



Annual report 2013

Council on Ethics for the Government Pension Fund Global



Annual report 2013 | Council on Ethics
for the Government Pension Fund Global

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Introduction

The activities of the Council on Ethics

1 Introduction

The Council on Ethics for the Government Pension Fund (GPF) is an independent council appointed by the Ministry of Finance which makes recommendations to the Ministry on the exclusion of companies from the Fund and the placing of companies under observation. The Council makes recommendations following a concrete assessment of a given company's activities against guidelines adopted by the Ministry of Finance. The Ministry makes the final decision on the exclusion or observation of a company. The council has five members and a secretariat of nine persons.

Independent of the Fund's ownership interest in a company, its home country or size, the Council on Ethics seeks to identify companies that should be excluded from the Fund or placed under observation. Companies are identified by means of systematic reviews of problem areas, enquiries from interest groups and news monitoring. The Council uses an external consultancy firm to conduct daily online searches in multiple languages for news items on the companies in the portfolio. The search results are communicated to the Council in quarterly reports on companies associated with gross breaches of human rights, gross corruption, severe environmental damage or other matters covered by the guidelines. The Council also uses a separate external consultancy firm to monitor companies that may be engaged in activities that contravene the weapons and tobacco criteria.

Most of the work of the Council on Ethics involves obtaining and quality-assuring information. The Council employs a number of consultants and also obtains information from, for example, researchers and civil-society organisations. The companies in the portfolio are also an important source of information, and companies under assessment are sent written questions and given an opportunity to comment on a given matter before the Council decides whether or not to issue a recommendation.

2 The Council's activities in 2013

The Council on Ethics works on multiple cases simultaneously and aims to consider cases under all of the guidelines' criteria. While some cases are taken up in response to a specific incident, others are examined as part of projects or sectoral studies that may span several years.

Since 2010, the Council on Ethics has reviewed the GPF's investments in companies involved in several types of activities with a potentially severe environmental impact. The work done on these sectoral studies is described on page 31 of this annual report. The Council's review of companies involved in particularly destructive logging are discussed separately on page 34.

In the past year, the Council on Ethics has focused on examining activities for which the reported risk of breaches of labour rights is particularly high. This is discussed in greater detail on page 27.

In its 2013 annual report, the Council on Ethics stated that it intended take a closer look at oil companies producing oil in Equatorial Guinea. The Council wished to assess whether these activities could be said to breach fundamental ethical standards because the production of the country's dominant natural resource appeared to benefit only the governing elite, while the living conditions of the population at large were among the poorest in the world. In this case, the Council has not recommended the exclusion of any companies, since the responsibility of the companies is too remote to qualify for exclusion under the Fund's criteria. Nevertheless, the Council takes the view that the companies have a responsibility to assess and counteract human rights violations, including breaches of economic and social rights. This is discussed further on page 23.

In 2013, the Council on Ethics also conducted a review of companies engaged in the construction sectors in countries ranked particularly highly on various international corruption indices. Companies associated with credible corruption allegations were examined more closely. Following the study, the future risk of corruption was evaluated based on, for example, the companies' handling of previous corruption cases and internal anti-corruption systems. This project is now in its final phase.

When new companies become involved in a type of activity that has previously resulted in exclusion, the Council on Ethics also evaluates these companies. Examples in this regard include the construction of settlements on the West Bank and in East Jerusalem and the production of mineral resources in Western Sahara.

Table 1 below summarises the company studies conducted by the Council on Ethics in 2013 compared to data from 2012 and 2011.

Table 1. Overview of the Council on Ethics' activities^a

Year	2011	2012	2013
Limited companies in the GPFG at year-end (approx.)	8,000	7,500	8,500
Total number of excluded companies at year-end	55	56	60
Companies on official observation lists at year-end	2	2	1 ^b
Companies excluded during the course of the year	5	1	9
Companies re-included during the course of the year	1	0	5
Number of recommendations issued	4	11	11
Companies contacted by the Council	31	64	43
Companies met by the Council	9	9	18
New cases considered by the Council (approx.)	140	60	30
Total number of companies examined during the course of the year (approx.)	230	230	180
Total number of company studies concluded during the course of the year (approx.)	50	110	70
Council meetings	10	10	9
Secretariat members	8	8	9
Budget	11.6 mill.	12 mill.	12.5 mill.

a. Recommendations published after year-end but before the annual report is published are not included in the table.

b. The Ministry of Finance has also decided that the Council is to make a new recommendation regarding AngloGold Ashanti after five years.

Of the 60 excluded companies, 40 were excluded because they produce tobacco or particular weapons. Of the 20 companies excluded under the conduct criteria, 14 were

excluded because they cause severe environmental damage. Environmental damage may also often constitute a breach of human rights, for example the right to health. In the case of the 14 companies excluded for environmental damage, regard for human life and health formed part of the reasons for exclusion in 10 cases.

The Council on Ethics contacted 43 companies in 2013 and held meetings with 18. The Council contacts companies that it wishes to assess more closely following its initial studies. Most meetings with companies take place after the Council has sent the company in question a draft recommendation for comments. As a rule, the companies request meetings with the Council. It appears that, in some cases, this dialogue motivates companies to implement new measures to limit the negative consequences of their activities.

Fewer cases were considered by the Council on Ethics in 2013. This is because the Council launched no new sectoral reviews in 2013, but did conclude several reviews that were already in motion at the beginning of the year. Although sectoral studies may initially identify quite a large number of companies, only a very small proportion of studies result in a recommendation to exclude.

3 Published recommendations

Since the previous annual report of the Council on Ethics, the Ministry of Finance has published decisions on 15 companies based on recommendations made by the Council, as shown in Table 2. In these recommendations, the Council recommended the exclusion of 13 companies, and that two companies should be placed under observation. The Ministry of Finance excluded 12 companies and asked Norges Bank to exercise ownership in three companies. All recommendations published since the Council's previous annual report are appended to this annual report. Recommendations are also published on the website of the Council as the Ministry of Finance announces its decisions.

A total of 8 recommendations concern severe environmental damage. The first concerns the mining company Zijin Mining Group Co. Ltd., which during a 10-year period experienced several breaches of tailing dams containing mining waste. The consequences for the environment were very serious. The Council on Ethics does not normally recommend the exclusion of a company based on an individual incident. The fact that Zijin had experienced several such accidents, with catastrophic consequences, led the Council to conclude that the risk of repetition is unacceptably high.

The second recommendation concerns the mining company Volcan Compañía Minera SAA, which operates a lead mine in the Peruvian highlands. The mine is located in the middle of a town that has developed around the mining operation. Lead pollution is causing significant damage to the locals' health, and children are particularly exposed. Even though the health damage is also linked to historic pollution, the Council on Ethics concluded that the company currently operating the mine is also responsible for old tailings which it now owns and which continue to release lead pollution into the environment. The Council also found it likely that the current mining operation was increasing the health burden, and stated that companies must take particular care in such situations

so that they do not cause an already challenged population further harm.

The next recommendation relating to mining pollution involves AngloGold Ashanti Ltd., which was established through a merger of several companies in 2004 and continues the mining operation of one of the merger partners in Ghana. The Council on Ethics recommended excluding the company based on the extensive arsenic pollution coming from the mine. Although the company had plans for several measures to improve conditions in the longer term, the Council took the view that the damage was so extensive that it was improbable that the measures would sufficiently reduce the risk of severe environmental damage. The Ministry of Finance decided not to exclude the company and instead ordered Norges Bank to follow up on the matter through the exercise of ownership. In addition, the Council is to re-evaluate the company after a period of five years.

Two of the recommendations concern companies that are contributing to environmental damage through the logging of tropical forest or the conversion of forest into plantations. These companies are Ta Ann Holdings Berhad and WTK Holdings Berhad.

Two of the recommendations concern serious oil pollution. The Council on Ethics recommended placing the oil companies Eni Sp.A. and Shell Plc. under observation due to oil pollution linked to the companies' onshore oil production operation in the Niger Delta, Nigeria. Instead, the Ministry of Finance ordered Norges Bank to include oil spills and environmental conditions in the Niger Delta in its exercise of ownership for a period of between 5 and 10 years, and to report on its work during this period. In the Council's view, the exercise of ownership and observation are relatively similar instruments.

The exclusion of Sesa Sterlite reflects a restructuring of the company Vedanta Resources Plc. which has been excluded from the Fund since 2007 along with its subsidiaries, Malco Energy Ltd. and Sterlite Industries Ltd.. In 2013, a judgment by the Indian Supreme Court ordered the authorities to comply with the indigenous population's demand that Vedanta not be permitted to develop a bauxite mine on their land. This was an important, but not the only, reason for the Council on Ethics' recommendation to exclude the companies. In the Council's view, an unacceptable risk remains that the company will cause severe environmental damage. The parent company, Vedanta, therefore also remains excluded from the fund while the subsidiaries, Malco and Sterlite Industries, have been merged into Sesa Sterlite.

Only one decision involving the exclusion of a company due to human rights violations was published in 2013. Zuari Agro Chemicals Ltd. was excluded for using child labour in the production of hybrid seed in India. The Council on Ethics has had a strong focus on this issue. In an article in last year's annual report, the Council described how the scale of child labour had fallen, particularly since multinational companies had begun to work systematically to prevent child labour in their production chains. Some new studies which have come to the Council's attention suggest that this positive trend may be easily reversed. Accordingly, the Council will continue to monitor the issue and, if necessary, resume conducting its own surveys into the scale of child labour in companies included in the GPFG.

Two recommendations were also published concerning the construction company Africa Israel Investments Ltd. and its subsidiary Danya Cebus Ltd. The Council on Ethics first recommended the re-inclusion of these companies, which had been excluded for

constructing settlements on the West Bank since 2009. The companies had informed the Council that they would no longer build settlements on the West Bank. The Council later became aware that the companies were constructing Israeli settlements in East Jerusalem, which falls into the same category. The Council considered that this was also a ground for excluding the companies, and again recommended their exclusion.

Since the previous annual report, three recommendations relating to the product criteria have been published. These involve a total of four companies. The two weapons manufacturers Lockheed Martin Corp. and Alliant Techsystems Inc. have both stopped producing key components for cluster munitions, but continue to manufacture key components for nuclear weapons. In other words, the recommendations involved only a change of the reason for exclusion. In addition, Schweitzer-Mauduit Int. and Huabao Intl. Holdings Ltd. were excluded because they produce reconstituted tobacco.

Table 2. Overview of the companies for which a decision has been published since the previous annual report.

Company	Recommendation date	Publication	Decision	Criterion
Zijin Mining Group Co. Ltd.	18 June 2012	14 October 2013	Exclusion	Severe environmental damage
Volcan Compañía Minera SA	21 June 2012	14 October 2013	Exclusion	Severe environmental damage
WTK Holdings Berhad	25 June 2012	14 October 2013	Exclusion	Severe environmental damage
AngloGold Ashanti Ltd.	27 June 2012	14 October 2013	No exclusion	Severe environmental damage
Ta Ann Holdings Berhad	3 December 2012	14 October 2013	Exclusion	Severe environmental damage
Huabao Intl. Holdings Ltd.	24 January 2013	8 May 2013	Exclusion	Production of tobacco
Schweitzer-Mauduit Int.	24 January 2013	8 May 2013	Exclusion	Production of tobacco
Eni Sp.A.	20 March 2013	14 October 2013	No observation	Severe environmental damage
Royal Dutch Shell Plc.	20 March 2013	14 October 2013	No observation	Severe environmental damage
Zuari Agro Chemicals Ltd.	18 April 2013	14 October 2013	Exclusion	Gross human rights violations
Alliant Techsystems Inc.	2 May 2013	21 August 2013	Change of reason	Production of nuclear weapons
Lockheed Martin Corp.	13 June 2013	21 August 2013	Change of reason	Production of nuclear weapons
Sesa Sterlite	13 September 2013	30 January 2014	Exclusion	Severe environmental damage
Africa Israel Investments Ltd., Danya Cebus Ltd.	25 April and 1 November 2013	21 August 2013 and 30 January 2014	Revoked, followed by re-exclusion	War and conflict

This annual report also contains three recommendations related to human rights. These concern a total of five companies that – either directly or through subsidiaries – participate in a joint venture with the oil company China National Petroleum Company involving the construction of a gas pipeline across Burma. The recommendations were linked to the risk of human rights violations in connection with the construction of the pipeline. The Ministry of Finance had not finished considering the Council on Ethics' recommendations by the time the pipeline was finished. Following completion of the pipeline, the future-risk assessment had changed materially, and the Council therefore reversed its previous recommendations regarding the companies Daewoo International Corp., POSCO, GAIL India Ltd., Korea Gas Corp. and Oil and Natural Gas Corp. Ltd. These are nevertheless included in this annual report.

The annual report also contains a letter from the Council on Ethics to the Ministry of Finance about the French company Alstom SA, which the Ministry placed on an observation list in 2011 for up to four years. In its recommendation dated one year previously, the Council had recommended excluding the company due to the future risk of gross corruption. The Council is required to report annually on developments in the company, for as long as the company is on the list. In 2013, the Council's observation showed that the company is working to improve its compliance system but that it remains under investigation for corruption in several countries. Moreover, parts of the company remain excluded from participation in projects funded by the World Bank.

4 The Council's work in 2014

In the past three years, the Council on Ethics has invested considerable effort in sectoral studies focused on environmental issues. Although the reviews concerning particularly polluting oil activities in the Niger Delta and the deposit of mining waste have now been completed, other sectoral studies will continue into 2014. New recommendations to exclude are particularly likely in connection with environmentally damaging fishing and the conversion of forest into plantations. Sectoral studies make it easier for the Council to make decisions in new cases, as the cases that have already been evaluated provide precedents when dealing with new cases.

In its initial sectoral studies, the Council on Ethics adopted a relatively wide approach, seeking to identify all companies in the portfolio engaged in the same type of activity. In the remaining sectoral studies (smelting plants, coal-fired power plants and certain types of chemical manufacturing), using this approach can be more difficult since some of the sectors contain very many companies engaged in widely varying activities and using different technologies. It may be just as effective to examine a smaller number of companies that appear to cause very severe environmental damage as to cast the net widely and gradually narrow down the search. In 2014, the Council will give greater priority to its work on environmental damage caused by various forms of industrial activity.

The Council on Ethics will continue to monitor companies operating in areas where there is a particular risk that companies may contribute to conflict or participate in human

rights violations. Based on activities already known to the Council, it will be natural to pay particular attention to the production of minerals in Western Sahara. The Council will also continue to focus on labour rights, including in the textiles industry.

In its anticorruption work, the Council on Ethics will continue to look systematically at companies that are active in countries and sectors where the risk of corruption is particularly high according to international rankings. The Council has initiated a study of companies in the oil and gas sector that are operating in countries presenting a particularly high risk of corruption.

According to its exclusion guidelines, the Fund may not invest in companies that sell military materiel to certain countries. This follows from the “government bond exception” in the GPFG’s management mandate. Norges Bank ensures that no investment is made in government bonds, while the Council on Ethics is required to identify companies that may be selling weapons to the states in question. As of January 2014, the exception covers Syria, Iran and North Korea, while Myanmar is no longer included. The Council is currently reviewing the portfolio with the aim of identifying companies that are selling weapons or military materiel to these countries.

5 Organising the work on exclusions

In 2013, the Ministry of Finance’s Strategy Council advised the Ministry to reorganise its work on responsible investment in the management of the Government Pension Fund. Among other things, the Strategy Council recommended transferring the activities of the Council on Ethics – including the Council’s secretariat – to Norges Bank. The Strategy Council also made a number of proposals regarding how the newly integrated responsible-investment efforts should be conducted, hereunder work on ethics.

In the Council on Ethics’ view, implementing certain of the Strategy Council’s specific recommendations may set back the Fund’s ethical work. The Strategy Council has proposed that the reasons for excluding a company from the Fund should no longer be published, and that more information should instead be provided on principles and strategies. The Council on Ethics is of the opinion that public reasonings have been one of the most important components of the present system. Publication of recommendations has given the general public insight into the work being done, and the opportunity to evaluate whether the guidelines safeguard ethical values. Further, the Council is of the impression that the publication of thoroughly reasoned recommendations has contributed to focusing international attention on corporate ethical considerations. A number of other investors follow the Council’s recommendations. The combination of thorough preparatory work and publication means that the effect of withdrawal and observation is greater than the relatively modest number of companies that have been subjected to these measures would suggest.

It has also been important for confidence in the work on exclusions that the Council on Ethics is independent of both the Ministry of Finance and Norges Bank. Accordingly, the Council is of the opinion that, if decisions on the exclusion of companies from the

Fund are transferred to the Bank, a council on ethics must be established to advise the Executive Board of Norges Bank. In addition, as the Strategy Council has proposed, strong guidelines and incentives must be created for the work on individual companies. The Council on Ethics' position is set out in the Council's consultation comments, which can be found on page 270 of this report.

Safeguarding ethical considerations is an important aspect of the management of the GPFG. Responsible management of the Fund helps to build support for the allocation of a proportion of Norway's oil revenues for future generations. The Council on Ethics hopes that any decision to adopt new responsible investment guidelines will serve to strengthen the ethical work of the Fund as a whole even further.

Ola Mestad
Chair
(Signature)

Dag Olav Hessen
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Ylva Lindberg
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Marianne Olsson
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Members of the Council and of the Secretariat

The Council on Ethics



Ola Mestad (Chair), Dr. juris and Professor at the Centre for European Law, University of Oslo.

Ylva Lindberg, BA, Managing director of SIGLA.

Dag Olav Hessen, Dr. philos, Professor at the Institute of Biology, University of Oslo.

Bente Rathe, Master in Business Administration.

Marianne Olsson, Attorney and partner at the lawfirm Mageli ANS.

The Secretariat

The Council has a Secretariat that prepares cases for the Council.

The Secretariat has the following employees:

Eli Lund Executive Head of Secretariat (Economist)

Magnus Bain (Cand. jur)

Erik Forberg (Cand.scient)

Pia Rudolfsson Goyer (Cand. jur., LLM)

Hilde Jervan (Cand. agric.)

Aslak Skancke (Graduate Engineer)

Irmela van der Bijl Mysen (Cand. jur)

Pablo Valverde (Master in War Studies)

Hege Havig-Gjelseth (Secretary)

Recommendations in this annual report

18.06.2012

Recommendation to exclude Zijin Mining Group Co. Ltd.

The Council on Ethics recommended the exclusion of Zijin Mining Group Co. Ltd. from the GPFG due to an unacceptable risk of the company causing severe environmental damage through its activities.

Several serious incidents had occurred at the company's facilities in recent years, where tailing dams containing mining and processing waste have collapsed and caused extensive pollution and loss of human life. The Council on Ethics considered that there was an unacceptable risk of similar, future incidents, and therefore recommended that the company should be excluded from the GPFG.

(Published 14 October 2013)

21.06.2012

Recommendation to exclude Volcan Compañía Minera SAA

The Council on Ethics recommended the exclusion of the mining company Volcan Minera SAA due to an unacceptable risk of the company contributing to severe environmental damage through its activities.

The company operates a lead mine in the Peruvian highlands. The mine is located in the middle of a town that has developed around the mining operation. The Council on Ethics considered the company's contribution to the extensive lead pollution that was causing significant damage to health, particularly among children. Even though the health damage was also due to historic pollution, the Council on Ethics found that the company currently operating the mine also bore responsibility for old tailings which it now owned and which continued to release lead pollution into the environment. The Council on Ethics also found it likely that the current mining operation was increasing the health burden. In its assessment, the Council emphasised that companies must take particular care in such situations, so that they do not cause an already challenged population further harm.

(Published 14 October 2013)

25.06.2012

Recommendation concerning WTK Holdings Berhad

The Council on Ethics recommended the exclusion of WTK Holdings Berhad due to an unacceptable risk of the company causing severe environmental damage through its logging and conversion of tropical forest into plantations in Sarawak.

(Published 14 October 2013)

- 27.06.2012** **Recommendation to exclude AngloGold Ashanti Ltd.**
The Council on Ethics recommended the exclusion of the mining company AngloGold Ashanti Ltd. due to extensive arsenic pollution from the company's goldmines in Ghana.
The company was established through a merger of several companies in 2004, and continued the mining operation of one of the merger partners in Ghana. The mining operation had long been the cause of extensive arsenic pollution. Although the company had plans for several measures to improve conditions over time, the Council on Ethics took the view that the damage was so extensive that it was improbable that the measures would sufficiently reduce the risk of severe environmental damage. The Council on Ethics was also of the opinion that the environmental damage could potentially infringe the local population's right to health.
(Published 14 October 2013)
- 3.12.2012** **Recommendation concerning Ta Ann Holdings Berhad**
The Council on Ethics recommended the exclusion of Ta Ann Holdings Berhad due to an unacceptable risk of the company causing severe environmental damage through its logging and conversion of tropical forest into plantations in Sarawak.
(Published 14 October 2013)
- 24.01.2013** **Recommendation to exclude the companies Schweitzer-Mauduit International Inc. and Huabao International Holdings Ltd.**
The Council on Ethics recommended to the exclusion of the companies Schweitzer-Mauduit International Inc. and Huabao International Holdings Ltd. due to involvement in tobacco production.
(Published 8 May 2013)
- 20.03.2013** **Recommendation concerning the company Eni Sp.A.**
In March 2013, the Council on Ethics recommended that the company Eni be placed under observation due to the extensive environmental damage resulting from its oil production in the Niger Delta. The company is a minority partner in a joint venture with the Nigerian state oil company and is also the operator. Due to considerable uncertainty about future developments, the Council on Ethics recommended observation of the company.
(Published 14 October 2013)

20.03.2013

Recommendation concerning the company Royal Dutch Shell plc.

In March 2013, the Council on Ethics recommended that the company Royal Dutch Shell be placed under observation due to the extensive environmental damage resulting from its oil production in the Niger Delta. The company is a minority partner in a joint venture with the Nigerian state oil company as well as the operator. Due to considerable uncertainty about future developments, the Council on Ethics recommended observation of the company.

(Published 14 October 2013)

18.04.2013

Recommendation to exclude Zuari Agro Chemicals Ltd.

The Council on Ethics recommended the exclusion of Zuari Agro Chemicals Ltd. from the GPFG due to an unacceptable risk of the company contributing to the worst forms of child labour through its production of hybrid seed.

The Council on Ethics surveyed the scale of child labour use in the company's production of hybrid seed in 2011 and 2012. It was found that an average of 20 per cent, and in some cases up to 30 per cent, of the workforce producing seed for the company was made up of children. The Council on Ethics accepted that the company did not own the farms on which the seed was cultivated, and was in formal terms not the employer of those working there, but nevertheless found that the seeds were cultivated on assignment for – and under the supervision of – the company.

In its assessment, the Council on Ethics emphasised the systematic use of children in the company's production operation. The young age of the children and the health risks to which they were exposed through their work, including as a result of insecticides, indicated that the activities should be considered as the worst forms of child labour.

