

Mr Clive Bates  
Director  
Action on Smoking and Health (ASH)  
102 Clifton Street  
London EC2A 4HW

November 11th, 2002

***Re: Inclusion of Tobacco stocks in Dow Jones Sustainability Indexes***

Dear Mr. Bates,

Thank you for your letter voicing your concerns regarding the inclusion of a Tobacco stock, in particular British American Tobacco (BAT), in the Dow Jones Sustainability Indexes (DJSI). We welcome your critical feedback on this sensitive subject. I would like to clarify a number of specific issues that you raise in your letter.

***It is noteworthy that we agree that including the "least bad company" in a sector is an acceptable approach to selecting components for the DJSI.***

The DJSI does not exclude any industry, preferring to engage in constructive dialogue with companies that lead their industry in the transition to sustainability. By pursuing a Best-in-Class approach within each industry, including Tobacco, the DJSI is designed to reward companies that lead in evolving the full spectrum of issues in corporate sustainability. A minimum standard is also demanded. This minimum standard has been the reason why Tobacco stocks have not been included in the DJSI in its first 3 years, as we felt that the Tobacco companies approach to various issues, most notably smuggling, was not progressive enough. However, if investors wish to exclude certain industries for moral or ethical reasons, the DJSI offers the possibility to invest into sustainability indexes which exclude tobacco, gambling, alcohol, armaments or a combination of all. Furthermore there is the possibility to construct customized indexes using client specific screens.

***Many industries do harm to society, either directly or indirectly.***

Industries such as Tobacco, Alcohol and Gambling can do direct damage to individuals and society. Others such as Energy do damage more indirectly. Selecting companies that are active in "doing less harm" is therefore a more appropriate approach than selecting companies who "do no harm".

***BAT did not convince us that they are not involved in large-scale smuggling.***

However, this year, we believe BAT's decision to reduce the supply into duty-free markets, the main distribution channels used for smuggling, is a genuine attempt to continuously reduce exposure to smuggling. BAT's recognition of their role and responsibilities in stopping smuggling is a significant advance on previous attempts to merely deny that this activity is occurring. We consider these actions as an example for the whole industry and recognise this as a real step forward.

***BAT has raised public and investor expectations, and now must live up to its promises.***

We will closely monitor, as we do with all 300 companies in the DJSI, whether BAT lives up to its promises and continues to improve its performance. Should this not be the case, we will remove the company from the DJSI – this exclusion can occur at any time throughout the year. The negative impact on BAT's reputation of not living up to its promises and possibly being excluded from the DJSI in the future for genuine lack of performance, should encourage BAT to step up and deliver, which should advance the corporate sustainability agenda within this industry globally. While your inputs add significant insight to BAT's behaviour, we currently do not intend on excluding them from the DJSI.

As we review our position on companies yearly, we would very much welcome receiving input and data from ASH that may assist us in conducting a comparative analysis of company performance.

Furthermore, we recognise the responsibility we have in assessing companies in an objective and systematic manner across all industries. We also recognise the influence, reputation and PR value of the DJSI for companies. In this regard we are often approached by companies to have a positive view of their performance. This is exactly the same as how companies manage their other investor relations; SAM is no exception to the requirement to maintain objectivity. We therefore strongly contest your accusation that BAT has bought favourable consideration from SAM.

An effect of BAT's inclusion in the DJSI is that it has helped to stimulate debate amongst the investment community regarding the sustainability challenges the Tobacco industry faces. This is beneficial to both your cause and ours, as ultimately we are both working towards the goal of sustainability, albeit using different mechanisms to influence change.

***We do not consider BAT a "sustainable company".***

No company anywhere is sustainable in an absolute sense. We identify companies that lead in the transition to a sustainable future, and therefore identify the relative sustainability performance of a company to its peer group. Developing a financial index of publicly-listed equities with sustainability leaders is designed to mobilise the capital markets to reward companies that lead in this transition. We recognize that the Tobacco industry is not absolutely sustainable in its current business model and that the Tobacco industry will have to change significantly to

move close to a more sustainable business model – if even possible. Our objective and yours – to achieve change – is the same, but the means are different.

***Our research is designed to verify the integrity of company information.***

We gather our information on companies from 3 sources:

1. ***SAM Online Questionnaire & Company Documentation.*** I have attached a copy of our Tobacco industry questionnaire for your attention and would very much welcome your constructive critique on how we test company performance.
2. ***Media & Stakeholder Analysis (MSA).*** We monitor each company daily, via Dow Jones Interactive/Factiva, for any input from civil society on a corporate accountability. In particular, we checked the ASH-website, studied recent litigation cases (such as the EU-case on smuggling against Philip Morris and RJ Reynolds) and also analysed the report of the UK Commons Health Select Committee that led to the DTI investigation. We considered relevant public information which is available to us. We also verified the sources that you recommended to us a number of months ago during our first exchange.
3. ***Company Meetings & Interviews.*** We have met both BAT and other major players in the Tobacco industry over the past 12 months for significant periods of time to discuss our concerns about the Tobacco industry.

Therefore, via a highly systematic research process, which is audited annually by PwC, we checked what you refer to as “the spin against the reality”.

