimise its asbestos liability from the rest of the company by transferring the company's head office to the Netherlands, and utilising the corporate veil.

The actions taken by the company were seen by the CEO as consistent with 'commercial morality', while Greg Combet, Secretary of the ACTU, commented in the media that James Hardie's movement of assets offshore was 'one of the most morally and legally repugnant acts in Australian corporate history'. As a consequence there have been calls for the public to boycott James Hardie's products.

Following James Hardie's actions, there has been increasing pressure to change the Corporations Act by excluding product liability from the privilege of 'limited liability'. A similar change has been disputed in the US, where companies have resorted to 'Chapter 11' bankruptcy in an attempt to minimise liability.

Greenhouse

The fossil-fuel industry may be potentially liable for the impacts of global warming. The question here is - when will the link between greenhouse gases and climate change become a 'scientific certainty', so that down the track companies cannot dispute it? Most scientists would argue that such evidence exists today.

So where does this leave companies which are fundamentally involved in fossil fuels? At a strategic level, it may require them to rethink their business, as shown by BP's move to 'Beyond Petroleum' – renewing their commitment to the environment and solar power. However, such a strategic change takes time. In the meantime, companies can balance the potential liability of their fossil-fuel products, e.g. coal or gas, with climate change initiatives in other parts of their business which produce 'carbon credits'. Climate change product liability may affect related industries sooner rather than later, as shown by the recent case of a number of US States taking power generation companies to court over climate change.

Conclusion

The message is quite clear – the consideration of product liability issues has a direct impact on a company's public image, legal operating environment, competitive advantage and ultimately company value. For this reason and from a social responsibility standpoint, AMP Capital's Sustainable Funds have not invested in tobacco companies or James Hardie. In addition, the AMP Capital Sustainable Funds team has been integrating the climate change agenda into its strategy for a number of years, notably by investing in companies taking a lead in the transition to cleaner and more efficient energy systems.

stock story

CSR - Building for the future

CSR has developed into one of Australia's leading diversified industrial companies with a history of strong cash flows and consistent shareholder returns. Originally a sugar company, CSR now has three key businesses - Building Products, Aluminium, and Sugar - operating mainly in Australia and New Zealand.

CSR has had a chequered background with respect to environmental and social issues. In the case of asbestos, it is still having to address the legacy of its past actions (see lead article). However, CSR has significantly improved its environmental and social performance. For example, it is involved in the use of ethanol as a fuel extender, cost-effective fertilisers from waste materials, and building products that provide thermal and acoustic insulation in machinery, factories and residential dwellings.

The company has also invested millions of dollars in developing a 63 megawatt-capacity 'green electricity' plant at its Pioneer raw sugar mill. Once completed, CSR will be producing approximately 12% of Australia's renewable energy production target. It has also called for an extension of the Federal Government's renewable energy scheme, introduced in 2000 to reduce Australia's greenhouse gas emissions.

CSR also has a 25% interest in one of the most cost and energy efficient aluminium smelters in the world. The company's move into renewables demonstrates how a company can balance the climate change exposure that may come from being involved in aluminium and positions it well to meet the challenges and opportunities of a carbon constrained world.

Our Sustainable Funds team views CSR as a company trying to achieve economic, social and environmental sustainability. It still has some way to go, but it continues to display social and corporate responsibility and has proven that it can operate a sustainable and lasting business - it will soon celebrate its 150-year anniversary.

AMP Capital's Sustainable Future Australian Share Fund holds an overweight position in the stock.

research & engagement

Our Sustainable Funds team engages with companies to encourage better environmental and social performance. Companies we engage with are not necessarily approved for investment in our Sustainable Future Funds.

Australia

The Australian Sustainable Funds team's research focus over the past few months was on corporate governance and the proxy voting of listed companies. The team posted a 'Corporate Governance and Voting' position paper on their website (www.sustainablefuturefunds.com) in August 2004. The position paper outlines what the Sustainable Funds team considers 'best practice', both in terms of traditional corporate governance such as disclosure and transparency, and broader governance issues including a company's relationship with various stakeholders and their reporting of environmental, safety and employee issues.

The team also reviewed their Socially Responsible Investment (SRI) company assessment process (the process used by the team to assess companies for inclusion in their Funds). As part of the review, the team compared their current process to 'best practice' standards around the world. These standards are a product of various SRI research reviews from professional bodies in the US and Europe. Each step of the team's process was reviewed in detail and some enhancements were made.

The review confirmed that our Sustainable Future Australian Share Fund continues to be of 'best practice' in the areas of transparency and the consideration of broader sustainability issues. Areas for improvement include explicitly linking 'industry specific' sustainability and 'corporate social responsibility' to investment decisions.