(Published 14 October 2013)

- 25.04.2013
and
1.11.2013** **Recommendations concerning the companies Africa Israel Investments Ltd. and Danya Cebus Ltd.**
In April 2013, the Council on Ethics recommended revoking the exclusion of the companies Africa Israel Investments Ltd. and Danya Cebus Ltd. At that time, the companies had been excluded since August 2010 due to the construction of Israeli settlements on the West Bank. The Council on Ethics found that the activities had concluded and that the basis for exclusion was no longer present. However, new information showed that the companies were engaged in the construction of settlements in East Jerusalem. The exclusion of the companies was therefore recommended in November 2013.
(Published 21 August 2013 and 30 January 2014)
- 2.05.2013** **Recommendation concerning the exclusion of Alliant Techsystems Inc.**
The Council on Ethics recommended that the company Alliant Techsystems Inc. should no longer be excluded from the GPFG due to its production of cluster munitions. However, the Council on Ethics recommended the continued exclusion of the company from the GPFG due to its production of key components for nuclear weapons.
(Published 21 August 2013)
- 13.06.2013** **Recommendation concerning the exclusion of Lockheed Martin Corp.**
The Council on Ethics recommended that the company Lockheed Martin Corp. should no longer be excluded from the GPFG due to its production of cluster munitions. However, the Council on Ethics recommended the continued exclusion of the company from the GPFG due to its production of key components for nuclear weapons.
(Published 21 August 2013)
- 13.09.2013** **Recommendation concerning Sesa Sterlite.**
Vedanta Resources and its subsidiaries Sterlite Industries and Malco had previously been excluded from the GPFG. Vedanta had been restructured, and the subsidiaries were now owned by a new company, Sesa Sterlite, in which Vedanta Resources had a controlling stake. The restructuring did not alter the companies' activities. The Council on Ethics therefore recommended the exclusion of both Vedanta and Sesa Sterlite.
(Published 30 January 2014)

2.05.2011,
8.05.2012
and
13.09.2013

Recommendations concerning the companies POSCO, Daewoo International Corporation, Oil and Natural Gas Corporation Ltd. (ONGC), GAIL India and Korea Gas Corporation (Kogas).

In 2011 and 2012, the Council on Ethics recommended the exclusion of the companies Daewoo International Corporation, Korea Gas Corporation, Oil and Natural Gas Corporation Ltd. (ONGC) and GAIL India Ltd. (GAIL) from the investment universe of the GPFG due to the risk that they might contribute to serious, systematic human rights violations in connection with the construction of an 800 km overland gas pipeline across Myanmar.

On 13 September 2013, the Council on Ethics reversed its recommendation because construction of the pipeline had been completed and the basis for the earlier recommendations was therefore no longer present. The Ministry of Finance has noted the Council on Ethics' most recent recommendation.

(Published 17 December 2013)

Companies the Ministry of Finance has decided to exclude from the Government Pension Fund Global at year-end 2013

Cluster Weapons

- General Dynamics Corp.
- Hanwha Corp.
- Poongsan Corp.
- Raytheon Co.
- Textron Inc.

Nuclear Weapons

- Alliant Techsystems Inc.
- Boeing Co.
- EADS Co., including its subsidiary
 - EADS Finance BV
- GenCorp Inc.
- Honeywell International Corp.
- Jacobs Engineering Group Inc.
- Lockheed Martin Corp.
- Northrop Grumman Corp.
- Safran SA
- Serco Group Plc.
- The Babcock & Wilcox Co.

Anti -Personnel Landmines

- Singapore Technologies Engineering Ltd.

Companies supplying arms or military equipment to Burma

- Dongfeng Motor Group Co. Ltd.

Tobacco

- Alliance One International Inc.
- Altria Group Inc.
- British American Tobacco BHD
- British American Tobacco Plc.
- Grupo Carso SAB de CV
- Gudang Garam Tbk pt
- Huabao International Holdings Ltd.
- Imperial Tobacco Group Plc.
- ITC Ltd.

- Japan Tobacco Inc.
- KT&G Corp.
- Lorillard Inc.
- Philip Morris Int. Inc.
- Philip Morris Cr. AS
- Reynolds American Inc.
- Schwitzer-Mauduit International Inc.
- Shanghai Industrial Holdings Ltd.
- Souza Cruz SA
- Swedish Match AB
- Universal Corp. VA
- Vector Group Ltd.

Human Rights

- Wal-Mart Stores Inc., including its subsidiary
 - Wal-Mart de Mexico SA de CV
- Zuari Agro Chemicals Ltd.

Violations of the rights of individuals in situations of war or conflict

- Shinkun & Binui Ltd.

Environmental Damage

- Barrick Gold Corp.
- Freeport McMoRan Copper & Gold Inc.
- MMC Norilsk Nickel
- Rio Tinto Plc. and
- Rio Tinto Ltd.
- Samling Global Ltd., including its subsidiary
 - Lingui Development Ltd.
- Ta Ann Holdings Berhad
- Vedanta Resources Plc., including its subsidiaries
 - Sterlite Industries Ltd.
 - Madras Aluminium Co. Ltd.
- Volcan Compañía Minera SAA
- WTK Holdings Berhad
- Zijin Mining Group Co. Ltd.

Other particularly serious violations of fundamental ethical norms

- Elbit Systems Ltd.
- Potash Corp. of Saskatchewan

Companies under official observation at year-end 2013

Gross corruption

- Alstom SA

The work of the Council on Ethics on companies producing oil and gas in Equatorial Guinea

In 2012, the Council on Ethics decided to assess whether companies producing oil and gas in Equatorial Guinea could be said to breach basic ethical standards given that the exploitation of natural resources is not benefiting the population at large. The fact that living conditions in Equatorial Guinea are among the worst in the world at the same time as oil revenues have made it a high-income country was decisive in the Council's decision to examine the exploitation of natural resources in this particular country. This work is now completed.

In 2013, the Council on Ethics reviewed an extensive body of information and held a series of meetings with various stakeholders, including the World Bank, the International Monetary Fund, interest groups, Professor John Ruggie and oil companies operating in the country.

Equatorial Guinea is the third-largest oil and gas producer in sub-Saharan Africa. Its large oil revenues and small population (700,000 people), mean that the country has a per capita GDP equivalent to that of a medium-sized European country. Accordingly, the World Bank ranks Equatorial Guinea as 'High income: non OECD', on a par with countries such as Qatar, Saudi Arabia and Singapore.¹

Figures from the UN and the World Bank indicate that oil production in Equatorial Guinea is bringing little benefit to the population.² Despite almost two decades of oil production, life expectancy is 50.6 years, lower than the average for the least developed African countries (53.4 years). Child mortality is higher than the average for sub-Saharan Africa, and on a par with Afghanistan. The average number of years of schooling lies below the average for the region, and has been falling for the past 20 years. According to the country's own statistical data, four out of five members of its population live below the poverty level of two dollars per day.³ The lack of reliable statistical data means a great deal of uncertainty is associated with these figures. Available data supports the proposition that oil production is not benefiting the population.

Oil and gas currently account for 98.8 per cent of Equatorial Guinea's export revenues.⁴ However, oil and gas production has peaked, and the International Monetary Fund has pointed out that the country has not developed alternative industries to fall back on when its oil runs out. Meanwhile, according to Transparency International and other sources, President Obiang has used his position to appropriate the country's oil wealth.⁵ The president, who came to power in 1979 after deposing his uncle in a military coup, is the world's longest-serving head of state.

Members of the president's family are under investigation for corruption in the USA, France and Spain, and documents released from the investigations describe how the president's family is appropriating public funds.⁶ A study conducted by the World Bank in 2010 shows that the country lacks basic systems for distributing and controlling public expenditure.⁷ The president determines how funds are to be spent, and there are no publicly available budgets or other forms of control on spending.

The Council on Ethics has evaluated the activities of the oil companies against three of

the criteria in the guidelines on exclusion and observation: gross corruption, contribution to human rights violations and other gross breaches of fundamental ethical norms.

A 2004 report by the US Senate's Permanent Subcommittee on Investigations showed that oil companies were paying large amounts directly into bank accounts belonging to the president and his closest family.⁸ The companies have subsequently amended their procedures, and payments are now made only into State accounts. The companies have also implemented compliance systems to avoid becoming involved in gross corruption in Equatorial Guinea.

Nevertheless, in the view of the Council on Ethics the main problem was not direct corruption but rather that the companies, by producing the country's most important resource, made it possible for the governing elite to acquire the oil revenues for private purposes. Accordingly, this could be regarded as participation by the companies in a kind of misappropriation by the power elite. At the same time, the Council on Ethics took the view that it could also be relevant to assess these activities against the human rights criterion. According to the International Covenant on Economic, Social and Cultural Rights, each signatory state must 'take steps... to the maximum of its available resources, with a view to achieving progressively the full realization of the rights recognized in the present Covenant by all appropriate means'.⁹ The signatories to the covenant, including Equatorial Guinea, are obliged to ensure that they provide all of their inhabitants with a minimum level of education, access to basic health services, decent living conditions and clean water. The UN Committee on Economic, Social and Cultural Rights monitors implementation of the covenant. On several occasions, the committee has asked Equatorial Guinea to explain why it is failing to meet its obligations under the covenant, without receiving a reply.¹⁰

The question considered by the Council on Ethics is whether companies producing a country's most important resource and paying direct and indirect taxes into State accounts can be said to contribute to the State's breaches of norms. The threshold for exclusion from the Fund must be high. The report of the Graver Committee states, among other things, that, 'It is not equally clear that an owner is also complicit in the company's actions and behaviour. Some form of systematic or causal relationship must exist between the company's activities and the actions to which the investor does not wish to contribute. Investment in a company cannot be considered to entail complicity in actions that were impossible to anticipate or be aware of or circumstances over which the company in question could not have any significant degree of control.'¹¹

It appears clear that human rights are being violated, since the country's substantial revenues are not being used to improve the living conditions of the population. It appears equally clear that those closest to the president are appropriating a large proportion of the revenues. Given that this is thoroughly documented in various public reports, this is something the companies know about. On the other hand, the companies cannot be said to have a significant degree of control over the situation. Accordingly, given the high threshold for exclusion, the Council on Ethics has not recommended the exclusion of any of the companies from the Fund.

Notwithstanding the above, there are major differences in how the companies

are dealing with the challenges presented in Equatorial Guinea. All of the companies emphasise compliance with relevant laws, both in Equatorial Guinea and in their home countries. While some companies have stated that this is all that can be required of them, others are seeking to live up to international expectations of companies that risk contributing to human rights violations.

As the Council wrote in last year's annual report, considerable developments have taken place internationally in the field of corporate social responsibility. Since the UN Guiding Principles on Business and Human Rights were unanimously endorsed by the UN Human Rights Council in 2011, the protect-respect-remedy framework has been incorporated into all of the most important international guidelines on business and human rights. The responsibility to respect that all companies have applies to all rights, including economic and social rights.

The Guiding Principles provide that, as part of meeting this responsibility, companies should implement human rights due diligence processes to gain an understanding of what rights they affect through their activities, and how these are affected. Companies are also required to take steps to counteract and prevent any negative consequences, and to monitor the effects of these measures. One company has informed the Council that it has initiated this process as a result of its dialogue with the Council.

Several organisations, such as Human Rights Watch, are of the opinion that the lack of credible information is one of the greatest challenges in Equatorial Guinea, where neither oil-revenue information nor the national budget are otherwise publicly available. All companies producing oil and gas in Equatorial Guinea support the Extractive Industries Transparency Initiative (EITI) and state that they would like to see greater transparency. Nevertheless, some of the companies have been strongly criticised for supporting an ongoing court case against the US Securities and Exchanges Commission (SEC) concerning certain provisions in the regulations relating to the Dodd-Frank Act which, among other things, would require oil companies to publish how much they pay the authorities in the countries in which they operate. Only one company has informed the Council that it voluntarily publishes all of its payments in Equatorial Guinea.

How companies operate in resource-rich countries with weak governance systems can have a profound impact on the living conditions of the local population. Often, companies' contracts provide that they must support social projects, contribute to educational scholarships, or use local employees. This gives companies some leeway which they should utilise.

Although the Council on Ethics has not recommended the exclusion of companies producing oil in Equatorial Guinea, it remains of the opinion that oil companies face difficult ethical challenges when they choose to operate in such a country. In certain respects, Equatorial Guinea is a unique case since the imbalance between the country's economic opportunities and the living conditions of the general population is so great. Nevertheless, there are many resource-rich countries in which the governing elite acquires State funds for private purposes. In such countries, it is particularly important that companies make systematic, deliberate efforts to prevent their activities from having negative consequences. Companies operating in resource-rich countries with weak governance should have

robust systems in place for preventing corruption, publish payments made to authorities, persons and companies closely connected to the governing elite, and comply with the UN Guiding Principles.

Notes

- 1 <http://data.worldbank.org/country/equatorial-guinea>.
- 2 See, for example, UNICEF's Childinfo for an overview of socioeconomic data, http://www.childinfo.org/country_profiles.php?input=47, the World Bank DataBank <http://databank.worldbank.org/data/home.aspx> and UNDP's Human Development Report <http://hdr.undp.org/en/countries/profiles/GNQ>.
- 3 According to a report written by UNDG and Equatorial Guinea in 2012, see <http://www.undg.org/docs/12798/UNDAF-2013-2017-Firmado.pdf>. See also UNDG (2006), "*Bilan Commun de Pays (CCA)*" at <http://www.undg.org/docs/7647/CCA%20VERSION%20EDITE.doc>.
- 4 The International Monetary Fund (2012), "*Republic of Equatorial Guinea: 2012 Article IV Consultation*", <http://www.imf.org/external/pubs/cat/longres.aspx?sk=23819.0>.
- 5 http://www.transparency.org/news/feature/clamping_down_on_kleptocrats.
- 6 District Court for the Central District of California (2012), "*Second Amended Verified Complaint For Forfeiture In Rem*", Case Nr. CV 2:11-3582-GW-SS, June 2012.
- 7 World Bank (2010), "*Equatorial Guinea Public Expenditure Review (PER)*".
- 8 United States Senate, Permanent Subcommittee on Investigations (2004), "*Money Laundering and Foreign Corruption: Enforcement and Effectiveness of the Patriot Act. Case Study Involving Riggs Bank*".
- 9 http://www.regjeringen.no/nb/dep/ud/dok/rapporter_planer/rapporter/2004/oksoskonvensjon.html?id=106240.
- 10 CESCR (2012), "*Implementation of the International Covenant on Economic, Social and Cultural Rights: list of issues prepared in the absence of the initial report of Equatorial Guinea due in 1990*", [http://www.refworld.org/publisher,CESCR,COUNTRYREP,GNQ,5069548e2,0.html](http://www.refworld.org/publisher/CESCR,COUNTRYREP,GNQ,5069548e2,0.html).
- 11 NOU 2003:22, "*The Petroleum Fund – management for the future: proposed ethical guidelines for the Government Petroleum Fund*", http://www.regjeringen.no/nb/dep/fin/tema/statens_pensjonsfond/ansvarlige-investeringer/graverutvalget/Report-on-ethical-guidelines.html?id=420232.

The work of the Council on Ethics on assessing serious breaches of labour rights

1 Labour rights

Under the guidelines' human rights criterion, the Council on Ethics should focus on particularly serious matters such as forced labour and the worst forms of child labour. The Council has therefore primarily concentrated on industries in which there is a risk that such matters may arise and has, for example, commissioned a study of industries and regions where forced labour is widely used in order to identify companies that should be examined in more detail. The Council has also evaluated industries and companies that have been directly accused of breaches of standards. These cases have concerned various matters regulated by ILO conventions, such as forced labour, debt slavery, child labour, dangerous working conditions, involuntary overtime and unreasonable employment conditions.

The preparatory works to the guidelines state that the threshold for excluding companies should be high. Credible evidence is required of concrete, serious or systematic human rights violations that are directly linked with a company in the Fund, and there must be an unacceptable risk that such breaches will occur in the future.

The Council on Ethics' first recommendation to exclude a company for breach of labour rights concerned the US company Wal-Mart.

The company was excluded due to the systematic occurrence of poor working conditions among its sub-contractors. Since then, the Council has evaluated many companies with regard to breaches of labour rights. A discussion of some of the Council's experiences in this area is included below.

2 What the Council on Ethics has emphasised

Generally speaking, the Council gives weight to whether breaches are gross or systematic, that is, whether they are repeated over time and whether they are found in many of the company's activities – in short, whether there is a pattern that indicates that breaches of standards are a “normal” part of the company's activities. The Council also conducts cumulative assessments, where the sum total of many less-serious breaches of standards is deemed more serious than the individual breaches alone.

A critical point in the Council's assessment is the connection between the company and the breaches of standards, in other words whether the company can be blamed for the breaches. If the breaches are committed by entities owned by the company, the company is responsible for them. However, breaches of labour rights are more often found in manufacturing companies that form part of a supply chain, and in such cases it is particularly difficult to evaluate the company's responsibility. The company's proximity to – and control over – the breaches of standards will be important in the Council's assessment,

as will be the actions carried out by the company in order to prevent breaches of labour rights in its supply chain. If the company is the only purchaser from a sub-contractor, or the most important client, this may indicate a close connection between the company and the breaches of standards. Moreover, in some cases companies in the Fund may purchase goods from a market in which goods from many manufacturing sources are mixed, making it more difficult to establish a direct connection between specific products and the manufacturing sites where the breaches are committed. When there are many links in a supply chain, the final link cannot be expected to have equally great control over the entire chain. At the same time, the more serious a given breach, the stricter the requirements demanded of the company to take steps to prevent human rights violations in its supply chain.

Based on public reports on breaches of labour rights and the Council's own study on forced labour, the Council has in the past year focused its efforts on industries in which the risk of breaches of standards is particularly high. An overview of some of these studies is provided below.

The electronics industry in China

In 2013, the Council on Ethics assessed electronics manufacturers in the Fund with operations in China, focusing on potential breaches of labour rights – particularly forced labour. The starting point for the assessment was reports by several NGOs and media coverage from 2011 onwards concerning highly censurable working conditions.

The Council on Ethics has been in contact with several electronics manufacturers and their customers, researchers, interest groups and organisations that gather data from factories and workers to improve the conditions of employees. Further, the Council has assessed data on working hours, pay and health and safety in the electronics industry and compared it to other industries in China.

These studies indicate that working conditions at factories in China have improved in recent years, particularly since the introduction of a new act on employment contracts in 2008. Many of the larger companies seem to be more aware of their responsibilities. Companies that have previously been strongly criticised appear to have improved their working conditions. In addition, workers at a number of Chinese factories have become more aware of their rights, and it has become easier for employees to obtain external help in connection with employment conflicts.

It also appears that working conditions in the electronics industry with respect to pay, working hours, safety and social benefits are better than the average for other industries in China. The companies in which the Fund is invested are primarily large companies that supply to multinational Brands. These companies now often work with their manufacturers in China to improve the social conditions of workers, including among sub-contractors. In general, therefore, it appears that working conditions in this industry have improved in recent years.

Agricultural production in Brazil

In the past few years, the Council on Ethics has studied working conditions in several companies in the Brazilian agricultural industry. Official reports have indicated that companies have been involved in forced labour as well as other less serious breaches of labour rights. The latter category includes the unlawful use of overtime, shortened work breaks, poor hygienic conditions and poor living conditions. Often, these breaches of standards have occurred further down in the supply chains of companies in the Fund, and it has therefore been difficult to establish a clear connection between a given company and the breaches of standards.

Much of the Council's work has focused on working conditions in the sugar industry. Here, the authorities and interest groups have reported systematic breaches of provisions in ILO conventions and Brazilian employment legislation, including several instances of forced labour. The Council has conducted studies that have included both searches of official archives and field surveys. These studies show that sugarcane plantations have become largely mechanised in the past few years. Demand for physical labour has therefore fallen considerably, and with it the risk of companies being involved in gross breaches of labour rights.

Further, Brazilian authorities cooperate closely with the UN labour organisation, ILO, to uncover breaches and to improve working conditions, particularly in the agricultural sector. This makes information on human rights violations publicly available, and helps to prevent new breaches.

Hybrid seed production in India

The Council on Ethics has worked on the issue of child labour in the production of hybrid seed in India since 2005. This has also been an important topic in NBIM's exercise of ownership. Measures implemented by large multinational companies in recent years appear to have brought about a considerable reduction in the use of child labour in this type of production. Nevertheless, child labour may remain in extensive use among companies that have not introduced such measures. In 2013, the Council recommended the exclusion of one company producing hybrid seed in India on the grounds of contribution to the worst forms of child labour. The Council will continue its work in this sector in 2014, and will conduct further studies to identify instances of child labour.

The fisheries industry in Asia

In 2013, the Council on Ethics launched a study of human rights violations in the fisheries industry in certain countries in Asia. Reports have been received of, for example, the extensive use of forced labour and human trafficking in the supply chains of several companies in this industry. The Council has begun surveying connections between companies in the Fund and gross breaches of standards, and will continue this work in 2014.

3 The Council's experiences

Experience indicates that forced labour is not widespread in the operations of listed companies, but that it may occur in their supply chains. The studies conducted by the Council on Ethics show that the Fund rarely is invested in companies with the worst working conditions. Documenting poor working conditions and the responsibility of companies for these is a major challenge, particularly when supply chains are long.

The Council has also observed that there are many initiatives at both national and international level that aim to improve working conditions. The efforts of the authorities and civil society appear to be an important factor in the reduction of forced labour in companies examined by the Council.

The Council notes that the way in which companies view and express their responsibility for human rights is changing. It appears that companies are responding more quickly to allegations and implementing measures sooner than before. This is consistent with the UN Guiding Principles, which state that companies have a responsibility for human rights violations not only in their own operations but also in their supply chains.

Environmental studies

In recent years, the Council on Ethics has conducted a relatively broad review of various issues relating to the environment; see the Annual Report for 2012 for more detailed information. The following is a brief update on the status of this work.

Oil production and pollution

In 2013, the Council on Ethics concluded its assessment of oil pollution in the Niger Delta, Nigeria. Pollution in the area is extensive, but several factors indicate that the companies' room for action is too limited to conclude that the primary reason for the pollution is lack of action by the companies. The majority of the pollution is due to sabotage by third parties. At the same time, the ownership arrangement – a joint venture in which the Nigerian State oil company is the majority owner – may be hindering optimal follow-up of problems at the local level.

In 2012, the Council recommended placing the companies Royal Dutch Shell plc. and Eni Sp.A under observation. The Ministry of Finance decided that Norges Bank should monitor oil production in the Niger Delta through its exercise of ownership, and the Council is therefore not looking into this topic further.

Work has also continued on obtaining information about companies involved in oil-sand production in Canada in 2013. The Council on Ethics has particularly considered the local effects of such activities.

The oil-sand industry has suffered much criticism due to the climate effects of its activities, the conversion of wilderness areas into mines, and local pollution. Oil-sand operations involve major interventions in nature that have a negative effect on the populations of certain animal species, and have clearly caused local air and water pollution. Even though areas are “reclaimed”, they do not regain their previous quality. In some cases, indigenous population groups have also suffered negative consequences.

Some positive changes have occurred in oil-sand production in recent years. The majority of new fields are now producing with the aid of *in situ* technology that involves smaller interventions than surface production, although this technology is often more energy-intensive. The supervisory authorities have been significantly strengthened and their coordination improved.

A major problem is the storage of polluted tailings, which are currently kept in tailing ponds. Better regulations on such ponds have been introduced, but the extent of compliance is uncertain. Methods for terminating ponds have been developed and tested at full scale, and most companies have committed to sharing knowledge about the development of environmental technology.

There is no doubt that oil-sand production is problematic for several reasons. However, it is difficult to identify any individual company with a practice that distinguishes it negatively and significantly from the other companies.

The main problem is the effect on the climate. The Council on Ethics has therefore concluded its systematic review of companies that produce oil sand. Such companies may, just like other companies, be reviewed if company-specific information is received indicating that a particular company is causing severe environmental damage.