***We do not consider Swedish Match to be the best company in the Tobacco industry.***

Within our assessment universe of 17 Tobacco companies (from UK, USA, Malaysia, Sweden, Indonesia, Japan, South Korea, South Africa and Brazil), we consider that BAT leads its industry in addressing the challenges of sustainability. We did assess Swedish Match, but believe, primarily due to very low transparency and poor reporting, that they do not meet our minimum standards and are hence behind BAT in our view.

***We do not believe smuggling is the only “outstanding doubt” regarding BAT.***

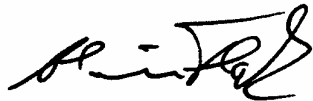
Our assessment criteria are derived from global and industry sustainability challenges. While this clearly includes smuggling, other challenges around litigation, health, advertising, and sustainable agriculture are equally as important. Please refer to the attached SAM Questionnaire for full disclosure of the challenges we test.

Once again I would like to stress that we recognise the value of exchanging views on sensitive issues and welcome and value your input and insights. In this regard, I have attached a copy of our industry specific questionnaire for the Tobacco industry and would very much welcome your views on how we can further develop and improve our assessment of tobacco companies.

We would welcome the opportunity to meet with you personally, either in Zurich or London, to discuss these issues further. A specific opportunity may be when my colleague Mr. Colin le Duc is in London on November 19<sup>th</sup>.

Many thanks,

Yours truly,



Alois Flatz  
Head of Research  
SAM Sustainable Asset Management

Enclosed:

1. DJSI Approach
2. Copy of ASH letter
3. SAM Tobacco Industry Questionnaire as a separate attachment

## 1. DJSI approach

- **The DJSI is:**
  - A relative rather than absolute judgement on companies (ie: no company that is in the DJSI is sustainable in an absolute way)
  - A recognition that the transition to sustainability takes time and that companies must be encouraged to lead
  - A Best In Class approach to select companies on an industry basis
  - Not passing moral or ethical judgements on companies
  - Considering that every industry faces the challenge of sustainability
  - Not involved in negative screening of industries (unless requested by clients)
  - A holistic assessment based on 50 criteria across the TBL, not a single issue assessment
  - A system that includes a minimum standard and reality check
  
- **Companies that are in the DJSI:**
  - Lead their industries in the transition to sustainability
  - Embrace the opportunities and risks deriving from sustainability challenges
  - Are best positioned to add sustainable value economically, environmentally and socially
  - Must constantly improve their sustainability performance to ensure they are not replaced by competitors as members of the DJSI
  
- **The DJSI promotes CSR by:**
  - Engaging with companies in a constructive dialogue
  - Providing, via the questionnaire and the benchmarking feedback, a roadmap to corporate sustainability for companies
  - Rewarding companies for their leadership in moving all areas of the CSR agenda forward by identifying them as leading companies
  - Constantly updating the methodology to reflect leading edge practice, thereby constantly challenging the leaders to progress with achievable goals rather than setting totally unrealistic demands on companies to divest entirely from certain activities immediately etc...
  - Stimulating the competitive impulses between companies with a Best In Class approach and clear identification of leaders
  - Not naming and shaming non-DJSI member companies
  
- For further information please visit [www.sustainability-indexes.com](http://www.sustainability-indexes.com)

## ***2. Copy of ASH Letter***

To: Sustainable Asset Management - Dow Jones Sustainability index  
From: Clive Bates, Director, Action on Smoking and Health

Dear Alois Latz

I understand from 'AccountAbility' in the UK, that British American Tobacco was admitted to the SAM Dow Jones sustainability index because they convinced you that they were not involved in smuggling (see note below). I don't know if that is the case, but is an astonishing conclusion to draw if it is - and flies in the face of a great deal of evidence for which the only counter is evidence-free denials from BAT. I am copying below an e-mail I sent to colleagues in the UK SRI community that gives a perspective on this finding and suggests some sources that you really ought to have considered before reaching this conclusion. And by the way, if this was SAM's only outstanding doubt about the company's conduct, then I am very surprised indeed.

Also, I thought you ought to be aware how BAT is using the new status you have conferred upon it. In BAT's 3Q results statement, SAM's ranking of its position as "best in its industry" has become and unqualified: "an excellent overall sustainability performance...". Again, I copy an e-mail circulated in the UK.

Please excuse the rather blunt tone of these e-mails appended below. It reflects my dismay at the PR gift that SAM has dropped in BAT's lap, it seems without looking too carefully for evidence or checking the spin against the reality.

Finally, I attach our new review of the BAT social report. I have already supplied you with the alternative report we launched in advance of BAT's publication, this is a shorter look at what BAT's report said once it was published.

I hope you will reconsider the listing of BAT in the light of these comments and reports. And please could SAM refrain from referring to the company as 'sustainable' - there is a very great difference between 'sustainable' and being the least-bad company in a vile and mendacious industry that kills

almost 5 million people per year now, and 10 million per year by 2002. In any event, SAM is wrong to class BAT as the least-bad. I would offer that accolade to Swedish Match. I hope that makes it clear that I am not against CSR or even picking the lest-bad companies in any sector. But to choose BAT strains credibility and to call its business 'sustainable' is laughable.

If you ever feel the need for more evidence to support your decisions about BAT, please do get in touch. In the meantime, I look forward to hearing if and how you decided that BAT was not implicated in large scale tobacco smuggling.

Regards

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