Dr Ian Woods (Senior Research Analyst) released a paper on 'Emissions Trading and the Australian Aluminium Industry' in June. The paper investigates the potential impact on company earnings of a proposed Emissions Trading Scheme (ETS) in Europe and NSW (and also a potential Australia-wide ETS).

The focus of company research this period was on the Consumer Discretionary (Media: Radio, TV and Newspaper), Financials, Industrials, and Materials sectors. Companies assessed included West Australian Newspapers, Insurance Australia Group, AMP, John Fairfax Holdings, Leighton Holdings, AAV and Alcan. Initial Public Offerings assessed included Lipa Pharmaceuticals, JB Hifi, B&D, Super Cheap Auto and Zinifex Limited.

The team was involved in a range of engagement activities over the period. These are discussed below:

- Sponsorship of the 'Clean Energy Future' presentation in Sydney which discussed the role of energy efficiency and renewable energy technology (including green power and solar power alternatives) in meeting Australia's energy needs up to 2040. The presentation was prepared for a range of industry and Non Government Organisation groups.
- Dr Ian Woods met with the major banks, including ANZ and the National Australia Bank, to discuss broader corporate social responsibility issues facing the banking sector.
- Sponsorship of a gaming industry update run by the 'Christian Centre for Socially Responsible Investment on Community Action on Pokie Problems'. The topic addressed the political risks and ethical issues facing the gaming industry in Australia. Various Australian share portfolio managers from AMP Capital Investors attended, as did gaming analysts from a number of fund managers and stock brokers.
- Dr Ian Woods and Sarah Kim (Research Analyst) attended Rio Tinto's Corporate Social Responsibility Review of its global operation. Key issues discussed included human rights in developing countries, environmental compliance, occupational health of Rio's workers in Africa and Asia (eg. employees with HIV AIDS), and the safety of workers all around the world.
- Attending the Ethical Investment Association's Forestry Lunch that showcased five forestry investment companies/products to fund managers and asset consultants.





International

The northern summer was a busy and productive time for Henderson Global Investors' SRI team (who manage the AMP Sustainable Future International Share Fund). Three new members were added to the team's SRI Advisory Committee. As part of this change process the Henderson Global Investors' SRI team identified three key priorities for the future

1. To further increase their emphasis on investing in companies that provide sustainability solutions, termed 'Industries of the Future'.

The team has identified strong investment opportunities flowing from a range of themes (such as clean energy, environmental management, quality of life and health) and are constantly looking for new themes and companies that are positively contributing to a sustainable economy.

2. To raise the corporate responsibility hurdle in a range of key sectors, recognising that 'best in class' is often not enough.

Many companies and sectors have now reached a corporate social responsibility plateau, and the new challenge for the team is to identify the characteristics of true corporate leadership. The Henderson Global Investors' SRI team has started to address this challenge with the oil sector. After gauging investor views, along with industry trends and performance, the team has decided to avoid investments in oil exploration and production companies for their retail SRI funds.

3. To focus their engagement programme on 'emerging issues of critical importance' - for companies and society as a whole.

Critical issues include the ethical dimensions of mobile phone technology, the investment implications of workplace stress, and gaining better assurance on business ethics performance.

Changes to Henderson's SRI team and advisory committee

Kirsteen Morrison, former senior portfolio manager for the AMP Sustainable Future International Share Fund, resigned at the end of May 2004. Nick Robins, Head of SRI Research, has been appointed to Head of the SRI Funds team in order to draw the research and fund management elements of the UK SRI team together. Iain Clarke, Chief Investment Officer (International), has been appointed to manage the AMP Sustainable Future International Share Fund until a permanent replacement is found.

Henderson Global Investors invited Ram Gidoomal, Adrian Henriques and Paul Hohnen to join the team's SRI Advisory Committee (continuing members are Reg Green and Frans Berkhout). Profiles of new and existing committee members can be found at www.henderson.com/sri.

Henderson Global Investors also announced it would provide additional resources to its SRI team by recruiting a specialist international fund manager.

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profile



Matthew Rey

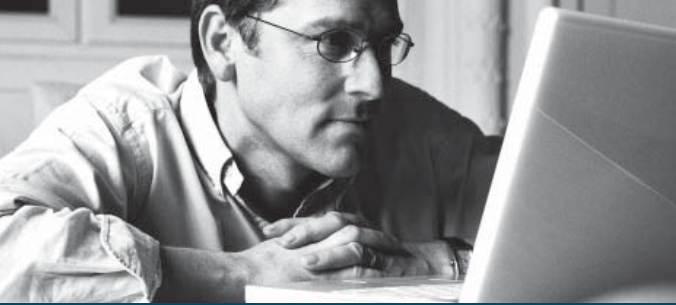
Portfolio Manager, AMP Capital Investors' Sustainable Funds team

With over \$220 million sourced in Australia currently under management, AMP Capital Investors' Sustainable Funds are increasingly becoming recognised within the Australian funds management industry as 'mainstream'. The fund has experienced significant growth over the past 12 months which has enabled the Sustainable Funds team to widen its scope and capabilities in identifying and managing suitable ASX-listed stocks. Importantly, this growth has also enabled the team to add to its existing depth of experience.