Mining activities where waste management presents a particular risk

In 2013, the Council on Ethics concluded its work on companies that deposit mining waste in the sea. The Council is not aware of any companies in the GPFG that engage in large-scale depositing in rivers.

The Council has previously recommended the exclusion of companies engaged in extensive depositing of mining waste in riverbeds. Following a thorough review of two companies depositing mining waste in the sea, the Council concluded that their practices were insufficiently covered by the severe environmental damage criterion. This is because the companies, as far as the Council is aware, have acceptable waste management procedures in place, and because they have monitoring systems that provide an adequate overview of conditions on the seabed. The marine areas involved, which have been relatively thoroughly examined, are not associated with any unique conservation values. An alternative arrangement involving onshore deposits, partly in primary rainforest areas, would in all likelihood have had a much greater negative impact on the environment. In addition, there are major safety challenges involved in establishing tailing ponds in earthquake zones.

The Council continues to examine uranium mines. Obtaining information of sufficient quality about the effects of certain mining activities is difficult, and there is reason to believe that the lack of reliable information will continue, not least due to the strategic importance of such mines. The lack of information and the particular environmental challenges associated with uranium mining mean that the Council on Ethics will continue to monitor this industry.

Generally speaking, obtaining information about companies that are generally unwilling to share information is highly time-consuming. Quality assuring information on such companies from different sources is also particularly demanding.

Illegal and other particularly destructive forms of logging

The Council on Ethics has invested considerable effort in obtaining information about logging and the conversion of biologically valuable tropical forest in Africa and South-East Asia. The Council has continued its work from previous years, giving particular emphasis to biodiversity in its reports. Recommendations have been made for the exclusion of four companies, and recommendations relating to a handful of additional companies are almost complete.

The Council's assessments have been resource-intensive, not least because it has gathered considerable information on matters which require a certain amount of local knowledge, such as locations, licenses, status and conservation values.

Looking forward, the work of the Council in this area will continue on approximately the same scale. See also the separate article on this topic.

Illegal fishing and other fishing activities that are particularly harmful to the environment

Work on studying companies that may be involved in fishing activities with a particularly harmful impact on the environment has continued, and assessments of several companies

have been completed or are close to completion. As in several other areas, this work has been extensive and complicated, partly because many vessels frequently change both their names and their flag states. Documenting the connection between these vessels and companies in the Fund is difficult, as is identifying where vessels are located, where they are in fact fishing, and what species and stocks they fish. The Council on Ethics has obtained information indicating that companies in the Fund are involved in both illegal fishing and fishing of threatened species.

The Council will continue its work in this area going forward.

Highly destructive dam project

The Council on Ethics will continue to survey major dam projects, albeit on a smaller scale. Many large dam projects are strategically important to the countries in which they are located, and the State is frequently involved both as an owner and as the licensing authority. This often limits access to reliable information. At the planning stage, it is uncertain whether the project will in fact be implemented, and which companies will in fact build the dam. The criteria provide that the Council may only recommend exclusion when there is a future risk that a company will cause severe environmental damage. Many dams have a relatively short construction period, and the therefore Council faces the challenge that information collection, analysis and the process leading up to a decision have to be completed in a short space of time.

Particularly valuable conservation areas

While many cases were closed in 2013, some are continuing. Several open cases concern companies that are establishing mines, dams or oil palm plantations in or close to conservation areas. These are being monitored as part of the Council's sectoral studies. For a more in-depth discussion of this area, see the Annual Report for 2012.

The work of the Council on Ethics on logging and the conversion of tropical forest into plantations

Commercial logging and conversion of tropical forest into plantations is considered one of the greatest threats to the preservation of ecosystems and biodiversity. Conversion involves trees being felled and vegetation being removed before an area is used to establish plantations for the production of palm oil, timber or other monocultures. Forest degradation and deforestation also result in considerable greenhouse gas emissions and contributed to around 10 per cent of global greenhouse gas emissions in the period 2000 to 2009.¹

In 2011, the Council on Ethics decided to survey companies in the GPFG involved in environmentally destructive logging of tropical forest or the conversion of such forest into plantations in South-East Asia and Africa. Few companies in the GPFG are directly involved in this type of activity in Latin America. As per the fall of 2011, around 40 companies in the GPFG were engaged in logging and/or plantation operations in Asia and Africa, including 35 in Indonesia and Malaysia. In 2012, NBIM included tropical deforestation in its statement of expectations regarding how companies deal with climate change, NBIM also sold its holdings in 23 companies with oil palm plantations in Indonesia and Malaysia that year.

Thus far, four recommendations have been published that concern the exclusion of logging companies (Samling Global and its subsidiary Lingui Developments Berhad, Ta Ann Holdings Berhad and WTK Holdings Berhad). These companies have in common that they all operate in Sarawak (Malaysia) and administer large licence areas – often totalling several thousand square kilometres – where rainforest is felled on a large scale without sufficient consideration being given to species – diversity and ecosystems. Some of the companies are felling forest in contravention of official requirements, increasing the environmental damage caused by the logging.

As regards the plantation companies, the Council seeks to clarify to what extent the companies are in fact engaged in activities that damage tropical forest, the scale of the activities and what environmental damage these cause, for example to biodiversity. As many companies do not wish to provide the Council with information, research is both time-consuming and resource-intensive.

What the Council has emphasised

The Council considers that tropical rainforests are among the most species-diverse ecosystems on earth. They are habitats for many threatened species and provide important ecosystem services such as carbon storage, water management and erosion protection. The logging and conversion of forest is a great threat to the future existence of these ecosystems. Further, the conversion of peatlands is a particular challenge in Indonesia, as the country is the source of 60 per cent of global greenhouse gas emissions linked to peat decomposition.² Although climate change has not been applied as a separate assessment

criterion, peatlands – in addition to being important carbon sinks – are unique ecosystems with their own individual biodiversity. Norway has entered into a partnership with Indonesia to support the country's efforts to reduce greenhouse gas emissions through deforestation, forest degradation and the destruction of peatlands. As part of this agreement, Indonesia has introduced a moratorium until 2015 on the award of new licences for the conversion of peatlands and primary forest.

The Council conducts an individual evaluation of each company to assess the risk of severe environmental damage in connection with forest conversion. The environmental consequences depend on whether the establishment of plantations results in deforestation, and on the effect that this has on biodiversity. If a plantation replaces previously established plantations, the consequences in terms of greenhouse gas emissions and on biodiversity will often be small. In its assessment, the Council gives weight to whether forests or peatlands will be converted, the scale of conversion, the extent to which the company's licence areas overlap with areas containing important biological values, the consequences of conversion in terms of loss of biodiversity – including consequences for threatened species and their habitats – and what measures the company is implementing to reduce the damaging effects.

Methods

All of the companies considered by the Council have in common that little public information is available on their plantation operations. The Council always begins by requesting information from the company, such as the location of the licence areas, whether there are forests or peatlands in the licence areas, the state of the forest, environmental impact assessments and reports identifying forest and other areas containing high conservation values (referred to as High Conservation Value (HCV) area assessments). Some companies provide extensive information, while others do not reply at all. In the latter case, the Council conducts its own research to discover the location of the licence areas. In this work, the Council uses satellite imagery, various types of maps (land cover maps and vegetation maps showing forest types, peatlands, etc.), publicly available official data from the authorities in the country in question, and academic literature.

For every company, the Council seeks to clarify whether the licence areas are located in areas of ecological importance (ecoregions)³ and what loss of biodiversity forest conversion will involve. Depending on the information received from the company, the Council gives weight to whether the state of the forest and conservation values located in the concession areas have been surveyed, how they were surveyed and how important conservation values are to be protected and managed. The Council considers whether biodiversity surveys have been conducted in accordance with internationally accepted guidelines⁴ and whether the measures implemented by the company are sufficient to protect important conservation values in the area. This assessment is generally undertaken with the assistance of experts.

In cases where the company fails to contribute information, there will be a limited basis for assessing the state of the forest, species diversity and ecosystems. Nevertheless, comparing the locations of the licence areas with other publicly available information,

such as maps of habitats for orangutans and other threatened species, land cover maps, and so forth may give an indication of the risk of loss of important environmental values. In such cases, the Council emphasises the fact that the lack of data and the company's lack of transparency about both surveys and the steps it has taken, raise the risk of severe environmental damage, not least given that the conversion of forest into plantations results in complete and irreversible change to ecosystems and vegetation.

What the Council has learned

Although all of the studied companies state that they focus on reducing environmental damage resulting from forest conversion, this is frequently inconsistent with their efforts in practice. The quality of surveys of biodiversity in licence areas varies considerably. Often, surveys lack information on what biodiversity will be lost and present deficient arguments as to which values are to be protected. Many of the companies concerned are members of the organisation Roundtable for Sustainable Palm Oil (RSPO), which promotes the sustainable production of palm oil. In the Council's experience, even if a company is a member of the RSPO, this does not in itself guarantee that high conservation values will be identified, protected and managed in such a way as to safeguard biodiversity in connection with the conversion of forest. For several of the companies, the sustainability aspect relates primarily to the local population, and less to biodiversity or climate change.

On the other hand, various companies are making positive, systematic efforts to reduce the environmental damage associated with conversion, for example by commissioning technically reliable environmental impact assessments and biodiversity surveys, and by identifying important conservation values. When companies allow environmental values to determine which parts of a licence area are to be converted and which parts are to be set aside for conservation, and have a good management plan in place, the risk of severe environmental damage is reduced.

Notes

- 1 IPCC 2013: *Climate Change 2013. The Physical Science Basis. Working Group I contribution to the IPCC 5th Assessment Report*, <http://www.ipcc.ch/report/ar5/wg1/#.Um6XYDhFD5o>.
- 2 *Fact Sheet Norway-Indonesia Partnership REDD+*, <http://www.norway.or.id/PageFiles/404362/FactSheetIndonesiaPeatMay252010.pdf>.
- 3 For example WWF's ecoregions, or Bird Life International's Important Bird Areas.
- 4 For example whether guidelines on surveys of forest containing high conservation values have been followed (the High Conservation Values Approach, see <http://www.hcvnetwork.org/about-hcvf>).



**The
recommendations
and letters on
exclusion and
observation**

To the Ministry of Finance

18 June 2012

UNOFFICIAL ENGLISH TRANSLATION

Recommendation to exclude Zijin Mining Group Co Ltd. from the investment universe of the Norwegian Government Pension Fund Global

1 Summary

The Council on Ethics for the Norwegian Government Pension Fund Global (GPFG) recommends the exclusion of the Chinese company Zijin Mining Group Co. Ltd.¹ (Zijin) from the GPFG because of an unacceptable risk of the company being responsible for severe environmental damage.

Zijin is a major producer of gold, copper and zinc and has a number of facilities for mineral extraction and metal production. Over the past years, there have been several serious incidents at the company's facilities where tailing dams from mining and processing have collapsed and resulted in extensive contamination and loss of human life.

The Council on Ethics has contacted the company several times with questions about the company's operations and the safety of such dams, but has not received any response.

The Council on Ethics finds that the risk of future incidents of this nature is great. This assessment is based on the scope and severity of previous accidents in combination with the company's unwillingness to provide information on risk-reducing measures.

2 Introduction

In the spring of 2011, the Council on Ethics decided to assess the Fund's investment in Zijin against the Guidelines for the Observation and Exclusion of Companies from the GPFG's Investment Universe (the Ethical Guidelines).² The background for this was the existence of information concerning large, serious accidents at the company's facilities resulting in extensive environmental damage.

At the end of 2011, the GPFG owned shares in the company valued at USD 42 million, amounting to a 0.5 percent share of the company.

2.1 WHAT THE COUNCIL ON ETHICS HAS CONSIDERED

The Council on Ethics has considered whether there is an unacceptable risk that Zijin is responsible for severe environmental damage as per paragraph 2, third subsection, letter c of the Ethical Guidelines.³

In this case, the Council on Ethics has assessed the risk that major accidents may occur

in the future at the company's production facilities. The background for this is that there have previously been several major accidents at the company's facilities which have resulted in extensive environmental damage. This involves tailing dams at waste disposal sites that have collapsed so that vast amounts of waste from mining operations, industrial waste and hazardous chemicals have been dispersed into river systems or flooded settlements and farmland. Over the past decade at least seven such incidents have been reported at the company's facilities in China.

2.2 SOURCES

Compared with previous cases where the Council on Ethics has recommended the exclusion of companies that have caused serious environmental damage, there is less information available in this case.

The Council on Ethics basis its assessment in this case in part on the limited information that is available from Chinese sources and the international press, as well as some information from the company's annual report and website.

The public information that is available as articles in the Chinese press often consists of rather general reports of these incidents. The degree of detail is generally low in the discussion of the company's lacking follow-up of government orders and the lack of reporting on environmental matters. Information available from the company on the matters that are the subject of this recommendation is limited and not very specific, and the company has not responded to the inquiries from the Council on Ethics. In accordance with the Ministry of Finance's White Paper to Parliament no. 20 (2008-2009), the Council on Ethics operates under the assumption that the absence of information concerning a company's conduct – and especially unwillingness on the part of the company to provide information – may contribute to the risk of complicity in unethical conduct being regarded as unacceptably high.⁴

3 Background

3.1 THE COMPANY'S OPERATIONS

Zijin Mining Group Co. Ltd. is the largest gold producer, the second largest copper producer and the fifth largest zinc producer in China. The company's revenue for 2010 totalled USD 4.1 billion.

The company operates in 20 Chinese provinces and in nine countries outside China, while its activities are organised in a number of subsidiaries.⁵ The Council on Ethics does not have a full overview of the company's activities, or where it has all of its production facilities. It is nevertheless clear that the company operates a large number of facilities for mineral extraction, preparation and metal refining.

The company was listed on the Hong Kong Stock Exchange in 2003 and the Shanghai Stock Exchange in 2008. The company's largest owners are Minxi Xing STE and the Newhanlu Industry Group, which have ownership interests of 39.9 and 14.9 percent, respectively. In addition to this, there are a number of owners with smaller ownership interests.

3.2 PROCESSING WASTE FROM GOLD AND COPPER PRODUCTION

Mining and the metal industry often generate vast amounts of waste that has to be managed. Waste that is not economically viable to recycle has to be disposed of. Where the production facility has been in operation for a long time, this may often involve large amounts of waste.

Below is a brief presentation of the processing stages for the manufacture of gold and copper, which are Zijin's primary products, as well as the types of waste normally generated during production.

Gold production

Gold is normally extracted from ore through hydrometallurgical⁶ processes where a cyanide solution⁷ is added to the crushed ore. The gold binds to the cyanide solution and is then extracted from this through further processing. Cyanide can, to some extent, be recovered from the ore reused; but this is not always done. Either way, gold extraction generally generates large amounts of waste from mining operations in the form of processed ore that contains cyanide. One tonne of ore normally yields between 0.1 to 3 grammes of gold.⁸ Ore that contains gold often also contains arsenic and heavy metals that can lead to serious long-term contamination after processing, for example, through runoff from tailing ponds.

Copper production

Copper is extracted from sulphide or oxide ores containing copper. The extraction method depends on the type of ore. Copper is extracted from sulphide ore through smelting processes, and hydrometallurgical processes are used for oxide ores, where sulphuric acid is added to the ore for the extraction of copper and subsequent refining. Regardless of what methods are used, copper slag will be generated from the smelting process as well as processing waste mixed with sulphuric acid. The latter will normally be refined and used for industrial purposes, and the waste is either neutralised with limestone before it is disposed of, or disposed of without further treatment. The waste also generally contains arsenic and various heavy metals.⁹

3.2.1 TAILING DAMS

Design and maintenance

Waste from the mining and metal industry that cannot be recycled must be disposed of. It is normal procedure to establish tailing dams to keep the waste within a limited area and prevent the leaching of chemicals and heavy metals. Tailing dams also ensure that water can evaporate from liquid waste and particles can settle.

Tailing dams can be constructed in different ways, and their design will depend on what types and what amounts of waste are to be disposed of, as well as local factors such as topography, bedrock, amount of precipitation and seismic risk. These facilities may range from relatively simple designs, with a simple dam barrier made of earth or waste from mining operations, to more advanced and extensive dams with several chambers for

treating waste in several steps or manage different types of waste.

This type of installation requires continuous monitoring and maintenance to ensure that they do not collapse. There are several factors which can weaken the structural stability of such dams over time, for example, erosion and overflowing following large amounts of precipitation.¹⁰

Accidents – dam failures

The risks associated with tailing dams are well known. Dams of this kind have been used in the mining and processing industry for over 100 years, and there have been a great number of accidents where the dams have collapsed and resulted in more or less serious damage. In addition to the seven dam failures that have occurred at Zijin's installations, the Council on Ethics is aware of 15-20 tailing dam failures with serious consequences at industrial installations throughout the world in the past decade.

In recent times, the largest accidents as a result of disposal dam failures in Europe have been in Italy (1985)¹¹, Romania (2000)¹² and Hungary (2010).¹³ In the US, the last major accident of this type was in 2008.¹⁴ In China (excluding Zijin), there were major accidents of this type in 2008¹⁵ and 2011.¹⁶

4 Environmental damage as a result of the company's activities

4.1 DAM FAILURES

The Council on Ethics is aware of the following reported incidents where Zijin's dam installations for industrial and mining waste have failed:

Xinyi, 21 September 2010

A dam at the company's tin mine in Xiny Quinpai in Guangdong province burst in September 2010.

Official media reported that 22 people were killed and that there was significant damage to roads, drinking-water plants and farmland, as well as extensive death of fish. The subsequent investigation found that the company had violated a number of government orders and provisions for the construction and operation of such dams.¹⁷

In August 2011, six people from the plant's management were sentenced to imprisonment for violations that led to the accident.¹⁸

Ting River, 3 and 16 July 2010

Two separate accidents within an interval of a few days and the company's response received much attention in Chinese and international media. On 3 July 2010, a dam collapsed at one of the company's copper refineries in Fujian and 9,000 cubic metres of industrial waste and chemicals flowed into the Ting River causing extensive environmental damage. An estimated 2,000 tonnes of fish died as a result of the accident.

The company did not acknowledge that the accident had taken place until nine days later, and had not attempted to limit the discharge in the meantime.¹⁹

In an announcement dated 16 July 2010, the company reported on the accident that had occurred on 3 July. The company wrote that an illegally installed pipe had lead untreated waste water to the river, and that government orders from 2009 to improve the drainage system had not been followed.²⁰

On 16 July 2010 a similar, however, smaller accident occurred at the same installation, and an additional 500 cubic metres of waste were discharged when another dam at the same installation also failed.

These incidents were, for example, reported in the Communist Party's English-language paper People's Daily, together with allegations that the company had offered bribes to Chinese journalists to prevent media coverage.²¹

Dongping, 25 April 2009

On 25 April 2009, there was a dam failure at the company's gold mine installation in Dongping in the Hebei province. It has been reported that there was an older dam that had partially failed and lead to extensive contamination of farmland.²² A similar accident allegedly also occurred in 2008 in Caikeng, but the circumstances surrounding this are unclear.

Shuiyindong, 27 December 2006

In 2006 a dam collapsed at Zijin Shuiyindong Gold Mine, and 200,000 cubic metres of waste was discharged as a result.²³ Nevertheless, the company claims that the extent of the damage was limited.²⁴ According to the pollution control authorities, the accident resulted in the drinking water for 100,000 people being contaminated with arsenic and cyanide.

The cause of the accident was probably that the company had overloaded the disposal dams by adding too much waste to them, combined with a long period of unusually heavy rain.²⁵

Tongkang, August 2000

On 25 August 2000, a disposal dam collapsed at Zijin's wholly-owned subsidiary Jinshan Mining's gold mine at Tongkang in Fujian province. The surrounding farmland and local roads were flooded by industrial waste.²⁶

4.2 OTHER MATTERS

The company has been criticised by both the authorities and special interest organisations.

In connection with the stock exchange listing of the company in 2008, the company's activities were reviewed by the environmental authorities. In accordance with the so-called Green Security Policy, the environmental systems and practices of all listed companies must be approved.²⁷ In this connection the environmental authorities pointed out a number of faults and defects in the activities at 11 subsidiaries in the Zijin Group. To a great extent this concerned tailings dams that were not designed and maintained in

accordance with regulations, in addition to previous orders to make improvements that had not been followed up. In a letter from the company to the special interest organisation Institute of Public and Environmental Affairs, dated 28 May 2010, the company explains that most of the faults and defects that were pointed out had been rectified or were in the process of being rectified.²⁸

In addition, the special interest organisation Green Law China,²⁹ in an open letter of July 2010, pointed out the insufficient follow-up of the government requirements and insufficient reporting of environmental matters.³⁰

In addition, it has been reported that the company had been investigated in 2010 by the authorities for failure to comply with orders to make improvements and insufficient environmental reporting from the company's copper production in Longyan.³¹

5 The company's position

Since 2009, the Council on Ethics has approached the company three times to request information on the company's activities. The company has not responded to any of these requests. In April 2012, a draft of this recommendation was submitted to the company, and the company was encouraged to provide any remarks or comments. The company did not respond to this, either.³²

The accidents in July and September of the same year are mentioned in the company's annual report for 2010. The company states that it has learned from these incidents and will put safety at the facilities first, and that work with accident prevention and management systems will be strengthened further.³³ The company's website also states emphasis on the environment and safety in connection with all the company's activities.³⁴

6 Assessment by the Council on Ethics

A review by the Council on Ethics shows that there have been 25 cases worldwide of accidents in the past ten years where dams for the mining and processing industries have collapsed and resulted in extensive damage and environmental pollution.

With regard to the company Zijin, the Council on Ethics has information on seven serious incidents over the past ten years where such dams have collapsed and resulted in extensive damage. Seen in relation to the total number of accidents worldwide during the same time period, it appears as if Zijin has been particularly exposed to such accidents.

It must be regarded as general knowledge that the operation of tailings dams in mining and the metal industries entails a risk of serious environmental damage, both acute and long-term. In the worst case scenarios, dam failures must be characterised as environmental catastrophes with regard to the extent of damage. In several of such accidents, people have drowned when populated areas have suddenly been flooded. In addition, drinking water sources have been contaminated, and there has been extensive impact on aquatic life and contamination of farmland.

The safe operation of tailings dams requires that they have been designed from the start to withstand both normal operating conditions and unusual circumstances, such as large amounts of precipitation and earthquakes, and that they are regularly maintained to compensate for the constant deterioration they are exposed to. The common factor for the accidents that have been discussed in this recommendation seems primarily to be installations that have been poorly (and in some cases illegally) designed, overloaded and insufficiently maintained, resulting in failure during periods of heavy precipitation. Accidents like this must be expected if they are not prevented.

The detailed consequences of the aforementioned events are not known. In general, it is also likely that disposal facilities that have not been adequately designed or are poorly maintained will have significant and continuous run-off of environmentally hazardous substances. In addition to the risk of acute, catastrophic events, it is, in other words, likely that these installations will entail significant contamination, even during day-to-day operations. In the cases where discharges into river systems stem from gold production installations, this is primarily in the form of arsenic, cyanide and heavy metal contamination.

In this case, the Council on Ethics compares Zijin's conduct with the environmental criteria in GPF's ethical guidelines, with particular emphasis on the risk of *future* environmental damage:

In assessing whether the company shall be excluded in accordance with subsection (3), the Ministry may, for example, attach importance to the probability of future norm violations; the severity and scope of such violations; the connection between the norm violations and the company in which the Fund has invested; whether the company is doing what can reasonably be expected to reduce the risk of future norm violations within a reasonable time frame; the company's guidelines for, and work on, safeguarding good corporate governance, the environment and social affairs; and whether the company is making a positive contribution to those affected, presently, or in the past, by the company's conduct.³⁵

Previous incidents and omissions can give an indication here of future patterns of behaviour, and the Council on Ethics finds that several serious accidents have occurred at the company's installations over the past decade. Even though these accidents generally occur after periods of heavy precipitation, dam failures cannot be considered natural disasters. It is likely that all the accidents can be explained by a combination of factors, where the installations have not been designed in accordance with the regulations, insufficient inspections and maintenance, overloading of installations, as well as inadequate compliance with government orders. These are all factors that lie within the company's control and area of responsibility.

The company's reporting on these events is very limited, and in China the company is criticised for lack of transparency and insufficient reporting. After the accident in 2006 the company made an announcement that the scope of the damage had been very limited, even though in reality it had been a disaster where, for example, the drinking water for 100 000 persons had been seriously contaminated. Information that the company had offered

bribes to journalists in connection with the accidents in 2010 in order to avoid press coverage reinforces the impression of lack of transparency.

In its 2010 annual report, the company states that it has learned from these events and that any future recurrence will be prevented. The Council on Ethics has on several occasions contacted the company with a view to obtaining more information on its activities and risk-reducing measures to prevent future environmental damage, but it has not received any response. The Council on Ethics finds that the unwillingness by the company to disclose information, in itself, contributes to increasing the risk that the GPF's investment in the company is in violation of the fund's ethical guidelines. In this connection the Council on Ethics makes reference to the White Paper to Parliament no. 20 (2008-2009), where the Ministry of Finance states:

'The availability of information in emerging markets is often limited.

Through its recommendations the Council on Ethics has developed a high standard of documentary requirements and evidence of violations of human rights or environmental damage. It can be difficult to meet the same requirements in a number of emerging markets. The result can be that a company in a developed market in a western country and a company in an emerging market that, based on the scope and degree of ethical guideline violations, should be treated equally, can be treated differently because there are different degrees of opportunities to document the violations of norms. This can lead to the exclusion of the "worst" companies in developed markets while "even worse" companies in emerging markets remain in the investment universe. The Ministry finds that a lack of information about a company's conduct, and not least the willingness of the company to disclose information may itself contribute to the risk of complicity in unethical conduct being regarded as unacceptably high. In practice this could mean that the same documentary requirements for justifying exclusion cannot be made in less transparent markets, where facts can be more difficult to prove.⁷³⁶

The Council believes that the above provision should be applied to cases like this, where a company responsible for severe incidents gives provides limited information on how it will avoid similar, future incidents. Based on an overall assessment, the Council on Ethics finds that there is an unacceptable risk for future, serious environmental damage as a result of Zijin's activities, and recommends the exclusion of the company from the GPF.

7 Recommendation

The Council on Ethics recommends that Zijin Mining Group Co Ltd. be excluded from the Norwegian Government Pension Fund – Global because of an unacceptable risk that the company is responsible for severe environmental damage.

Ola Mestad Chair (sign.)	Dag Olav Hessen (sign.)	Ylva Lindberg (sign.)	Gro Nystuen (sign.)	Bente Rathe (sign.)
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Notes

- 1 Issuer ID: 8503408.
- 2 Guidelines for the observation and exclusion of companies from the Government Pension Fund – Global's investment universe, http://www.regjeringen.no/en/sub/styrer-rad-utvalg/ethics_council/ethical-guidelines.html?id=425277.
- 3 See footnote 2, section 2 (3): 'The Ministry of Finance may, on the advice of the Council of Ethics, exclude companies from the investment universe of the Fund if there is an unacceptable risk that the company contributes to or is responsible for: [...] c) severe environmental damage'.
- 4 White Paper to Parliament no. 20 (2008-2009), section 4.6, see <http://www.regjeringen.no/pages/2172105/PDFS/STM200820090020000DDDDPDFS.pdf> (in Norwegian).
- 5 The company's website: <http://www.zjky.cn/english/tabid/1012/Default.aspx>.
- 6 Hydrometallurgy: Metal extraction by leaching of ore with chemicals dissolved in water, followed by precipitation, by means, for example, of electrolysis in an aqueous solution.
- 7 The cyanide is added as sodium cyanide (NaCn) or potassium cyanide (KCN) dissolved in water.
- 8 International Cyanide Management Code for the Manufacture, Transport and Use of Cyanide In the Production of Gold, <http://www.cyanidecode.org/>.
- 9 United States Environmental Protection Agency: *Profile of the Nonferrous Metals Industry* (2005), see <http://www.epa.gov/compliance/resources/publications/assistance/sectors/nfmetltn.pdf>.
- 10 Spitz, Trudinger: 'Mining and the Environment', CRC Press, 2009, chapter 18, *Tailings Disposal* and M. Rico et al: 'Reported tailings dam failures – A review of European incidents in the worldwide context', *Journal of Hazardous Materials*, 152 (2008), p. 846-852.
- 11 Val de Stava, Italy, 1985: The tailings dams for waste from mining operations from a fluoride mine collapsed and resulted in a tidal wave where about 200,000 cubic metres of water and mud flooded villages so that 268 persons were killed, <http://www.stava1985.it/>.
- 12 Baia Mare, Romania, 2000: After a tailings dam failed at a gold mine about 100,000 cubic metres of waste water containing cyanide flowed into the Some River. In addition to cyanide the discharge contained a number of heavy metals and resulted in severe contamination of several rivers and extensive fish death in rivers in Romania and Hungary. See 'Report of the International Task Force for Assessing the Baia Mare Accident': http://viso.jrc.ec.europa.eu/pecomines_ext/docs/bmtf_report.pdf.
- 13 Kolontar, Hungary, 2010: About 700,000 cubic metres of red mud from alumina production flooded several villages as a result of a dam failure in a disposal dam. Ten persons were killed when eight square kilometres were flooded in mud. MAL's website: http://english.mal.hu/engine.aspx?page=showcontent&content=Vorosizsap_HIR_EN.
- 14 Harrimann, Tennessee, USA, 2008: A disposal dam for ash waste from a coal-fired power station collapsed so that 4,000,000 cubic metres of ash waste and water covered an area of 1.6 square kilometres up to two metres thick. Significant damage to buildings and infrastructure, but no personal injuries, http://www.tva.gov/emergency/pdf/ash_release.pdf.
- 15 Xianfen, Shanxi, China, 2008: An illegally constructed disposal dam at a steel works collapsed and 265 persons were killed as a result when the tidal wave flooded a village. 'The unlicensed iron ore dregs retaining pond in Xiangfen City burst on Sept. 8, discharging a huge torrent of tailings, mud and rock that devastated a downstream village, an office building and a busy outdoor market. The death toll from the accident has risen to 265 with several still listed as missing by 5 p.m. on Sunday. An initial investigation found the collapse was due to negligence. The tailings dumping pond was built in violation of regulations and had few safety inspections.', People's Daily Online, 22. Sept. 2008, <http://english.people.com.cn/90001/90776/90882/6503998.html>.

- 16 In July 2011, the official Chinese website China.org.cn stated that the drinking water supply for 200,000 people had been contaminated as a result of a dam break at a magnesium plant in Mianyang in Sichuan province. In this connection it is also stated that there are over 12,000 disposal dams in China, of which 17% are in poor or dangerous condition. ‘The drinking water crisis in Mianyang, in Southwest China’s Sichuan province, caused by the pollution of the Fujiang River by a manganese plant, should be seen as a warning about the lax management of more than 10,000 toxic mine tailings in the country, environmentalists said.[...] On Thursday, a week after the river was contaminated by manganese ore residue flooding into it, the south-western city was still struggling to provide bottled water to more than 200,000 people who rely on the Fujiang River for their drinking water. [...] The 50-meter tailings dam, a wall built to hold the ore residue, was partly destroyed by a mudslide after heavy rain on July 21, said Liu Minggang, deputy head of Songpan county.[...] Statistics from the Ministry of Environmental Protection show that toxic mining residue now poses increasing threats to the environment and public health.[...] Since 2006, the Ministry has handled 43 emergency pollution cases caused by mine tailings, 10 of which disrupted supplies of drinking water. There are 12,523 mine tailings in the country, of which 17 per cent are in poor or dangerous condition, according to the environmental watchdog. “About 95 per cent of them are small, with limited capacity to deal with emergencies,” said a report published on the ministry’s website.’ see http://m.china.org.cn/2011-07/29/content_23099817.htm.
- 17 People’s Daily Online: <http://www.people.com.cn/h/2011/0712/c25408-3201948045.html>.
- 18 See http://www.china.org.cn/wap/2011-08/06/content_23155322.htm.
- 19 ‘Embattled Chinese gold miner Zijin ignored orders to repair a breach in a tailings reservoir last year, according to a stock exchange filing on a toxic wastewater discharge that polluted a river earlier in July.’ see Reuters, 17 July 2010: <http://www.reuters.com/article/2010/07/17/china-pollution-zijin-idUSTOE66G00I20100717>.
- 20 ‘An illegal man-made pipe connected the no. 6 leakage observation well and the flood discharge channel, as a result of which waste water directly entered the Ting River. The investigation discovered that the no. 6 leakage observation well and the flood discharge channel had been connected in an illegal way, the volume of leaked solution exceeded the amount re-pumped and the excess leaked solution entered the Ting River directly through the flood discharge channel. The investigation carried out by the relevant environmental protection department in Fujian in September 2009 discovered that the volume of waste water entering the Ting River through the flood discharge channel was too high and the plant was required to carry out remedial measures immediately. However, up to the time of the incident, the plant had not carried out remedial measures to a satisfactory level.’, The company’s press release of 16 July 2010: <http://www.zjky.cn/Portals/1/LTN20100719005-E.pdf>.
- 21 ‘The bribery accusation against Zijin Mining Group, China’s largest gold mining group, stemming from its attempts to cover up a sewage spill was approved by the central government recently. In early July 2010, a leak in the sewage tank in the Purple Mountain Copper Mine, which is owned by the Zijin Mining Group, led to 9,100 cubic meters of sewage being spilled into the Ting River and resulted in the death of 3.78 million kilograms of fish in the river, causing serious environmental pollution in neighbouring regions. But the Zijin Mining Group attempted to hide this severe incident at first. Investigations from the GAPP showed that after the pollution incident was exposed, the Zijin Mining Group indeed tried to give envelopes with money to reporters and journalists to keep them quiet, but those reporters who were involved all rejected the bribes immediately, refunded the money or turned it over to their head offices for evidence.’ <http://english.peopledaily.com.cn/90001/90776/90882/7120410.html>.
- 22 See report on <http://www.gzgov.gov.cn/gzgov/216457559920345088/20061228/217958.html>.
- 23 Reported on the website of the pollution control authority of Jinan: <http://www.jnepb.gov.cn/moudle/mainsub-end.aspx?id=DD63330F893528B9>.
- 24 The company’s announcement on the accident: ‘In the afternoon of 27 December 2006, an accident occurred at Guizhou Shuiyindong Gold Mine, which is owned by Guizhou Zijin Mining Co., Ltd. (“Guizhou Zijin”), a subsidiary of Zijin Mining Group Co., Ltd. (the “Company”). A section of the dam in the tailings storage slid during the period for maintenance. As a result, about 200,000 cubic metres of tailings with waste water flowed out mainly into deserted Xiaochang reservoir and a small part of it flowed out into Baifen reservoir which is used for irrigation only. A mild injury has been reported. After the accident, Guizhou Zijin started the emergency plan and reported it to the local authorities. All local authorities were actively involved in the remedial actions of the accident. Mr. Zou Laichong, a director of the Company visited the scene immediately. With the assistance and co-operation of other parties, the source of pollution is under control and its impact is limited to 2.5 km from the tailings storage. It has not caused serious casualty and affected the living of the people in the area.’, available on <http://www.infomine.com/index/pr/Pa459554.PDF>.
- 25 <http://www.hydroinfo.gov.cn/gb/szyzlnb/2006/6.htm> (in Chinese).
- 26 See <http://www.cf1234567.com/20100803/311431978.html> (in Chinese).
- 27 General Office of the State Environmental Protection Administration: http://www.mep.gov.cn/info/gw/huanban/200708/t20070816_107999.htm (in Chinese).
- 28 Letter from Zijin to the Institute of Public and Environmental Affairs, dated 28 May 2010: The letter closes as follows: ‘Our company would like to offer our sincere apologies for the failure to thoroughly complete all the

- improvement works, as was required by the EPB. Our company will: work towards increasing our knowledge of environmental protection work, establish a responsible attitude towards people and society, treat this environmental protection supervision order as an opportunity and carry out a total inspection of all internal environmental protection work in the company, improve the procedures for construction of all the company's environmental protection facilities, continue to strengthen investment in environmental protection, persist with the environmental protection projects and for the main projects carry them out in line with the "three simultaneous" procedures, maintain the environmental protection facilities and equipment so they are in a good condition, improve operational effectiveness and take advantage of internal recycling so as to discharge within the authorised standards. Our company promises to continue to strengthen and improve internal management and monitoring systems, ensure environmental protection investment, seek practical results and honour our commitment that we made when we floated on the stock market. At the same time we welcome the supervision by people from all parts of society.'
- <http://www.ipe.org.cn/Upload/file/Notices/Feedback/007-Feedback-Zijin-Mining-Group-Co-Ltd-EN.pdf>
- 29 Green Law China is a project in China that is run by the American organisation The Natural Resources Defence Council (NRDC), in which the aim is to promote the implementation of environmental legislation in China, <http://www.greenlawchina.org/about/>.
- 30 Open letter dated 24 July 2010 from Green Law China to the Hong Kong and Shanghai Stock Exchange, where the company is listed: 'Since 2005 this enterprise has broken different environmental rules and regulations in Hebei, Xinjiang, and Guizhou, resulting in both accidents and violations. These incidents led to a number of toxic and hazardous substances being discharged into local water bodies. After an investigation, we found no evidence to suggest that the company has made any public disclosure of this information. In 2007 to 2008, the Environmental Protection Department instituted inspections of listed companies and pledged to rectify and reform environmental issues that surfaced from these inspections. On May 14, 2010 the Environmental Protection Department publicly announced and circulated a notice of criticism against this company in particular and its untimely response to environmental issues. Apart from Zijin Mining, there were also several sub-subsidiary companies that were subject to the Environmental Protection Department's criticism. Responding to the Environmental Protection Department's criticisms, Zijin Mining merely gave a brief reply concerning Zijinshan copper mine's rectification and reform developments, stating that "rectification has already been completed."' <http://www.greenlawchina.org/2010/07/zijin-mining-groups-inadequate-disclosure-of-china-acid-spill-what-needs-to-be-done-2/>.
- 31 'Zijin Mining publicly criticised by the Ministry of National Environmental Protection for failing to rectify problems – including information disclosure – following pollution involving Zijin Copper wet plants', <http://eelib.zslib.com.cn/showArticle.asp?ID=11619&ArticlePage=6>.
- 32 The letter of 4 August 2009 from NBIM on behalf of the Council on Ethics with questions on the company's activities in Myanmar. The letter of 21 November 2011 from the Council on Ethics to the company with questions on what measures the company has implemented in order to prevent any future dam breaks at its facilities. Follow-up letter of 22 December 2011 with a request for a reply to the letter dated 21 November 2011. The letter from the Council on Ethics to the company 25 April 2012 with a draft of this recommendation and invitation to submit any comments or remarks. The Council has not received a reply to any of these letters.
- 33 Zijin Mining Group Company Ltd: Annual Report 2010: 'Business Strategies: (i) To comprehensively enhance the precautionary standard and the management standard in the environmental protection and safety system, to re-build Zijin's brand name in environmental safety, thoroughly implement the concept of scientific development, adhere to the philosophy of "putting safety first, prioritize environmental protection, seriously learnt the lessons from the "7.3" Incident and the "9.21" Incident, and properly manage the relationship among speed, efficiency and law-abiding and disciplined operation.[...]', <http://www.zjky.cn/Portals/1/Annual2010%20Summary%20Review.pdf>.
- 34 Zijin Mining Group Company Ltd, website *Sustainability – Safe operation*: 'During its production and construction, Zijin Mining Group seriously implements laws and regulations, such as Safe Production Law, Environmental Protection Law, Two Decisions, etc., as well as the important instructions of central government leaders on safe production, environmental protection and social security. It adheres to the guideline of "prevention & safety first", implements the principle of "He who is in charge is responsible", improves its administration strengthens its management, puts into effect the responsibility system level by level, checks and rectifies against hidden perils promptly, builds a sound interior precaution mechanism, makes efforts to carry out infrastructure construction, and guarantee key & critical positions. In this way, the whole company has maintained a favourable situation of "basically stable security, comparatively safe production, sound environmental protection measures and sustainable growth of economy', <http://www.zjky.cn/english/tabid/956/Default.aspx>.
- 35 Guidelines for the observation and exclusion of companies from the Government Pension Fund – Global's investment universe, section 2 (4), see http://www.regjeringen.no/en/sub/styrer-rad-utvalg/ethics_council/ethical-guidelines.html?id=425277.
- 36 The English translation of the White Paper provided in this document is unofficial. See footnote 4.

To the Ministry of Finance

21 June 2012

Unofficial English Translation

Recommendation on the exclusion of Volcan Compañía Minera SAA from the Government Pension Fund Global

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1 Summary

The Council on Ethics recommends excluding the Peruvian company Volcan Compañía Minera SAA (Volcan) from the Government Pension Fund Global due to an unacceptable risk that the company contributes to severe environmental damage through its mining operations in Cerro de Pasco, Peru.

Volcan is Peru's largest producer of lead and silver, and the country's second-largest producer of zinc. The mine is located in the middle of a city of 70,000 inhabitants. As the mining operation takes place in residential areas of the city, the Council has emphasised the consequences that the mining operation has for human life and health. The Council has focused especially on the risk to children's health resulting from high concentrations of lead in the soil and water.

There have been mining operations in Cerro de Pasco for several centuries. Volcan purchased the mine in 1999, and today the mining complex comprises open-pit and underground mines, two ore processing plants, nearly 30 ore stockpiles, two waste rock dumps and a tailings impoundment. With the exception of the tailings impoundment, all facilities are located in the town, and many are in the immediate vicinity of residential areas. The studies that the Council have considered show that the soil in Cerro de Pasco contains high and to some extent very high concentrations of lead, and that there is significant lead pollution in residential areas. The rivers are also heavily polluted by lead.

The population has been exposed to lead in a variety of ways, and several studies have shown abnormally high concentrations of lead in the blood of children in Cerro de Pasco. Lead is poisonous and can cause serious short-term and long-term health effects. Among other things, lead can affect children's intellectual development even at low concentrations. The World Health Organization considers a concentration of more than 10 µg lead per decilitre of blood to be harmful.

In the studies considered by the Council, nearly 1,300 children in Cerro de Pasco were evaluated in the period between 1999 and 2007. Depending on the neighbourhood, between 50 and 90 percent of the children had high blood lead levels (≥ 10 µg/dl), and in some cases the level was so high that there was significant risk of the child developing serious and chronic health problems. High blood lead levels occur more frequently near the open pit mines, waste rock dumps and ore stockpiles.

The Council first contacted Volcan in a letter dated 26 May 2010, and has subsequently communicated with the company several times. Volcan has twice been sent draft recommendations, and the company has contributed information and comments on the recommendations. The company's response is detailed in section four of the recommendation.

The Council understands that the fact that the residents of Cerro de Pasco are exposed to lead pollution caused by long-term mining is not disputed. More than half of the children have such elevated blood lead levels that their intelligence and development can be affected. The impact of the elevated lead levels is exacerbated by the children living in households with few means, where the standard of living can further aggravate the children's and families' situations. The Council considers it likely that the lead exposure that the children are subject to leads to chronic and serious health problems in children who

are already in a vulnerable situation, and that this could continue for generations unless the lead pollution is reduced.

Volcan argues that the company is not responsible for the serious environmental situation in Cerro de Pasco. The company seems to assume that after Volcan acquired the mine in 1999, the mining operation has not contributed to the lead pollution. The Council has not assessed who has primary responsibility for the current situation. The Council nevertheless considers it likely that activities that include the extraction and processing of lead ore and the storage of ore and waste rock in the middle of the city contribute to the high concentrations of lead. In the opinion of the Council on Ethics, the company does not appear to have conducted sufficient studies to clarify the causes of the high concentrations of lead in rivers and soil that are affected by the mining operation, and it also does not appear that the company has attempted to clarify the extent to which its activities affect children's health. According to accepted international norms such as the standards from the *International Finance Corporation (IFC)*, companies have an independent responsibility to prevent or reduce the risk of their activities having negative consequences for the safety and health of the inhabitants.

Volcan has implemented the measures the authorities have ordered, and it cannot be said that the company generally operates in Cerro de Pasco in conflict with its state-issued licences. The company does not see itself as contributing to the pollution as long as it complies with the requirements imposed by the state. The Council understands that Volcan's activities nevertheless can have harmful environmental effects. Among other things there has been shown to be heavy-metal runoff from Volcan's facilities, but the extent to which the diffuse discharges from the facilities are regulated, or how much is captured and processed, is unclear. The same uncertainty applies to discharges to soil. Several measures proposed in impact assessments and other reports to reduce discharges to water largely do not appear to have been implemented.

Volcan has a licence to operate the mine for several more decades. In a city in which residents already suffer from high levels of lead pollution and have done so for many years, all further additions of lead should be limited as much as possible. In the Council's opinion, this requires especial care to be exercised by the company, both as concerns examining the company's contribution to the pollution and to the measures which should be implemented. The lack of knowledge about how the company's activities affect the environment in Cerro de Pasco contributes to increasing the risk of serious health problems among children and the general population.

On the basis of an overall assessment, the Council believes there is an unacceptable risk that Volcan contributes to current and future severe environmental damage through its mining operation in Cerro de Pasco. The Council therefore recommends that the company be excluded from GPF's investment universe.

2 Introduction

On 10 March 2010, the Council on Ethics decided to evaluate the fund's investment in Volcan against the Guidelines for the Observation and Exclusion of Companies from the GPFG's Investment Universe (the Ethical Guidelines).

The background for this was the existence of information suggesting that the mining operation in the Peruvian city of Cerro de Pasco exposes the population to hazardous pollution from lead and other heavy metals. Cerro de Pasco is a city of 70,000 inhabitants and is located approximately 4,000 metres above sea level. The mining operation takes place in the middle of the city.

At the end of 2011, the GPFG owned shares in the company valued at NOK 45 million, corresponding to a holding of 0.22 per cent of the shares in the company.

2.1 WHAT THE COUNCIL ON ETHICS HAS ASSESSED

The Council on Ethics has assessed whether there is an unacceptable risk that Volcan is responsible for severe environmental damage according to Section 2, third paragraph letter b of the Ethical Guidelines.

In previous assessments of severe environmental damage, the Council on Ethics has emphasised whether:

- the damage is significant;
- the environmental damage will have irreversible or long-term negative effects;
- the damage has considerable negative impact on human life and health;
- the damage is a result of breaches of national laws or international standards;
- the company has failed to act in order to prevent the damage;
- the company has implemented adequate measures to rectify the damage;
- it is probable that the company's unacceptable practice will continue.