The team is pleased to announce the appointment of Matthew Rey to the role of Portfolio Manager. Matthew brings over five years' experience within the finance industry, where he has held a range of analytical roles, including equities research and corporate finance.

In addition to managing Australian Equity portfolios for the team, Matthew will be responsible for constructively engaging with companies on environmental and social issues.

Matthew holds a Bachelor degree in Law and Arts from Monash University and a Master of Finance from the Royal Melbourne Institute of Technology. His thesis, on whether corporate environmental performance is a leading indicator of financial performance, is currently subject to peer review by an international finance journal. By applying the theoretical concepts outlined in his thesis to a commercial context, Matthew will add significant value to the Sustainable Funds team.



news

your say

What is geosequestration and does it provide a solution to reducing carbon emissions and climate change?

Geosequestration is the collective term for the process of collecting, transporting and storing Carbon Dioxide (CO₂) under high pressure in a liquefied form underground. For many companies (especially those operating fossil-fuel power stations and, oil and gas production facilities) it is seen as the key solution to their dilemma of reducing greenhouse gas emissions.

The greatest technical challenge facing geosequestration is the capture of CO₂ emissions from power stations, which is both technically difficult and expensive. Many involved with the technology do not see it becoming 'commercially viable' for power stations within the next 20 to 25 years at best.

In the long-term, geosequestration may provide part of the solution to the problem of greenhouse gas emissions. However, given the technical and cost issues, it is still a high-risk solution to climate change and it clearly does not provide a short- to medium-term solution.

The AMP Capital Sustainable Funds team still place a higher priority on renewable energy and energy efficiency initiatives. The team believes that there is still a requirement to start 'pricing' greenhouse gas emissions before geosequestration becomes widespread. Also, it is critical that companies do not justify the development of 'high greenhouse gas emitting technologies' based on the potential of geosequestration - which is currently uncertain.

Higher oil prices in recent months, underpinned largely by increased worldwide demand and supply disruption, has raised concern about the longer-term impact of rising energy costs on the automotive industry. As the cost of energy rises, so too does the need for more efficient and cost effective alternatives to conventional vehicles.

Car manufacturers worldwide are now investing considerable money and resources in alternative vehicle technologies that benefit not only the consumer but also the environment. By investing in these technologies, they are attempting to create products that ensure both sustainable mobility and environmental protection.

The types of alternative vehicle technologies being developed by these manufacturers include hybrid and fuel cell concepts. Hybrid vehicles combine two or more sources of energy that enable the vehicle to move, in the process cutting fuel consumption by up to 20% when compared to a standard combustion engine. Exhaust emissions are also markedly reduced. But although hybrid vehicles are now readily available, many car manufacturers consider today's hybrid technology a short-term fix for moving away from the industry's reliance on petroleum fuels.

Combining the hybrid concept with fuel cell technology (whereby electricity is produced through a reaction between hydrogen and oxygen) is considered by many experts to be the ultimate solution to the industry's dependence on petroleum fuels - because of its cost, efficiency and environmental benefits (water is the only by-product). However, as with any new technology, there are several issues to overcome before the technology can be properly introduced to the mainstream automotive market. Perhaps the most important of these is the difficulty of storing and distributing hydrogen. It would be much more convenient if fuel cells could use more readily available fuel alternatives, such as methanol, but as methanol has similar properties to petrol it would detract from the technology's perceived benefits.

Despite the technical hurdles faced by car manufacturers, it's important that they continue to invest in the research and development of these and other types of alternatives to conventional vehicles. As the world's oil reserves decline and demand increases, the cost of energy will continue to rise.

The efforts of these car manufacturers will go a long way to reducing the industry's dependence on petroleum fuels (and the impact of those fuels on the environment) as well as ensuring that the level of mobility consumers currently enjoy is maintained.



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Sustainable Future Funds

The Sustainable Future Funds are a family of three SRI funds available to Australian investors: the Sustainable Future Australian Share Fund, Sustainable Future International Share Fund and Sustainable Future Balanced Growth Fund. The overall objective of these funds is to deliver superior returns to our clients by investing in companies that contribute to, benefit from and best adapt to the shift to an environmentally sustainable and socially responsible global economy.

Further information can be found on our website:

www.ampcapital.com.au or by contacting your adviser. Please note that you can subscribe to this newsletter on-line through our website.