The mining activity takes place in residential areas of the city, and the Council has therefore emphasised the consequences of the mining activity for human life and health, and particularly for the life and health of children. The Council has focused on lead pollution that can lead to long-term and chronic health problems. As GPFG's Ethical Guidelines apply to existing and future breaches of norms, the Council has assessed whether there is an unacceptable risk that the continued operation of the mine exposes children in Cerro de Pasco to hazardous quantities of lead.

Volcan acquired the mine in Cerro de Pasco in 1999. Much of the pollution is clearly the result of previous mining operations, but Volcan owns and operates the mine today. The Council considers all facilities, ore stockpiles, waste rock dumps and operations that fall within the company's current concession areas to be the company's responsibility.

2.2 SOURCES

This recommendation is primarily based on information that Volcan has sent to the Council, among other things through its responses to the Council's inquiries. The Council has *inter alia* been given access to the company's environmental monitoring reports and environmental impact assessments.

The Council has also based itself on a study conducted by the United States' *Centers for Disease Control* in 2007 which assessed women and children's exposure to heavy metals in Cerro de Pasco. Both the company and the authorities see this study as the most thorough assessment of the local population's exposure to lead and other heavy metals in Cerro de Pasco.

Further, the Council has communicated with several public agencies in Peru, including *OSINERGMIN* (an agency under the Ministry of Energy and Mines which was responsible for environmental monitoring of mines until 2011), the *Dirección General de Asuntos Ambientales Mineros* (directorate of mining-related environmental issues), *OEFA* (the Ministry of the Environment's organisation for environmental impact assessments and monitoring, which has been responsible for the environmental monitoring of mines since 2011), and *DIRESA-Pasco* (local health authority in the Pasco region).

3 Background

Volcan is Peru's largest producer of lead and silver, and the second-largest producer of zinc. All of the company's mines are located in the central mountain areas of Peru, and the mine in Cerro de Pasco is among the largest. The company is listed on the stock exchanges in Lima, Santiago and Madrid.

3.1 VOLCAN'S ACTIVITIES IN CERRO DE PASCO

There have been mining operations in Cerro de Pasco since the 1600s. Empresa Minera Paragsha S.A (Empresa Paragsha) began its activities in the city in 1902, and opened the Raul Rojas open-pit mine in 1956. Volcan acquired Empresa Paragsha from the state-owned company Centromin in 1999. Volcan also owns a smaller mine, El Pilar, which borders Raul Rojas.



Figure 1: Raul Rojas open-pit mine in Cerro de Pasco. The picture is taken from the north looking south.



Figure 2: Google Earth satellite image of Cerro de Pasco. The open-pit mine and the company's tailings impoundment, waste rock dumps and ore stockpiles are marked, as are residential areas and dumps that do not belong to Volcan. The Ayapoto neighbourhood, which is mentioned later in this recommendation, is marked with a circle.

In addition to the open-pit mines and underground mines, the mining complex consists of two ore processing plants (Paragsha and San Expedito), nearly 30 ore stockpiles,¹ two waste rock dumps and a tailings impoundment. These facilities are located at various sites in the city (see Figure 2). There is no smelter in Cerro de Pasco.

The lead and zinc ore is crushed, ground, and concentrated in a flotation plant. The concentrates are transported to a loading zone for further freight by train. Tailings from the process are deposited at a separate site west of the city. Tailings are a slurry of finely ground ore, process chemicals and water.

Ore with viable concentrations of gold, copper and silver are stored in ore stockpiles at various sites in the city for future processing. The company plans to build a new processing facility to exploit the ore, and this facility will remove 12 per cent of the ore stockpiles over the course of five years. The company plans to remove the remaining ore stockpiles over a thirteen-year period.² To the Council's knowledge, no concrete measures to this end have been implemented yet.

Unviable rock and ore are stored in waste rock dumps in the northern part of the city. Waste-rock and tailings from previous mining operations are stored in an area south-west of the city. These have never been part of Volcan's operations (see Figure 2).

In 2010, Volcan processed approximately four million tonnes of ore annually.³ The company has informed the Council that for commercial reasons, the open-pit mine has not been in operation since October 2010. Instead, underground mining - where concentrations of silver, lead and zinc are higher - has increased. The company's ore extraction has dropped by 45 per cent in the last year. The company has stated that the

open-pit shutdown is temporary, and that it has concrete plans to expand its open-pit mining activities.⁴

3.2 ENVIRONMENTAL REQUIREMENTS

In 1993, environmental requirements were imposed on mining operations in Peru through environmental protection regulations for the mining and metal industry.⁵ Among other things, the state requires that companies conduct the necessary studies and prepare a plan (known as a PAMA plan) for the measures that must be implemented in order for existing facilities to meet current environmental requirements.⁶ Additionally, companies must assess the environmental impact of new projects and identify measures to reduce the environmental impact of these. When the environmental impact assessment has been approved, the company is required to implement the measures.

Centromin created a PAMA for Cerro de Pasco in 1996, and Volcan inherited parts of the plan in 1999. According to Volcan, it has met all its obligations related to this plan.⁷ Volcan has also received approval for three impact assessments, which the company is required to implement. These form part of the regulations for the mining operation.⁸

The state imposes requirements on the company's discharge of pollutants, including a requirement that the lead content of the discharge not exceed specific limits. The discharge values are controlled through monitoring programmes that the state approves. The monitoring reports must be sent to the authorities every month. According to the above regulations, a company will by definition not pollute the environment as long as it complies with the discharge limits.⁹ The state also imposes requirements to the water quality in the river that is the recipient of the discharge from the mining activities.

Volcan has been fined a number of times for violations of environmental laws. In responding to questions from the Council on Ethics, the company stated in an appendix to its letter dated 12 July 2010 that the state has imposed administrative fines for more than 20 different violations of environmental provisions. These included processing greater amounts of ore than permitted, building a processing plant without assessing the environmental impact, discharges to water in excess of the limits, and failing to implement measures it had been ordered to complete.¹⁰

4 Environmental conditions in Cerro de Pasco

Volcan's mining operations occupy a 6.3 km² area in and around Cerro de Pasco. About half of this area (3.25 km²) is located within the town itself.¹¹ The open-pit mines, processing facilities, ore stockpiles and waste rock dumps are in the immediate vicinity of the areas where people live. Some residential areas, including Ayapoto (see figure 2), are located inside the company's concession. For years settlers have illegally set up their houses within the company's concession areas, also before Volcan acquired the mine. This is still ongoing; since 2006, several hundred people have settled on various ore stockpiles or waste rock dumps in the city, including 450 people in the autumn of 2011.¹²

Long-term mining operations have led to both the water and the soil being

significantly polluted by lead and other heavy metals. The population has been exposed to this pollution in various ways, and in recent years several studies have shown abnormally elevated blood lead levels in children in the city (this is discussed further below). Several studies also show that the population is exposed to a number of hazardous compounds of *inter alia* thallium, caesium, antimony, copper and arsenic.

Several attempts have been made since the 1960s to move the population; most recently, in December 2008, the National Congress of Peru decided that the population in Cerro de Pasco should be relocated.¹³ To the Council's knowledge, no decision has yet been made about how to finance this, and the moving process is at a standstill.¹⁴ Local authorities are now primarily focused on improving conditions in the city, as they do not believe that the move will ever take place.

4.1 SOIL LEAD CONCENTRATIONS

The Council on Ethics has considered four studies of the lead content of the soil in Cerro de Pasco.¹⁵ The Peruvian Ministry of Health is responsible for three of these while one was conducted by the US Centers for Disease Control (CDC), a professional agency under the federal Department of Health and Human Services in the USA.¹⁶

In total, these studies have taken 113 samples of the soil. The tests were taken in homes, school yards, playgrounds, and other areas to which children might have access. More than half of the samples (63 samples) had high concentrations of lead ($\geq 1,200$ mg lead per kilo of soil), while 12 per cent (14 samples) had concentrations of 5,000 mg/kg or more.¹⁷ By comparison, the Environmental Protection Agency (EPA) in the USA considers concentrations above 400 mg lead/kg soil to be harmful in areas where children play, while Norwegian authorities consider that lead concentrations should exceed 100 mg/kg soil in kindergartens, playgrounds and schools.¹⁸ Only 17 per cent (19 samples) showed lead concentrations below 400 mg/kg.

In the CDC's study, high concentrations of lead occurred more frequently near the open-pit mine and ore stockpiles.¹⁹ The study also showed high concentrations of lead ($> 1,200$ mg/kg) in 60 per cent (26 of 43) of the homes assessed. The absolute highest concentration (20,000 mg/kg) was found 'in a sample obtained from a dirt path located next to one of the many piles of unprocessed ore found throughout the city.' The CDC concluded that 'The environmental assessment component of this investigation suggests widespread lead contamination throughout all three communities.'²⁰

In combination, the four studies show that the soil in Cerro de Pasco contains high and in part very high lead concentrations, and that the lead pollution is also significant in residential areas. Volcan's own environmental impact assessments also show a high lead content in the soil.²¹

4.2 LEAD CONCENTRATIONS IN WATER

There are three rivers in the area around Cerro de Pasco that are potentially affected by the mining activities: the Tingo, Ragra and San Juan rivers. The Council has focused on the Ragra River, which is the recipient of discharges from Volcan's processing facility, underground mine and the treatment plant that treats leachate from dumps and piles,

among other things. The river also receives sewage and runoff from two neighbourhoods in Cerro de Pasco. The Ragra River runs into the San Juan River.

According to local health authorities, the water supply in Cerro de Pasco is limited. It is therefore not uncommon for families to use water from rivers and wells for household use.²² The Council does not know which rivers are used for this purpose.

The state requires that lead concentrations in discharges do not exceed 0.2 mg/litre. Volcan is also required to measure lead concentrations and other pollutants at various points in the rivers, and the lead concentration in these waters must not exceed 0.1 mg/litre.

Volcan has three discharge points to the Ragra River, at which effluents from the mine, the processing facility, ore stockpiles and waste rock dumps are discharged into the river. In its communication with the Council, Volcan asserts that these discharges usually remain within the limits imposed by the state (0.2 mg/litre).²³ This is confirmed by the company's monitoring reports. Volcan has no other direct discharges to the river.²⁴

The Council has considered the company's monitoring reports for the Ragra River for the period between January 2009 and March 2011. The results of the measurements show that the water in the Ragra River contains high concentrations of lead, and that these increase downstream from the discharge points. At the measurement station (E-02A), which is the first measurement station downstream of the discharge points, all measurement values exceed the authorities' water quality limits (0.1 mg/litre), and the average lead concentration during the period was 0.885 mg/litre.²⁵

Measurements that the authorities conducted in March 2010 immediately downstream from the same measurement station (E-02A) also show very high lead concentrations in the water, with maximum concentrations of 8.0 mg/litre. In 2010, the authorities' measurements showed an average lead concentration at this point in the river of 1.3 mg/litre.²⁶

In its communication with the Council, Volcan states that the values registered at the measurement stations downstream from the discharge points cannot be caused by the company's discharges, as Volcan's discharges are within the maximum limits. Volcan therefore believes that the company cannot be held responsible for the high values that are registered downstream of the company's discharge points. The company believes further that runoff and leachate from old dumps that do not belong to Volcan, as well as runoff from other surfaces in the city, are the reason for the high levels of lead in the river.²⁷

In 2005, however, Volcan was fined by Peruvian authorities for having exceeded the maximum limits at a measurement point downstream of the company's operations. In the 2007 appeal case, the authorities confirmed Volcan's responsibility for the values that are measured at the company's measurement stations. The authorities found that the company did not have sufficient proof that the discharges were not caused by the company's activities.²⁸

To the Council's knowledge, no systematic studies have been made with a view to identifying the cause of the high lead concentrations downstream of the company's discharge points in the Ragra River.

A 2006 study that the consultancy firm Ground Water International conducted for Volcan concluded that there is significant runoff of heavy metals from waste-rock dumps

and ore stockpiles to the ground water.²⁹ Some of this drains into the open-pit mine, where the water is pumped and treated, while the rest follows natural drainage routes to the Ragra River.³⁰ Though the report does not quantify the volume of the discharge, it indicates that diffuse discharges from the mining activities, related to runoff and leachate from the ore stockpiles among other things, likely add a significant amount of lead to the rivers in Cerro de Pasco.

The environmental impact assessments that the company has completed also suggest that the mining activities affect the rivers in ways other than through the three discharge points. In the assessments, the high levels of lead in the rivers are among other things associated with runoff from soil that is polluted from ongoing and previous mining activities.³¹ One of the measures recommended in the assessment to reduce the contribution of lead was to remove the topsoil in the area covered by the environmental impact assessment.³²

4.3 BLOOD LEAD LEVELS IN CHILDREN IN CERRO DE PASCO

Since the mid-1990s, several studies have been conducted that show that residents of Cerro de Pasco have high blood levels of lead and other heavy metals.³³ The Council has considered four of these studies in greater detail.³⁴ Three were conducted by the health authorities and the fourth was conducted by the US Centers for Disease Control (CDC) in 2007 as referenced in section 3.1.³⁵ The Council's assessment is largely based on the latter study in particular.

Lead is poisonous and can cause serious long-term and short-term health effects. Lead is absorbed in animals and humans, and over time high concentrations of lead can accumulate in their bodies. The absorption of lead is often slow and takes place through long-term, chronic exposure. Too much lead in the body can *inter alia* lead to damage to red blood cells and to the nervous system. Brain development in foetuses and small children is especially vulnerable to damage caused by lead. Research shows that lead exposure can affect the intellectual development of children, even in low concentrations. Lead can also affect the ability to have children.³⁶ Intake of lead can occur through water, food, air, soil and dust.³⁷ Small children absorb 25-50 percent of the daily intake of lead, compared with 5-10 percent for adults. Nutrition affects how much lead is absorbed. For example, low levels of calcium and iron increase the absorption of lead.³⁸

In this recommendation, the Council has especially focused on children as they are a particularly vulnerable group in this context.

The concentration of lead in organisms can be measured in different ways. The most common method is to measure the lead concentration in the blood (blood lead levels, or BLL). According to the World Health Organization (WHO), a concentration above 10 µg lead per decilitre of blood is harmful, but it is also impossible to identify a safe level for children.³⁹ Research conducted by the WHO and the EU's science committee has shown that levels below 5 µg lead can also harm children's development.⁴⁰ Any concentration of lead in the blood can therefore be said to be harmful to children, although not all children react in the same way to high BLLs.

The four studies that the Council has considered cover different neighbourhoods and span several years (1999-2007). The studies provide a picture of the exposure to lead at

the time the studies were conducted, but do not provide a basis from which to evaluate the development of BLLs in children in Cerro de Pasco over time. In total, nearly 1,300 children have been examined. Of these, 849 children - 65 per cent - had BLL values above 10 µg. The table below summarises the results of the studies.

Table 1: Summary of results from studies of children's BLL in Cerro de Pasco⁴¹

Studies	Number and age of children tested	BLL average (µg/dl)	BLL range (µg/dl)	Number of children with BLL above 10 µg/dl (%)	Comments
CDC (2007)	163 children between 1-12 years of age	10.5	3.6-64.0	53	Children and women of childbearing age in three neighbourhoods around the open-pit mine were tested. The highest values were found in the Ayapoto neighbourhood, where nearly 90 per cent of the children had BLLs above 10 µg/dl, and the average BLL was 15.6 µg/dl. Ayapoto is located near the open-pit mine and next to a waste rock dump.
Instituto Nacional de Salud – Cerro de Pasco (2006)	338 children between 1-12 years of age	13.2	3.33-71.24	51.8	Children in one district were surveyed. The highest values were found in areas near the open-pit mine, and this was also where the lead concentrations in the soil were highest.
Instituto Nacional de Salud – Cerro de Pasco (2005)	236 children between 1-10 years of age	15.79	6.17-34.53	85	The study covers two smaller settlements on the outskirts of the city. All children between one and ten years of age living in the area covered by the study were tested. The percentage of children with BLL above 10 µg/dl was highest in the neighbourhood closest to old dumps.
DIRESA (1999)	545 children, age not reported	15.1	Not reported	68	The study does not identify where the tests were conducted.

All studies show that between 50 and 90 percent of the children – depending on the neighbourhood – had elevated blood lead levels (≥ 10 µg/dl). In some cases, the concentrations were so high that there was significant risk that the children develop serious and chronic health problems. The studies also indicate that higher values are more common near mining facilities such as the open-pit mine, waste rock dumps and ore stockpiles.⁴² The Ayapoto neighbourhood, which is located within the company's concession, appears to be especially vulnerable to high BLLs.⁴³

The Council's focus on lead notwithstanding, it is worth mentioning that the CDC found that children also had high concentrations of other metals. Ninety per cent of the children had high concentrations of at least one metal in their blood.⁴⁴ CDC concludes that 'The findings from the analyses of 14 metals in blood, serum, and urine collected from participants [in the study area] indicate a high level of metal intoxication.'⁴⁵

5 Information from Volcan

5.1 THE COUNCIL'S COMMUNICATION WITH VOLCAN

The Council first contacted Volcan in a letter dated 26 May 2010 inquiring about the mining operation and the environmental conditions in Cerro de Pasco. Since then, the company has received two drafts of the Council's recommendation, in October 2010 and in September 2011. In every instance, Volcan has provided extensive replies to the Council's questions and detailed comments on the draft recommendations. In March 2011, a video conference was held between Volcan and members of the Council and Secretariat.

As a result of the company's comments, this recommendation differs in some aspects from the drafts submitted to the company.

5.2 THE COMPANY'S MEASURES TO IMPROVE THE ENVIRONMENTAL CONDITIONS IN CERRO DE PASCO

Volcan stresses that the company's activities comply with the government's requirements and notes that the company has fulfilled all its obligations in accordance with the action plan for the mining facility (the PAMA plan, see section 3.2). Additionally, the company is working to implement measures required by the environmental impact assessments for new facilities, and Volcan believes this will change their operations:

'Volcan has recently obtained three EIA approvals... which optimize the environmental management operations in Cerro de Pasco. Today virtually all of the direct area of influence of the mining operations in Cerro de Pasco is covered by approved EIA measures. Coupled with the annual recertification of the ISO 14001, Volcan believes that the plans and operations that have been recently approved will represent concrete changes compared to the way the operation of Cerro de Pasco was being conducted before (i.e. solely under the guidelines of the PAMA).'⁷⁴

Volcan states that it has an environmental management system that is certified according to the international environmental management standard ISO 14001. This means that the company has an environmental management system that makes it possible to identify how the company affects the environment and systematically reduce the environmental impact. The standard is a procedural standard and does not define levels of pollution or specific measures. It is up to the company to identify relevant problems and define goals and measures, and the company itself defines how ambitious environmental goals and measures should be.⁴⁷

The Council has especially requested information concerning the measures the company has implemented in order to reduce residents' and children's lead exposure. The company states that all transport vehicles to and from the mine are to be covered, and that the tires are to be washed before vehicles leave the area of the mine in order to prevent the spreading of polluted soil. Wherever possible, ore is not to be transported through residential areas, and the roads are to be watered to prevent dust problems within the company's facilities. According to the company, other measures are addressed through the environmental management system, such as measures that keep mining operations and residential areas separate.⁴⁸ This is not specified further.

Volcan has also informed the Council that it has been buying up houses in the city's most vulnerable areas since 2005.⁴⁹ These are primarily areas that will be located within the planned expansion of the open-pit mine, and which the Council assumes must be removed in any case.⁵⁰ The company also believes that the planned processing plant that will exploit the ore stockpiles will have a positive effect on the environmental situation in the city.

Volcan states that the company conducts health campaigns in risk areas. The most recent campaign that the Council is aware of ran in the Ayapoto neighbourhood in March 2011. It focused on teaching families about better nutrition and hygiene in order to reduce the absorption of lead. Additionally, Volcan has entered an agreement to purchase services from a 'lead contamination mitigation specialized group' in the Pasco region. Among other things, the group is to prevent and measure children and women's lead exposure in mining areas in the Pasco region; monitor cases of unacceptable concentrations of heavy metals and identify sources of pollution. In cooperation with local health authorities it is to develop strategies to reduce pollution that children are exposed to, conduct social programming and implement awareness campaigns. Volcan has not specified what this actually entails for the company or for Cerro de Pasco and has not given a timeframe for this work.

The Council has also asked whether the company has implemented or planned studies to survey the sources of lead pollution in water and soil. In its response, Volcan refers to a collaboration with local health authorities that has been ongoing since 2003:

“In Cerro de Pasco the Regional Directorate of Health (DIRESA, as per the Spanish acronym) established the “Multi-disciplinary Technical Committee for Lead in Blood related Issues” in August 2003, and the company has been actively involved from the beginning supporting diagnostic studies to obtain technical information and develop intervention programs to minimize the impact on the health of vulnerable populations.”

Volcan does not elaborate on whether this collaboration has resulted in new knowledge about the issues mentioned here. At the same time, in its last letter to the Council, Volcan states that it is currently considering a new project “to enhance the understanding of the complex picture of contamination in the area”, including “To conduct a study of soil (together with CDC or others), including natural background values, sources of dust migrations, migration patterns as well as historical migration and its influence on soil values found.”⁵¹

5.3 VOLCAN'S RESPONSE TO THE COUNCIL

The company's responsibility for the environmental conditions in Cerro de Pasco

Volcan's main argument has consistently been that the company cannot be blamed for the serious environmental situation in Cerro de Pasco. The company does not deny the environmental situation in the city, but believes that there is no basis to claim that these are caused by Volcan's activities. The company believes that the environmental situation is largely a result of previous mining activities (prior to Volcan's acquisition of the mine) as well as a number of other issues outside the company's control.

‘While the Council has correctly identified the overall environmental situation and its health impacts in Cerro de Pasco, we will emphasize that this, to a large extent, is due to a number of different factors. This encompasses poor planning and operations of the mining operations by past owners (including Centromin) insufficient management by municipalities and governmental bodies as well as events and factors well beyond the ordinary control and management objectives of a mining company.’⁵²

In subsequent correspondence, the company has pointed to the following factors among others as determinants of the environmental situation: ⁵³

- A naturally high lead-content in the rock, which is a prerequisite for viable deposits of lead.
- Runoff from old waste rock dumps that Volcan is not responsible for.
- Other pollution from previous mining that contributes to the pollution of soil and water.
- Poor city planning and a failure to take existing mining operations sufficiently into account in the approval of new residential areas.
- The use of materials with high lead content in homes.
- Lack of action on the part of the authorities to prevent unauthorised persons from accessing the company’s concession.
- Lack of action on the part of the authorities to improve nutrition and hygiene in families in order to reduce the absorption of lead in children.

Volcan is therefore of the opinion that if the company is excluded from the fund it will be held responsible for issues that primarily are caused by previous mining companies and local authorities: ‘Through centuries, and especially the last 60 years, a number of severe mistakes, failures and omissions from former stakeholders are registered. If Volcan were to be held responsible for this, including clean-up and relocation of the urban settlement, Volcan would obviously not have acquired the operation in the first place, and neither would others.’⁵⁴ Furthermore: ‘COE [the Council on Ethics] must be able to provide sufficient proof of causation in order to defend its allegations against the company. The burden of proof is left with COE and any effort to turn it on the company is declined.’

Volcan also notes that the company does not feel responsible for issues that were not addressed in the action plan (PAMA) when the company acquired the mining operation:

‘Judging from the PAMA projects that were transferred to Volcan through the acquisition of Empresa Minera Paragsha, it can be seen that “persistent high lead in blood levels” was not addressed in the PAMA project. Most probably the PAMA was not designed to tackle that issue. Therefore, we fail to see how Volcan may be held responsible for not addressing unidentified underlying conditions when the privatization took place.’

The company points out that there is a need to know more about background values of lead in Cerro de Pasco, alternative sources of exposure, the spread of lead particles in the air, and the effect of previous mining operations on the current environmental situation in the city. As such studies do not exist, the company believes that it is impossible to conclude that Volcan’s activities affect the environmental situation in the city.⁵⁵ Volcan

also emphasises that as long as its activities are conducted in compliance with the requirements imposed by the state, the company cannot be accused of contributing to the severe environmental situation in the city.

High blood lead level in children

Volcan believes that the high blood lead levels among children in Cerro de Pasco is caused by multiple factors, including undernutrition and anaemia, poverty and low educational levels among the population. These are also factors that can exacerbate the effects of high blood lead levels: ‘There is an evident contaminating factor in the environment, but at the same time, all “favourable” conditions (anaemia, malnutrition, unbalanced food intake, deficient sanitary infrastructure, among others) for the contamination effect to be magnified are present.’⁵⁶

The company believes that these conditions should be included in the assessment of the company’s responsibility. Further, the company notes that only ten per cent of the children in the CDC study had BLLs above 19 µg/dl.

The company believes that the core of the problem is that people have been allowed to settle in the close vicinity of the mining operation. Volcan writes that ‘Not surprisingly, the BBL is highest for people living in the mineral rich neighbourhood of the mine. The results underline the need for relocation of the inhabitants. Again, the root of the problem is the urban settlement in the close vicinity of the mining operations.’

With regard to the Ayapoto neighbourhood, which is located next to the open-pit mine and where particularly high BLLs have been documented, Volcan emphasises that:

‘The mentioned studies indicated that the highest levels of heavy metals were found in soil located in the Ayapoto zone. The Council on Ethics indicates that this level would be associated with the proximity of the urban area to ore stockpiles. It should be mentioned that:

- Ayapoto is also located near to the ore (pit zone) suggesting that the quantity of heavy metals in soils may be indicative of the natural background concentrations
- Ayapoto is also located near to the state-owned waste rock deposit Excelsior (an abandoned mine site)
- The Ayapoto zone was an industrial mining area that was illegally occupied by settlers at the time the mine was operated by the state-owned company Centromin. Later the state declared this zone to be an urban area without evaluating whether it was a habitable zone.’⁵⁷

The company concludes that it is impossible to determine whether its activities are the cause of the high lead-content of the soil without first conducting a study of ‘the multiple possible local dust and metal sources (different anthropogenic and natural sources, partly historic contamination).’

The Council’s methods

Volcan strongly rejects the Council’s methods and conclusions.⁵⁸ The company believes that the Council has not proven sufficiently that there is a causal relation between the environmental conditions in Cerro de Pasco and Volcan’s activities. ‘Volcan firmly believes that the documentation of [the Council] as to Volcan’s contribution to the overall

environmental situation in the area is clearly overstated. The major issue is the question of causation; to what extent does Volcan contribute to the environmental situation in the area in question in violation of regulations and conditions imposed on its operations. Volcan believes that [the Council's] empirical documentation is clearly insufficient.'

6 The Council on Ethics' assessment

In this recommendation, the Council has not focused on the effects on the external environment. Rather, it has assessed whether there is an unacceptable risk that the company's activities subjects people, particularly children, in Cerro de Pasco to hazardous exposures to lead.

The Council understands that there is no disagreement on whether long-term mining activities in Cerro de Pasco have led to very high concentrations of lead in soil and water which expose residents to very high lead values. More than half of the children have high and to some extent very high concentrations of lead in their blood. The concentrations are at such a level that they can affect children's intelligence and development. Such damage is chronic, irreversible, and can have consequences for the rest of their life. The effects are exacerbated by the children largely living in poor households with limited opportunities for treatment or monitoring. Unsatisfactory sanitation, the absence of safe drinking water and poor nutrition can further worsen the children's and families' situation. As the mining facility can continue to pollute even after the mining operation has closed, it is likely that new generations of children will be exposed to the same health hazards unless the pollution is reduced. The Council therefore believes that the environmental damage in Cerro de Pasco is serious, will have long-term effects, and that it is likely that the lead exposure that the children are subject to will lead to chronic and serious health problems in a group that is already vulnerable.

In all its communication with the Council, Volcan has asserted that it is not responsible for the serious environmental situation in Cerro de Pasco. The company believes that the lead-pollution is primarily caused by old mining operations, the absence of follow-up measures on the part of the state, and high natural background values of lead. Volcan seems to assume that after it acquired the mine in 1999, the mining operation has not contributed to the serious environmental situation in the city.

It is necessary to emphasise that the Council's mandate is to consider future risk, based on available information. The Council does not need to prove that there is a direct causal relationship between the company's operations and the environmental situation. It is sufficient that the Council assess the risk that the company contributes to the hazardous exposure to lead to which residents are subjected.

The Council on Ethics has not assessed who is responsible for the current situation, but finds it likely that a business that includes mining operations and the processing of lead ore – and that has ore stockpiles and waste rock dumps in the middle of the city – is likely to contribute to the high concentrations of lead. The high lead values measured in the rivers in Cerro de Pasco may indicate that leachate and runoff from Volcan's ore stockpiles and waste rock dumps and runoff from soil contribute to the pollution. Several of the company's environmental impact assessments and other studies that have been

conducted also suggest that this may be the case. Runoff of heavy metals from waste rock dumps and ore stockpiles, among other things, is considered to be one of the most serious environmental problems of mining operations worldwide.

In the opinion of the Council on Ethics, the company does not appear to have conducted sufficient studies to clarify the causes of the high concentrations of lead in rivers and soil that are affected by the mining operation, and it also does not appear that the company has attempted to clarify the extent to which its activities affect children's health. Given that a long-term exposure to lead, even at low concentrations, can lead to serious health problems, the Council would expect a mining company in this situation to do more to clarify the consequences of its activities. According to internationally accepted norms such as the standards from the International Finance Corporation (IFC),⁵⁹ companies have an independent responsibility to prevent or reduce the risk of their activities having negative consequences on the safety and health of local inhabitants. Among other things, this means that companies must identify risks and impacts, as well as measures that can prevent and reduce these.

Volcan has implemented the measures which the authorities have ordered, and it cannot be said that the company generally operates in Cerro de Pasco in a manner which conflicts with its state-issued licences. The company does not see itself as contributing to pollution as long as its activities comply with the authorities' requirements. The Council understands that Volcan's activities nevertheless can have harmful environmental effects. For example, heavy metal runoff has been documented from Volcan's ore stockpiles and waste rock dumps, but the extent to which diffuse discharges from these facilities are regulated is not clear. The same uncertainty applies to discharges to soil. Several measures proposed in impact assessments and other reports to reduce discharges to water and soil appear largely to not have been implemented. The company is planning measures, for example removing ore stockpiles, which in the long term can contribute to reduce the exposure to lead. However, the Council is unaware of any concrete schedule for when all the ore stockpiles will be removed. The Council has noted that the environmental authorities have fined the company repeatedly for issues in Cerro de Pasco and elsewhere, but this has not been emphasised in this assessment.

Volcan has a licence to operate the mine for several more decades. In a city where residents already suffer from high levels of lead pollution, and have done so for many years, further increase of lead should be limited to the greatest extent possible. In the Council's view, this requires that the company exercise special care as concerns both evaluating the company's contribution to pollution, and which measures should be implemented. The absence of knowledge about how the company's activities affect the environment in Cerro de Pasco contributes to increase the risk of serious health problems among children and the population more broadly.

On the basis of an overall assessment, the Council believes there is an unacceptable risk that Volcan contributes to current and future severe environmental damage through its mining operation in Cerro de Pasco.

7 Recommendation

The Council on Ethics recommends that the company Volcan Compañía Minera SAA be excluded from the investment universe of the Government Pension Fund Global due to an unacceptable risk that the company contributes to severe environmental damage.

Ola Mestad Chair (sign.)	Dag Olav Hessen (sign.)	Ylva Lindberg (sign.)	Gro Nystuen (sign.)	Bente Rathe (sign.)
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Notes

- 1 The company's Issuer Id: 154314
- 2 <http://www.regjeringen.no/nb/sub/styrer-rad-utvalg/etikkradet/etiske-retningslinjer.html?id=425277>.
- 3 In previous recommendations, the Council has elaborated on and specified the criteria for severe environmental damage. See for example the recommendations for Freeport McMoRan, Barrick Gold and Vedanta on www.etikkradet.no.
- 4 United States Centers for Disease Control (CDC [2007]): *Final report on heavy metals exposures among children and women of childbearing age in three mining communities in Cerro de Pasco, Peru*.
- 5 Volcan's annual report *Memoria Anual 2010*, available at <http://www.bvl.com.pe/eeff/CM0001/20110330195901/MECM00012010AIA01.PDF>.
- 6 Both are referred to hereafter as 'the open-pit mine'.
- 7 The picture was obtained from <http://www.editorialvirtual-mapp.com/CERRO-DE-PASCO.html>.
- 8 Minera Interandina de Consultores S.R.L. (2007) *Estudio de Impacto Ambiental Ampliación Paragsha - San Expedito*, appendix 4-22: *Ubicación de los stockpiles y botaderos*.
- 9 Attachment to Volcan's email to the Council on Ethics, 14 May 2011.
- 10 Volcan 2011: *Análisis y discusión de la gerencia al segundo trimestre del año 2011*, available at <http://www.volcan.com.pe/site/inversionistas/Reportes%20de%20Resultados/2T%202011%20Análisis%20de%20la%20Gerencia.pdf>.
- 11 See footnote 9.
- 12 *Reglamento para la protección ambiental en la actividad minero-metalúrgica*, D.S.N° 016-93-EM de 28-ABR-93, available at http://intranet2.minem.gob.pe/web/archivos/dgaam/publicaciones/compendio99/016-93_059-93.pdf.
- 13 PAMA stands for *Programa de Adecuación y Manejo Medioambiental*.
- 14 Volcan's letter to the Council on Ethics, 2 December 2011.
- 15 Volcan's letter to the Council on Ethics, 2 December 2011. According to Volcan, the mining operation is regulated by three impact assessments: 1) The expansion of the Paragsha and San Expedito facilities (approved in 2008), 2) The expansion of the Raul Rojas open-pit mine (also known as Plan L, approved in 2011) and 3) The construction of a new facility for the processing of oxidised ore (approved in 2011).
- 16 Section 2 (Definitions): 'Contaminación Ambiental. - *Acción que resulta de la introducción por el hombre, directa o indirectamente en el medio ambiente, de contaminantes, que tanto por su concentración, al superar los niveles máximos permisibles establecidos, como por el tiempo de permanencia, hagan que el medio receptor adquiera características diferentes a las originales, perjudiciales o nocivas a la naturaleza, a la salud y a la propiedad.*' The regulations are available online on: http://intranet2.minem.gob.pe/web/archivos/dgaam/publicaciones/compendio99/016-93_059-93.pdf.
- 17 Appendix to Volcan's letter to the Council dated 12 July 2010. Osinergmin publishes some of these cases, see *Resoluciones de Gerencia General-Sanciones*, <http://www.osinerg.gob.pe/newweb/pages/GFM/1484.htm>.
- 18 Volcan's letter to the Council on Ethics, 13 January 2011. The Yanamate Lake and the Ocroyoc tailings impoundment are outside the city and are not included in the figures above.
- 19 Volcan (2006), *Informe de Fiscalización Externa de Normas de Protección y Conservación del Ambiente. - Segunda inspección - Invasión del pasivo ambiental "Don Paco"*. See also <http://agendapasco.com/2011/10/10/pobladores-invasen-ilegalmente-terrenos-en-la-zona-alta-de-san-juan/>.
- 20 *Ley N. 29293: Ley que declara de necesidad pública e interés nacional la implementación de medidas para lograr el desarrollo urbano sostenible concertado y la reubicación de la ciudad de Cerro de Pasco*. Available at http://www.pcm.gob.pe/InformacionGral/sc/2010/Ley29293/Ley_29293.pdf.
- 21 On 29 January 2012, local media reported that the relocation process had stopped. See *Reubicación de Cerro de Pasco sería postergada* in <http://peru21.pe/2012/01/29/impresia/reubicacion-cerro-pasco-seria-postergada-2009518>.
- 22 Dirección Regional de Salud Pasco (DIRESA) 2008: *Resultados de los análisis de suelos - Ciudad de Cerro de Pasco y sus distritos Simon Bolívar, Yanacancha y Chaupimarca*, DIRESA 2007: *Vigilancia sanitaria de suelos superficiales - Champamarca y Quiulacocha*, Centers for Disease Control 2007: *Final Report: Heavy metals exposures among children and women*

- of childbearing age in three mining communities and* Centro Nacional de Salud Ocupacional y Protección del Ambiente Para la Salud (CENSOPAS) 2006: *Niveles de plomo en sangre y factores de riesgo asociados a la exposición de este metal en niños de 1 año a 12 años de edad y mujeres en edad fértil, distrito de Yanacancha, Cerro de Pasco - mayo 2006.*
- 23 In 2007, the Ministry of Health in Peru contacted the CDC to get help to assess the exposure to lead and other potentially hazardous substances among the population in Cerro de Pasco. The CDC conducted studies in Cerro de Pasco in May to July 2007, including of the presence of lead in the soil. The results are documented in the above-mentioned report. In its letter to the Council on Ethics dated 12 July 2010, Volcan writes that this is the most relevant of the studies that have been conducted.
 - 24 There is no agreed-to international standard for lead concentrations in soil. The maximum limits for lead in soil therefore vary between countries and types of land use. Stricter limits are commonly imposed on areas that children use as compared to, for example, industrial areas. EPA defines lead contents above 400 mg/kg soil as action level for clean-up in areas where children play. The maximum limit is set to 1,200 mg/kg for other areas where children spend time. In this recommendation, values above this limit are considered high. Peru has no established maximum levels for lead concentrations in soil, but in at least one study that the Council has considered, the health authorities refer to a proposal to establish an upper limit of 140 mg/kg for residential areas and 1,200 mg/kg for industrial areas (DIRESA 2008).
 - 25 The Norwegian Climate and Pollution Authority: *Anbefalte kvalitetskriterier for jord i barnehager, lekeplasser og skoler basert på helsevurderinger*, available at http://www.klif.no/nyheter/dokumenter/kvalitetskriterier_barnehager.pdf.
 - 26 Centers for Disease Control 2007: *Final Report: Heavy metals exposures among children and women of childbearing age in three mining communities*, p. 19: 'Although no clear pattern of contamination is evident, small clusters of yard soil samples containing high levels of lead can be seen in proximity to spent ore stockpiles and to the open pit.'
 - 27 See footnote 26, p.17. The neighbourhoods that are referenced are Ayapato, Chaupimarca, Paragsha. The study found that the pollution was likely caused by a constant source of lead: 'Using a t-test analysis, yard soil sample levels did not vary significantly from soil taken from the dripline ($p > 0.05$), suggesting a consistent source of contamination in these areas that did not originate from the home or roof.'
 - 28 Minera Interandina de Consultores S.R.L. (2007), p. 213.
 - 29 Dirección Ejecutiva de Epidemiología de Pasco 2009: *Análisis situacional de salud Pasco*, available at <http://www.diresapasco.gob.pe/diresajs/epidemiologia/files/ASIS%20PASCO%202009.pdf>.
 - 30 Volcan's letters to the Council on Ethics, 2 December 2011 and 14 January 2011.
 - 31 Volcan's letter to the Council on Ethics, 14 January 2011.
 - 32 The company's measurement reports for the period between January 2009 and March 2011. The maximum concentration that was registered at this point was 4.046 mg/litre (September 2009). The minimum concentration was 0.180 mg/litre (December 2010). By comparison, in Norway, fresh water with a lead concentration above 0.005 mg/litre is considered highly polluted; see <http://www.klif.no/publikasjoner/vann/1468/ta1468.pdf>.
 - 33 DIRESA - Unidad Ecología y Protección del Ambiente (2010), *Protección de los recursos hídricos*, available at http://www.diresapasco.gob.pe/diresajs/sama/u_protect_ambiente/Vigil_Recur_Hidricos.pdf.
 - 34 In its letter to the Council on Ethics dated 2 December 2011, Volcan writes: 'The main impacts on water quality come from abandoned mining sites (Excelsior, Quiulacocha and colonial-age mining sites) and untreated domestic wastewater from the Cerro de Pasco city... It is highly likely that lead in water comes primarily from runoff contaminated with lead that already exists in the environment...'
 - 35 *Resolución de Consejo Directivo Organismo Supervisor de la Inversión en Energía y Minería OSINERGMIN N. 307-2007-OS/CD*, 7 June 2007: 'With regard to monitoring station E-215, the appellant states that discharges from multiple sources are collected here... and that it should not be held responsible for these when it is impossible to identify the sources of the materials that exceed the discharge permit... [Volcan] has not presented the necessary proof to confirm that the company is not the source of the discharges that exceed the discharge permit.'
 - 36 Ground Water International (2006), *Investigación Hidrogeológica de la Mina Subterránea y de las Facilidades Superficiales de la Unidad Minera Cerro de Pasco*.
 - 37 Appendix 3-13 in the environmental impact assessment for the expansion of the facilities in Paragsha and San Expedito, Minera Interandina de Consultores S.R.L. (2007).
 - 38 Minera Interandina de Consultores S.R.L. (2007), p. 199: 'The different tests that have been taken suggest that the TSS [Total Suspended Solids] and Pb in the rivers are caused by runoff of rain water to the main river [Ragras in this recommendation]. Within the project's area of direct influence (área de influencia directa del proyecto), an important source of pollutants [to water] appear to be the city's soil (likely due to transport of waste rock) and [dumps and stockpiles]. Further, 'It is necessary to continue and intensify the watering of roads to the waste rock dumps, as it is likely that this is one of the main causes of the high metal content in [the Ragras river]' (p. 213).
 - 39 Minera Interandina de Consultores S.R.L. (2007), p. 213.
 - 40 The Council is aware of the following studies from the period between 1996 and 2007: Universidad Nacional Mayor de San Marcos, facultad de Farmacología y Bioquímica, OPS/OMS CICOTOX 1996: *Análisis de dosaje de plomo en las muestras de sangre total: Miraflores y Paragsha - Cerro de Pasco*, Dirección General de Salud Ambiental del Min-

- isterio de Salud (DIRESA) 1999: *Estudio de plomo en sangre en la población seleccionada de Cerro de Pasco*, Astete, Jonh *et al.* 2005: *Determinación de plomo en sangre y factores asociados en niños y mujeres gestantes de las poblaciones de Quiulacocha y Champamarca – Cerro de Pasco*, Instituto Nacional de Salud, Cerro de Pasco, Centro Labor & Ministerio de Salud 2002: *Estudios de plomo y efectos en órganos blancos: Champamarca, Paragsha, Huayllay y Yaulí*. An analysis of the study is available here: <http://www.ciudad.org.pe/downloads/boletinesredal/BOLETINRE-DAL14.doc>, Astete, Jonh *et al.* (2006): *Niveles de plomo en sangre y factores de riesgo asociados a la exposición a este metal en niños de 1 año a 12 años de edad y mujeres en edad fértil – Distrito de Yanacancha*. Instituto Nacional de Salud, Cerro de Pasco and Centers for Disease Control (CDC (2007), ‘*Final Report: Heavy metals exposures among children and women of childbearing age in three mining communities*’.
- 41 CDC (2007), Astete (2006) (Instituto Nacional de Salud), Astete (2005) (Instituto Nacional de Salud), and DIRESA (1999).
- 42 See footnote 23.
- 43 <http://www.miljostatus.no/Tema/Kjemikalier/Noen-farlige-kjemikalier/Bly/#B>.
- 44 Scientific Committee on Health and Environmental Risks – SCHER 2011: *Lead Standard in Drinking Water*. http://ec.europa.eu/health/scientific_committees/environmental_risks/docs/scher_o_128.pdf
- 45 US Agency for Toxic Substances and Disease Registry, <http://www.atsdr.cdc.gov/substances/toxsubstance.asp?toxid=22>.
- 46 The WHO and the US Centers for Disease Control (CDC) guidelines for blood lead levels is 10 µg lead per decilitre of blood <http://www.inchem.org/documents/ehc/ehc/ehc165.htm>. Peruvian health authorities also use this limit (see the health authorities’ *Resolución Ministerial N° 511-2007/MINSA*, available at <ftp://ftp2.minsa.gob.pe/normaslegales/2007/RM511-2007.pdf>).
- 47 WHO *Issue Brief Series – Lead*: <http://www.who.int/heca/infomaterials/lead.pdf>; WHO (2010) *Childhood Lead Poisoning*, <http://www.who.int/ceh/publications/leadguidance.pdf> and Scientific Committee on Health and Environmental Risks – SCHER 2011: *Lead Standard in Drinking Water*. http://ec.europa.eu/health/scientific_committees/environmental_risks/docs/scher_o_128.pdf.
- 48 See footnote 40.
- 49 See for example the discussion in CDC (2007) and tables 38-41, as well as the conclusion in *Instituto Nacional de Salud – Cerro de Pasco* (2006).
- 50 See especially the conclusion in CDC (2007), p. 23.
- 51 In the study, high concentrations are understood as those ‘Greater than the 95th percentile intervals as reported in the Third National Report on Human Exposure to Environmental Chemicals. Values reflect weighted analyses.’ CDC (2007), p. 36. Other important metals mentioned in the study include caesium, thallium, antimony, cobalt, molybdenum, cadmium, tungsten and mercury, but arsenic was also found in high concentrations.
- 52 CDC (2007), p. 22.
- 53 Volcan’s letter to the Council on Ethics, 2 December 2011.
- 54 http://www.iso.org/iso/iso_14000_essentials.
- 55 Volcan’s letter to the Council on Ethics, 12 July 2010.
- 56 Volcan’s letter to the Council on Ethics, 13 January 2011.
- 57 Attachment to Volcan’s email to the Council on Ethics, 14 May 2011.
- 58 Volcan’s letter to the Council on Ethics, 02 December 2011.
- 59 Volcan’s letter to the Council on Ethics, 14 January 2011.
- 60 Volcan’s letters to the Council on Ethics 10 July 2010, 14 January 2011, and email dated 14 May 2011.
- 61 See footnote 58.
- 62 Volcan’s letter to the Council on Ethics, 13 January 2011.
- 63 See footnote 62.
- 64 Volcan’s letter to the Council on Ethics, 13 January 2011.
- 65 Volcan’s letter to the Council on Ethics, 2 December 2011.
- 66 IFCs *Environmental and Social Performance Standards* cover eight areas that companies should take into account, including: PS1: Social environmental assessment and management system, PS3: Pollution prevention and abatement, PS4: Community health, safety and security. Companies that apply for financing from IFC must fulfil these criteria. Among other things, IFC’s Performance standard 4 states that: ‘Performance Standard 4 recognizes that project activities, equipment, and infrastructure can increase community exposure to risks and impacts. While acknowledging the public authorities’ role in promoting the health, safety, and security of the public, this Performance Standard addresses the client’s responsibility to avoid or minimize the risks and impacts to community health, safety, and security that may arise from project related-activities, with particular attention to vulnerable groups.’ To the Council’s knowledge, Volcan has not applied for financing from IFC, but the Council nevertheless considers this to be a generally accepted indication of how companies ought to behave. IFC’s *Sustainability framework*: http://www1.ifc.org/wps/wcm/connect/Topics_Ext_Content/IFC_External_Corporate_Site/IFC+Sustainability+Framework.

To the Ministry of Finance

25 June 2012

UNOFFICIAL ENGLISH TRANSLATION

Recommendation to exclude WTK Holdings Berhad from the investment universe of the Government Pension Fund Global

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1 Summary

The Council on Ethics recommends the exclusion of the Malaysian company WTK Holdings Berhad (WTK) from the Norwegian Government Pension Fund Global (GPF) because of an unacceptable risk that the company is responsible for severe environmental damage through its logging operations.

WTK is a Malaysian logging company involved in the harvesting of timber and the manufacturing of plywood and sawn timber. All its natural forest concessions and mills are located in Sarawak, Malaysia. To the Council's knowledge WTK holds six timber licenses totalling approximately 194,000 hectares, as well as two licenses for planted forest (plantation development) covering a total of about 131,000 hectares. WTK is part of the unlisted WTK Group. The Council has only assessed the logging operations in the concession areas belonging to the listed company.

In accordance with the Ethical Guidelines, the Council contacted WTK in December 2010 requesting information on the company's forest operations. WTK did not respond to the Council's request. In February 2012, the Council sent a draft of this recommendation to the company for comments. Since then, the company has been contacted on several occasions but has not responded. The recommendation is mainly based on the Council's own research including the company's environmental impact assessments, which are publicly available at the library of the Natural Resources and Environment Board in Kuching and Sibu in Sarawak, and satellite-imagery analysis.

In its assessment, the Council has emphasized the environmental damage associated with the conversion of tropical forests to plantations, environmental damage associated with logging, and the fact that the company's practices seem to breach normal requirements and are therefore assumed to be illegal. The Council has also emphasized the scale of the damage and to what extent it causes long-term and irreversible impacts, whether the damage is a result of violations of national laws or international norms, and what the company has done to mitigate impacts.

All but one of WTK's license areas overlap with The Heart of Borneo and The Sundaland Biodiversity Hotspot, which are considered to be among the most biodiverse ecosystems on earth. In this region, WTK has licenses to establish plantations covering an area of about 130,000 hectares, of which 70,000 hectares will be completely cleared and the remaining 60,000 hectares along riverbanks and on steep slopes will be significantly affected because of the increased fragmentation of forests and habitats. The Council attaches importance to the fact that the area being cleared is home to numerous species which are totally protected in Sarawak, according to WTK's own environmental impact assessments. A number of them are also listed on The International Union for Conservation of Nature's (IUCN) Red List of threatened species. The development of plantations on this scale will further reduce their habitats and increase the risk of rare and endemic species becoming extinct.

The Council has studied one of the company's timber license areas in the Melatai River Basin, where WTK is permitted to conduct selective logging and where WTK started intense logging during the period 2006-2010. The timber harvesting seems to have caused

extensive erosion and numerous landslides along roads, rivers and on steep slopes, which may cause long-term impacts on the ecosystem in the license area. In the Council's opinion it cannot be ruled out that WTK's logging practices have contributed to the landslides that filled the Rajang River with 300,000 cubic metres of logs and debris in October 2010. Based on the available information, the Council concludes that WTK's forest operations appear to cause extensive and irreversible environmental impacts.

WTK seems to have breached numerous government requirements which companies normally have to comply with. This applies both to the license area for planted forest and the timber license area, in the three areas which the Council has studied. In these three areas, it appears that WTK has logged outside the concession's boundaries, in buffer zones along river banks and roads, and on steep slopes, which normally is not permitted in Sarawak. In one of the license areas, the Council has estimated that the area which has been illegally logged amounts to about 4,000 hectares. The Council has not had access to the licenses, and it is possible that the company has been exempted from the requirements and that concession boundaries have been changed. Based on available information, the Council finds it probable that WTK's logging practices are in conflict with government requirements. The Council emphasizes that the same practice is found in all of the researched areas, and that the assumedly illegal logging appears to have caused extensive environmental damage, in particular in the timber license area studied by the Council. In addition, the Council finds that illegal logging in itself is unacceptable and a breach of international norms.

The Council's assessment is that WTK does little to reduce the environmental damage associated with its logging and clearing of forests. The Council stresses that WTK neither seems to have carried out assessments to identify and protect important ecological values, nor implemented other measures to mitigate the environmental impacts associated with the conversion of forest.

WTK's licenses will be valid for many years to come. There is no indication that the company will end these operations or substantially change the way they are run in the near future. The company's unwillingness to provide information strengthens the assessment that the practice will continue.

The Council on Ethics therefore recommends the exclusion of WTK Holdings Berhad from the investment universe of the Norwegian Government Pension Fund Global because of an unacceptable risk of the company being responsible for severe environmental damage.

2 Introduction

In November 2010, the Council on Ethics decided to assess the Fund's investment in the Malaysian company WTK Holdings Berhad. The decision built on information that the company could be involved in illegal logging and environmentally damaging forest operations in Sarawak, Malaysia.

At the end of 2011, the GPFG held 10,096,000 shares in the company, with a market value of about USD 4.2 million.

2.1 WHAT THE COUNCIL HAS ASSESSED

The Council on Ethics has assessed whether there is an unacceptable risk that WTK contributes to or is itself responsible for severe environmental damage as per paragraph 2, third subsection of the Guidelines For the Observation and Exclusion of Companies From the GPF's Investment Universe (the Ethical Guidelines).¹

In previous recommendations concerning severe environmental damage, the Council has put particular emphasis on whether:²

- the damage is significant;
- the damage causes irreversible or long-term effects;
- the damage has considerable negative impact on human life and health;
- the damage is a result of violations of national laws or international norms;
- the company has neglected to act in order to prevent the damage;
- the company has not implemented adequate measures to rectify the damage;
- it is probable that the company's unacceptable practice will continue.

It is existing and future violations that are covered by the Guidelines. The Council has therefore assessed whether there is a risk that the company's practice will continue in a similar manner in the future.

In the present recommendation the Council has assessed the environmental damage associated with WTK's logging and clearing of tropical rainforests in Sarawak, Malaysia.

Environmental damage associated with the clearing of tropical forests

The logging and conversion of tropical forests to plantations is considered to be among the greatest threats to forest ecosystems and biodiversity. It also contributes significantly to greenhouse gas emissions. In Sarawak companies must have a license in order to convert rainforest to plantations (so-called licenses for planted forest). This requires the removal of trees and vegetation so that the area may be used for plantations for the production of palm oil, timber or other crops. Clearance of rainforest is considered to have devastating effects on biodiversity, natural habitats and eco-system services. Plantations are mono-cultures with little ecological value compared to the natural rainforest.

All except one of WTK's concession areas are within the Heart of Borneo area (see Figure 2). This is a WWF initiative to which the governments of Indonesia, Malaysia and Brunei have all signed up and pledged to manage the area in a manner that is sustainable. This area:

“is the largest transboundary tropical forest expanse remaining in South East Asia. Home to an astounding 6% of the world's total biodiversity, from the orangutan to the world's largest flower, and containing the headwaters for 14 of Borneo's 20 major rivers, it is one of the richest treasure-houses on the planet. More than 600 new species have been discovered within the Heart of Borneo since 1995, an average of 3 per month.”³

Sarawak, including the Heart of Borneo, is part of The Sundaland Hotspot.⁴ A hotspot is characterized by an exceptional biodiversity, having a high level of endemic species (at least 0.5 percent or 1,500 of the world's plant species), in addition to being threatened by human activity. To qualify as a hotspot, the region must have lost 70 percent or more of

its primary vegetation.⁵ The Sundaland Hotspot contains 25,000 plant species, of which 60 percent are not found anywhere else in the world. The remaining primary vegetation covers about 10 million hectares of the original 150 million hectares. A large number of birds, mammals and amphibians are threatened by extinction. The logging and conversion of forest to plantation are the main drivers of habitat loss and the biggest threat to this hotspot. Sarawak's deforestation rates are among the highest in the world. Between 2005 and 2010 about 10 percent, more than 865,000 hectares, of the state's forests were cleared. This is more than three times the deforestation rate for the whole of Asia over the same period and one of the highest deforestation rates in the world.⁶

Both the UN, the World Bank and national governments recognize the need to reduce deforestation and forest degradation through, *inter alia*, the establishment of the United Nations Collaborative Initiative on Reducing Emissions from Deforestation and Forest Degradation (REDD and REDD+) in developing countries, supported by the World Bank and others. The Norwegian Government has also supported these initiatives by allocating up to NOK three billion a year to efforts to reduce greenhouse gas emissions from deforestation in developing countries, but also the need to protect biodiversity and promote sustainable development is emphasized in this regard.⁷

The Council's point of departure is that the tropical rainforests of Borneo are among the most biodiverse ecosystems on earth. They provide habitats for many endangered species and ensure vital fundamental eco-system services, such as carbon storage, water management and soil stabilization. Tropical rainforests are important for the global environment, at the same time as the conversion of forests is a big threat to its future existence. Against this background, including the many international and national initiatives in place to reduce deforestation and forest degradation, the Council has assessed the environmental damage associated with the clearing of tropical forest. In its assessment, the Council emphasizes the scale of the logging and clearing, to what extent the company's licence areas overlap with areas of high ecological values, and which consequences the conversion of forest will entail for endangered species and their habitats.

Illegal logging

Illegal logging takes place when logging operations are in breach of national laws and regulations. This may among other things include logging outside the license area, logging in protected areas and of threatened species, or exceeding the harvest-quota stipulated in the timber license agreement. It may also entail that requirements on how forest operations are to be carried out are not followed, such as rules regarding logging methods and road construction, or not implementing measures to prevent erosion and the pollution of river systems.

Forestry is regulated in order to limit the environmental damage related to logging operations. When these requirements are not followed, there is a significant risk that the logging operations may lead to more extensive and severe environmental deterioration, than if the requirements had been met. Illegal logging may thus aggravate environmental damages associated with timber harvesting. Illegal logging may in itself provide a basis for exclusion under the criteria for severe environmental damage.

2.2 SOURCES

WTK does not disclose any substantial information on its license areas and forest operations in publicly available documents. The Council therefore contacted WTK in December 2010 requesting copies of licenses, forest management plans and environmental impact assessments for the various concession areas operated by the company, as well as information on the company's sustainable forest management practices.⁸ WTK has not responded to the Council's request.

In order to assess the company's operations, the Council has obtained publicly available documents at the libraries of the Natural Resources and Environment Board (NREB) in Kuching and Sibu in Sarawak, including the Environmental Impact Assessments (EIA) corresponding to WTK's license areas LPF/0022 and LPF/0032 and T/3148, as well as EIAs for single coupes of the license areas T/3081 and T/3132. No EIAs were found for WTK's other license areas.

In addition, the Council has obtained Landsat satellite imagery for all of WTK's license areas listed in Table 1, as well as a SPOT-image⁹ which covers an area along the Melatai River in WTK's license area T/3476. Landsat imagery has been analysed and compared with imagery for multiple time periods stretching back over ten years. These images have a 15-30 metre spatial resolution, which is sufficiently detailed to clearly show logging roads, forest degradation and clearance. In order to illustrate areas where the forest has deteriorated, these areas have been artificially coloured red on the images shown in this recommendation. The images are used to assess whether logging has been carried out in steep slopes, within buffer zones and outside license areas. Such activities are environmentally harmful and may conflict with government requirements.

A short field visit was made to Sarawak in November 2010. The aim was to explore the location and cause of a large landslide which had led to extensive environmental damages along the Rajang River the previous month. At that time the Council had information that logging in one of WTK's license areas could have contributed to the so-called logjam. Interviews were carried out with families of timber workers, local politicians and journalists.

This recommendation is based mainly on the Council's own research. Other sources are referred to in footnotes.

3 Background

3.1 ABOUT THE COMPANY

WTK Holdings Berhad (WTK) is a Malaysian forestry company primarily involved in the harvesting of timber and the manufacturing of plywood and sawn timber. All its natural forest concessions and mills are located in Sarawak, Malaysia.¹⁰ WTK is listed on the stock exchange in Kuala Lumpur, Malaysia. The listed company is part of the unlisted WTK Group, which has additional timber concessions in Sarawak and Papua New Guinea. The Council has only assessed the logging operations of the listed WTK Holdings Bhd.

3.2 WTK'S TIMBER LICENSES AND LICENSES FOR PLANTED FORESTS IN SARAWAK

Timber licenses cover areas where WTK is permitted to carry out selective timber logging. Selective logging is the harvesting of specific species of trees and of a minimum tree size. The Council has identified six timber licenses held by the WTK, totalling approximately 194,000 hectares. In addition the company has a long-term contract with the Sarawak Timber Industry Development Corporation (STDIC)¹¹ to harvest 92,000 hectares of forest in one of STDIC's license areas in Sarawak.¹² There is no information on the actual size of the areas where WTK has rights to harvest timber, as this information is not published by the company. It is therefore possible that WTK may have other license areas which are not known to the Council.¹³

WTK also holds two licenses for planted forest (plantation development) covering a total of 131,000 hectares. Within these areas, WTK is permitted to clear the forest and convert the area to plantations. The Council does not know whether the company has other licenses for the development of plantations.

Table 1 below provides a list of WTK's licenses which have been identified by the Council, while Figure 1 shows the location of WTK's license areas within Sarawak. All of the licensees are wholly owned subsidiaries of WTK.

Table 1: List of WTK's timber licenses (Timber license, T/) and licenses for planted forests (LPF) in Sarawak identified by the Council

License No.	Type	Name of subsidiary	Area (hectares)	Net plantable area (hectares)	License valid until ¹⁴
T/3080	Timber	Ninja Developments Sdn. Bhd.	19,250 ha	N/A	30 Aug. 2020
T/3081	Timber	Limpah Mewah Sdn. Bhd.	53,050 ha	N/A	31 July 2020
T/3148	Timber	First Count Sdn. Bhd.	18,477 ha	N/A	16 Aug. 2020
T/3132	Timber	Sanitama Sdn. Bhd.	26,885 ha	N/A	22 June 2020
T/3064	Timber	Sut Sawmill Sdn. Bhd.	12,425 ha	N/A	28 Feb. 2020
T/3476	Timber	Interglobal Empire Sdn. Bhd.	63,450 ha	N/A	5 Dec. 2022
LPF/0022	Plantation Forest	Immense Fleet Sdn. Bhd.	63,875 ha	35,235 ha	21 Feb. 2062
LPF/0032	Plantation Forest	Immense Fleet Sdn. Bhd.	68,001 ha	36,520 ha	27 Feb. 2063



Figure 1: Map showing WTK's timber licenses (red boundaries) and forest plantation licenses (green areas) and areas where WTK has a logging contract with STDIC (T/3401 Area C), which the Council has been able to identify.¹⁵

4 The Council's research

The Council's research has been limited to the license areas where maps, satellite images and other information have been available, and where logging and clearing have been carried out recently. This has narrowed the assessment to WTK's two license areas for planted forest (LPF/0022 and LPF/0032) and one timber license area (T/3476).

4.1 LICENSE AREAS LPF/0022 AND LPF/0032

Environmental damage associated with the clearing of forests

In license areas allocated for plantation development, companies are permitted to clear all forest, except for forest on steep slopes, in buffers zones along rivers and other specific areas. The government requires that companies carry out an environmental impact assessment (EIA) to identify environmental values in the license area, identify potential environmental risks associated with the development stages of the plantation and recommend mitigation measures to reduce environmental impacts.

According to the environmental impact assessments, WTK's license areas for planted forest cover 131,000 hectares which mainly will be used for the production of timber. Topographical conditions, roads, rivers and streams and so forth limit the area which can be planted to about 60 per cent of the area.¹⁶ By the end of 2011, WTK had cleared and planted forest and oil palm covering 15,000 hectares – about 20 per cent of the total planned.¹⁷ The company expected to convert a further 4,000 hectares in 2012.¹⁸

The EIA for LPF/0032 provides little information on the condition of the forest in the license area, other than the forest is a Mixed Dipterocarp Forest¹⁹ which has been degraded by previous logging. Nevertheless the EIA notes the presence of a wide range of rare and protected species of plants and animals in the areas of forest slated for clearance.²⁰ A number of these species are classified as endangered or vulnerable by the International Union for Conservation of Nature (IUCN).²¹ The EIA for LPF/0032 states that “the plantable area is to be cleared of the existing flora and along with them the habitats of the fauna,”²² and concludes that the clearance of the natural forest will have major adverse impacts on the flora and fauna in the area concerned: ‘species diversity of the indigenous flora in the affected areas could never be replaced.’²³ Regarding biodiversity, the EIA comes to two contradicting conclusions: On the one hand it states that that ‘in spite of their logged-over conditions, the forests are still rich in floral species and can play an important role in species conservation and environmental protection’.²⁴ On the other hand it declares that “as the Project sites are under forests that had been logged, and thus already greatly disturbed, the issue of biological conservation of the existing environment is not crucial”. In this context, the Council notes that it is widely recognized that secondary forests can retain important ecological values in terms of biodiversity and eco-system services.²⁵

The License area LPF/0032 is divided into four different areas, of which two border the Lanjak Entimau Wildlife Sanctuary (C and D, see Figure 2 for location).²⁶ The Sanctuary is the largest protected area in Sarawak, and has been proposed as a Unesco

World Heritage Site by the Sarawak government, among other things because of its significance as a habitat for orangutans (*Pongo pygmeus*) and a number of other threatened species.²⁷ The EIA notes the proximity to the Sanctuary: “It is noteworthy that the Lanjak Entimau Wildlife Sanctuary is found immediately south to the Areas A and D. This Totally Protected Area (TPA) is outside the Project Area and hence will not be affected by the Project Activities.”²⁸ A buffer zone between the License area and the Sanctuary shall prevent impacts on the Sanctuary. It is not clear how wide this buffer zone is.



Figure 2: Overlay of the boundaries of WTK's timber and plantation licenses with "Heart of Borneo" and with orangutan distribution, 1989 and 2004.²⁹

According to the EIA, which was carried out in 2003, orangutans are not present in the license area (it is not listed as a protected species).³⁰ Nevertheless, maps of orangutan distribution in Borneo suggest the continued existence of orangutans within WTK's license as late as in 2004 (Area D, see Figure 2).³¹ The same maps also show that in 1989-2004, orangutans are thought to have been present in a wide area of forest which overlaps with several of WTK's license areas. The logging and clearing of forests have contributed to the loss of habitats and the population of orangutans in these areas.

The Council is aware that the Sarawak government is planning to extend the protected area to the northeast and east because it is assumed that there are orangutan habitats outside the sanctuary. The expansion entails that the south-eastern part of Area C will have a longer common border with the Sanctuary.³² The Council notes that the EIA for LPF/0032 does not explicitly address the risk of orangutans being present in the license area, and that the company does not seem to have carried out any studies aiming to verify whether the animals have a presence in the license area.

There is not much information available on the condition of the forest in the other license area either (LPF/0022). The EIA notes that the area has been selectively logged in the past but nevertheless identifies a significant number of protected species,³³ of which eight are listed on IUCN's Red List of Threatened Species.³⁴ The EIA states that "adverse

impacts on soil and water factors are expected during logging, felling, log removal, burning and roading. Since site preparation involves clearing of the land, major adverse impacts are envisaged for flora and fauna factors, since their habitat will be destroyed.”³⁵

WTK’s own environmental impact assessments indicate significant biodiversity within the two license areas. Nevertheless, the assessments appear not to have been based on thorough surveys of flora and fauna, and studies to verify for instance the presence of orangutans in the part of the license area which borders the Sanctuary seem not to have been conducted. The EIAs conclude that the conversion of forests to plantations will cause the destruction of 70,000 hectares of tropical forests with irreversible impacts on biodiversity and habitats, including habitats for threatened species.³⁶ These operations will also lead to an increasing fragmentation of the rainforest, which may reinforce the negative impacts on biodiversity in the license area.

Possible illegal logging in LPF/0032

Despite the serious environmental impacts, the EIA recommends few specific mitigation measures to protect the threatened species and their habitats. The mitigation measures mentioned include maintaining natural vegetation in areas of steep slopes (slopes in excess of 35 degrees, so-called Class IV terrain) and riparian buffer zones. Here forest operations shall be avoided to protect wildlife and to prevent erosion and landslides: “the natural vegetation in the proposed conservation areas (which usually coincide with the steeper areas)... shall be preserved”.³⁷ And furthermore “clear felling will only be practiced in areas with very gentle terrain”.³⁸

A satellite image from July 2009 shows which forest areas within Area A of LPF/0032 had recently been clear-felled. Comparison with the concession map included in the EIA shows areas being cleared in steep-sloped terrain and outside the concession boundary (see Figure 3), in conflict with the mitigation measures recommended in the EIA.³⁹ As mitigation measures recommended in the EIA are mandatory for the company, the Council’s assumes that the logging in these areas is illegal.⁴⁰ The measures are in accordance with normal government requirements for forest operations in Sarawak.⁴¹

The total area cleared outside the concession boundary to the north of Area A is estimated to be 280 ha, while that cleared within conservation areas within the concession boundary (which appears to have occurred in 8 separate locations) totalled 730 ha. In total, WTK appears to have logged about 1000 hectares of forest illegally.

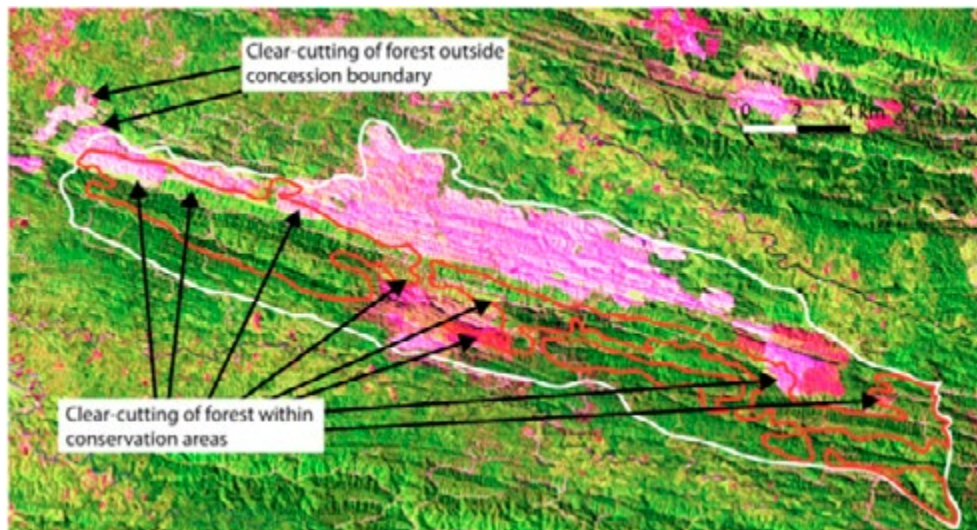


Figure 3: Landsat satellite image showing logging outside concession and within conservation areas, LPF/0032 Area A, July 2009 (white line is license boundary, red lines enclose conservation areas. Pink areas represent areas recently clear cut).

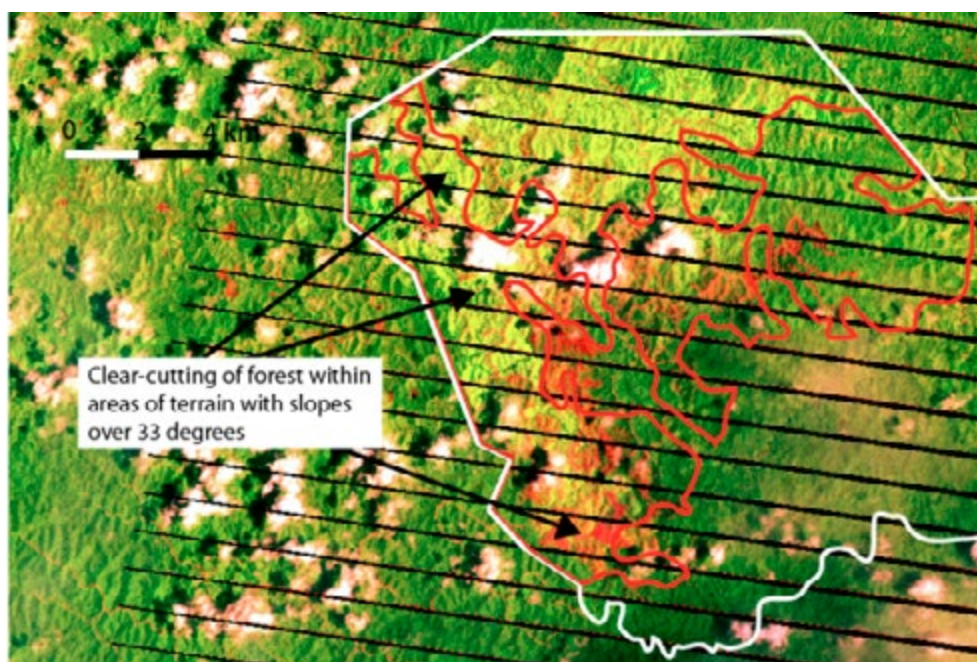


Figure 4: Landsat satellite image showing clear-cutting of forest within areas with slopes over 33 degrees, LPF/0032 Area C, March 2011 (white line is license boundary, red lines enclose steep slope areas, red areas on the image represent areas clear cut very recently, while light green areas represent areas clear cut slightly less recently. Black lines are due to satellite error).

Large areas have also been cleared within Area C of the license area, which most likely should not have been cleared (see Figure 4).⁴² The total area which appears to have been logged illegally within Area C, is estimated to amount to 3,000 ha. Logging had not commenced in Area B (2009) and Area D (2011) of the license area (LPF/0032).

As WTK has not responded to the Council, the Council has based its assessment on the maps which are included in the EIA for LPF/0032. It cannot be ruled out that the concession boundaries are imprecise, or that the boundaries have been adjusted in the official permit from the Sarawak government. Indeed, the EIA does state that the precise boundaries of steep terrain and buffer zones will need to be further clarified through ground surveys.⁴³ Based on available information, WTK does not seem to have implemented the mitigation measures recommended in the EIA, such as not logging in steep terrain and in riparian buffer zones. The Council assumes that this is in breach of the government's requirements, and that this practice has contributed to reinforce the environmental damage associated with the conversion of forests to plantations in LPF/0032.

4.2 TIMBER LICENSE AREA T/3476

The timber license area T/3476 is located in the Melatai River basin, where WTK is permitted to carry out selective logging. Melatai is a tributary of the Baleh River, which flows into the Rajang River (see Figure 2). The rainforest in the license area seems not to have been logged previously as no roads or other infrastructure appear on the satellite images. In Sarawak, companies are not required to conduct environmental impact assessments when logging virgin rainforest, and hence there is little information available on this license area.

Environmental damage associated with logging operations

Satellite images show that WTK over a period of several years has carried out extensive and intensive logging in this concession area. In 2009 and 2010 intense first round logging and road-building was ongoing in the south eastern part of the concession, in an area of steep terrain close to the Indonesian border (see Figure 5). Areas further north in were logged around 2007.

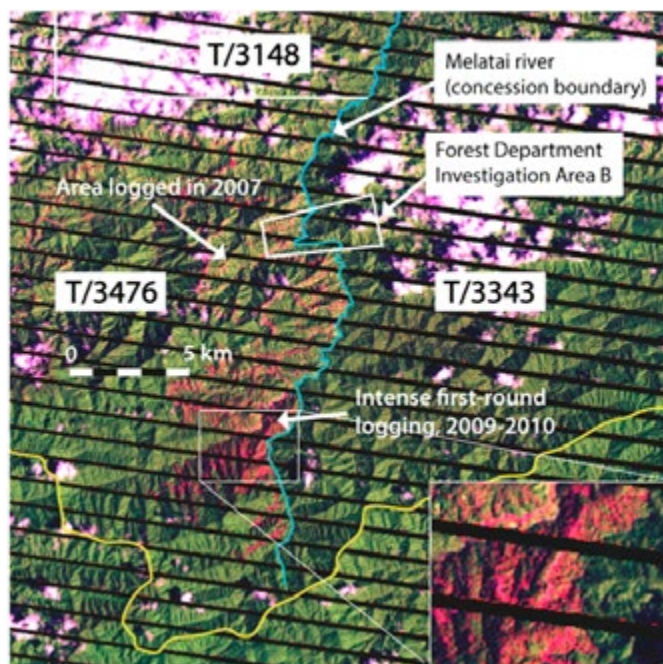


Figure 5: Landsat satellite image showing intensive logging upstream of log-jam source area in T/3476, February 2010, with close up in bottom right (Logged areas are coloured red. Yellow line indicates the international border).

Figure 6 below shows a SPOT satellite image of the southern part of T/3475, while Figure 7 is a close-up of an area along the Melatai River where WTK has carried out logging.⁴⁴

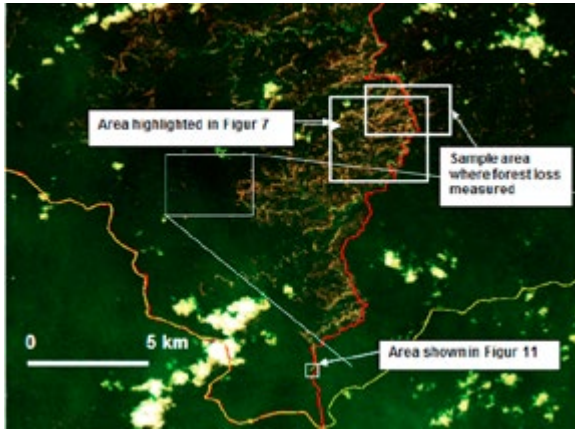


Figure 6: SPOT satellite image of the Upper Melatai river basin, 6 January 2011. The red line indicates the eastern boundary of WTK's T/3476 logging concession which follows the Melatai River. The yellow line is the Indonesian border.

The satellite images show extensive logging has been carried out on river banks, in steep terrain and along logging roads, which appear to have caused or contributed to numerous landslides in the concession area, both along rivers and roads. Erosion and many landslides can be seen extending along the downward slope below logging roads in Figure 7, Figure 8 and along the Melatai River in Figure 9.

Most of the erosion shown in Figure 7 and Figure 8 appear to be the result of landslides alongside logging roads. Based on the SPOT satellite image, the extent of the forest destruction has been estimated for a sample area of 275 hectares on each side of the Melatai River as a result of landslides and road construction (see Figure 6 for location). On the side where WTK has been logging, more than one third (36 per cent) of the virgin rainforest has been destroyed, while, less than 5 per cent of the forest has been destroyed by landslides on the other side of the river where no logging has been conducted.

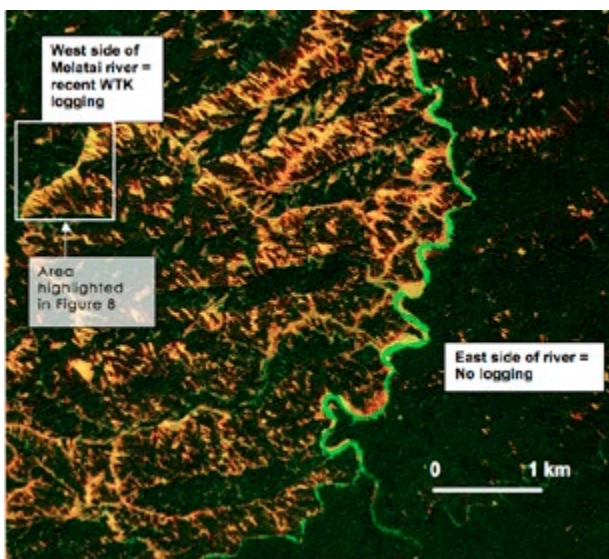


Figure 7: Close up of area along Melatai river, SPOT satellite image of 6 January 2011.

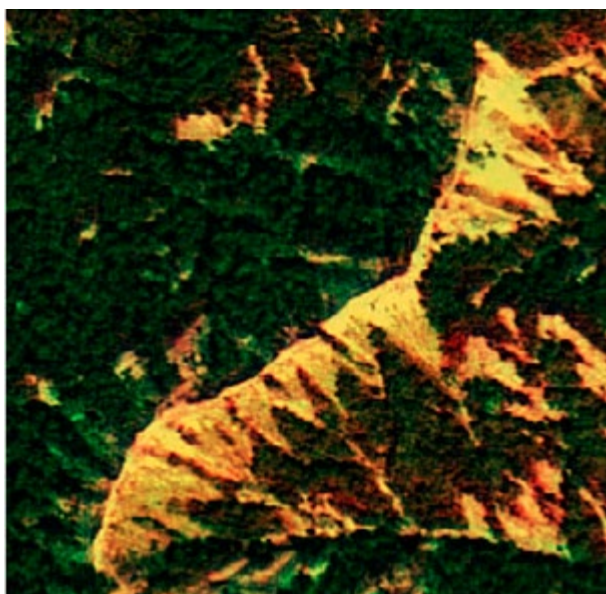


Figure 8: Close up of landslides along logging road in WTK license area T/3476, SPOT satellite image dated 6 January 2011

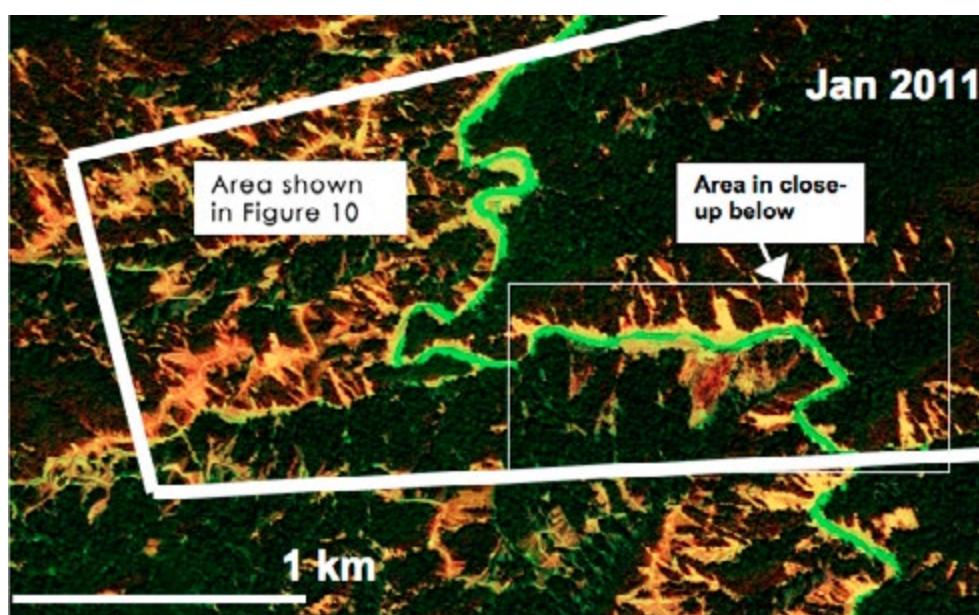


Figure 9: SPOT satellite image taken on 6 January 2011 showing landslides along the Melatai River in WTK's concession area T/3476, see Figure 5 for location. The Melatai River is coloured green. WTK's license area is located West of the river.

Figure 9 shows among other things a large landslide within T/3476 covering an area of 10 hectares, 500 metres along the river on the western side of the Melatai River (the area within the white rectangle and in the close up in Figure 10). Based on satellite images, it appears that the logging in this concession was finished in 2007. Logging will, however, reduce the ability of the vegetation to hold the soil in place, which can reduce slope stability many years after logging.⁴⁵ In the area where the large landslide occurred, the slope appears to have a gradient of 36 degrees.⁴⁶

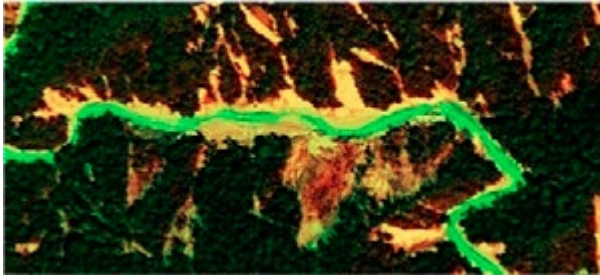


Figure 10: Close-up of a landslide on the South bank of the river

Assumed illegal logging

The Council is not familiar with which requirements WTK has to comply with because timber licenses, Forest Management Plans and other necessary permits have not been made available to the Council. The Council has nevertheless been informed that requirements normally follow a standard format, including requirements pertaining to logging on steep slopes, riparian buffer zones and along roads.⁴⁷ As mentioned previously, this means that logging is not permitted on slopes exceeding 35 degrees (Class IV terrain) and that timber harvesting and clearance within an area of 20 metres from permanent water courses must be avoided. Logging roads must be designed to ensure that erosion and siltation of streams and rivers are kept to a minimum. Moreover, there are requirements for buffer zones along roads, limiting the total width of the road clearance to 60 metres for main roads, 50 metres for secondary roads and 40 metres for feeder roads. Thus, it is likely that the clearing of forest for more than 20-30 metres from either side of a logging road is illegal.⁴⁸

Satellite images from different parts of WTK's license area T/3476 show that the company has cleared forest right up to the banks of rivers and on slopes that appear to be Class IV terrain. When it comes to road construction it appears that the clearance of forest along the roads is systematically much wider than the standard limits. An example of this is shown in Figure 11 where the width of the cleared area at the point of measurement is 123 metres, which is not exceptional along the length of road shown.



Figure 11: Google Earth Pro image from January 2011 showing logging road within WTK timber license T/3476 (for location see Figure 6)

Based on the information available to the Council concerning forestry requirements in Sarawak, WTK's practices in T/3476 appear to be in breach of requirements aimed at reducing the environmental damage associated with logging. The Council finds that the company's practice in this concession area shows signs of being systematic, and that it has caused extensive and long-term damage to the forest which may adversely affect the regeneration of the forest, biodiversity and ecosystem services.

The logjam in the Melatai River basin in October 2010

In October 2010, Malaysia's longest river, the Rajang River, was filled with 300,000 m³ of logs and debris in a length of 50 kilometres (see Figure 12). The Sarawak Land Development Minister James Masing described the incident (the so-called logjam) as an ecological disaster,⁴⁹ and two people were reported killed and one missing as a result of the incident. Chief Minister Abdul Taib Mahmud immediately promised a thorough investigation of the case.⁵⁰ A number of government bodies took part in the investigation, including the Sarawak Forest Corporation (SFC) and the Natural Resources and Environment Board (NREB).⁵¹ According to media reports, the preliminary conclusion was that sudden and unusually heavy rainfall had caused a number of landslides in the Melatai River Basin, causing large volumes of soil and debris to flow into the Melatai River and finally into the Rajang River.⁵² According to the SFC, logging did not cause the incident.⁵³ To the Council's knowledge, the final report of the investigation has not been published so far.



Figure 12: The "logjam" on the Rejang River in Sarawak, October 2010.⁵⁴

Many local politicians, NGOs and members of the public have questioned SFC's conclusion and claimed that extensive and illegal logging activities were the main cause of the landslide. Among others, Sarawak Land Development Minister James Masing⁵⁵ and a previous director at the SFC⁵⁶ stated that the landslides were caused by intensive and uncontrolled logging.

The government has confirmed that the logjam originated from the Melatai River basin. There are five timber licenses encompassing the Melatai river basin, of which WTK is the licensee in four and the contractor in the fifth (see Figure 13).⁵⁷ Analysis of a

series of Landsat satellite images stretching back to 2005 demonstrates that the only area where significant new logging has occurred during the last 5 years is the eastern portion of WTK's T/3476 concession (see Figure 5). Available information suggests that WTK has logged forest in riparian buffer zones, in steep terrain and along roads which seem to have contributed to considerable erosion and landslides in this concession area. In the Council's opinion, it cannot be ruled out that WTK's forest operations have contributed to the logjam.

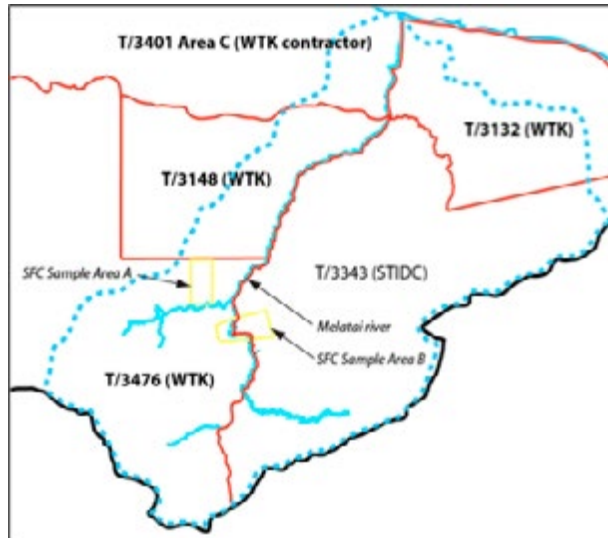


Figure 13: Timber licenses in the Melatai river basin. WTK is the licensee of T/3148, T/3132, T/3476 and the contractor in Area C of T/3401. The Sarawak Timber Industry Development Corporation (STIDC) is the licensee of T/3343.

4.3 RE-ENTRY LOGGING WITHOUT AN EIA

According to the Natural Resources and Environment (Prescribed Activities) (Amendment) Order, 1997, First Schedule, Article 2 (i), companies must have completed an Environmental Impact Assessment (EIA) approved by the Natural Resources and Environment Board (NREB) before undertaking re-entry logging in areas larger than 500 ha. Environmental impact assessments are also mandatory for the approval of land clearing and the establishment of plantations. These requirements were introduced in 2005.

To the Council's knowledge, WTK has received approval for an EIA for re-entry logging within timber license T/3148 and for re-entry logging in single coupes in T/3081 and T/3082. The EIA for the re-entry logging being carried out by WTK in T/3148 was approved in October 2009, after re-entry logging had been going on in the area for more than 8 years.⁵⁸ Information from other EIA reports for adjacent concessions and logging areas indicate that WTK has carried out re-entry logging in a number of its timber license areas – T/3080, T/3081, T/3064 and T/3132.⁵⁹ Yet no EIAs for these areas seem to have been carried out, as no record of such was found in NREB libraries. It cannot be ruled out that WTK has been exempted from the EIA requirement, although the NREB has informed the Council that no such exemptions are allowed for under the NREB ordinance.⁶⁰

5 Information provided by the company

5.1 WTK'S COMMUNICATION WITH THE COUNCIL

On 9 December 2010, the Council sent a letter to WTK requesting information and documents pertaining to the company's forest operations and the company's sustainable forestry practices. A follow up email was sent to WTK on 25 January 2011. WTK has not responded to the Council's request.

The Council sent the draft recommendation to WTK on 24 February 2012. The company has been contacted by the Council several times by telephone and by email, the last time on 10 April 2012. WTK has not responded to the Council.

5.2 WTK'S POSITION

WTK provides little information about its forest operations. In its Annual Report 2010, the company states:

“The WTK Group is committed to adopt and implement sound forest management practices to ensure forestry is economically, environmentally and socially sustainable. With strict adherence to the prescriptions of forest management plan in every concession area, the Group abides by the rules and regulations pertaining to cutting cycles, yield, annual allowable coupes, cutting rules, logging blocks, inoperable forest, obligatory species, merchantable tree sizes, enumeration and log measurement.”⁶¹

The company also states that all requirements regarding road construction are followed, and that it conducts environmental impact assessments to ensure that forest operations cause minimal environmental damage. In addition, WTK has highlighted its work on sustainability certification under the Malaysian Timber Certification System (MTCS). The company has so far invested about USD 3.85 million (RM 12 million) in this work. No units have yet been certified.

The 2009 WTK Annual Report states that the company is working to obtain MTCS certification of its forest plantations against a new standard for plantations issued by MTCS in 2009.⁶² This is not mentioned in the 2010 or 2011 Annual Reports.

6 The Council on Ethics' assessment

The Council on Ethics has assessed whether there is an unacceptable risk that WTK is responsible for severe environmental damage as per paragraph 2, third subsection, of the Ethical Guidelines. In this case, the Council has emphasized the environmental damage associated with the conversion of tropical forests to plantations, environmental damage associated with logging, and the fact that the company's practices seem to breach normal requirements and therefore can be assumed to be illegal. Illegal logging reinforces the environmental damage associated with forest operations and may in itself provide a basis for exclusion under the criteria for severe environmental damage.

In its assessment, the Council has emphasized the scale of the damage and to what extent it causes long-term and irreversible impacts, whether the damage is a result of violations of national laws or international norms, and what the company has done to mitigate impacts.

As shown in section 2.1, all but one of WTK's license areas overlap with the Heart of Borneo and the Sundaland Biodiversity Hotspot. These are regions with particular important biological values, which are threatened by deforestation and forest degradation.⁶³ WTK has licenses to establish plantations covering an area of about 130,000 hectares. About half of the area will be planted. In the Council's view, there can be no doubt that the removal of more than 70,000 hectares of tropical rainforest in one of the most biodiverse regions on earth will have severe and irreversible impacts on biodiversity and on the ecological services the rainforest provides. The clearing is also likely to have adverse impacts on the remaining 60,000 hectares of forest due to the increased fragmentation of the forest and habitats. The Council emphasizes that the area which is being cleared is home to numerous species which are completely protected in Sarawak, and a number of them are also listed on the IUCN Red List of Threatened Species. All these species are in rapid decline, mainly due to habitat loss caused by logging and the conversion of forests to plantations. A further reduction in their habitats at this scale will increase the risk of endangered species becoming extinct. WTK is familiar with the environmental damages associated with its conversions of forests, as the company's own environmental impact assessments state that loss of biodiversity and the destruction of habitats will be inevitable. In this context the Council notes the UN and World Bank's REDD initiatives which express an international consensus on the importance of limiting the degradation and deforestation of tropical forests as a way to mitigate climate change and biodiversity loss. WTK's conversion of tropical rainforest to plantations stands in stark contrast to international activities to reduce deforestation.

The Council also stresses the environmental damage associated with the harvesting of timber. As the available information is scarce, the Council has assessed WTK's logging practices in only one timber license. This concession is located in the Melatai River Basin, which was the source of one or more landslides (the logjam) which caused severe damages in and along the Rajang River. The forest here appears to be virgin rainforest which had not been logged before WTK started intense logging during 2006-2010. The timber harvesting seems to have caused extensive erosion and numerous landslides along roads, rivers and on steep slopes, resulting in considerable damage to the remaining forest, rivers, flora and wildlife, which may have long term negative impacts on the forest ecosystem in this concession. In the Council's opinion it cannot be ruled out that these practices contributed to the logjam. The Council therefore concludes that WTK's forest operations appear to cause extensive and irreversible environmental impacts.

Based on the information available to the Council, WTK's forestry operations seem to breach numerous government requirements. This applies both to the license area for planted forest and the timber license area which the Council has studied. The research has been limited to three areas in two of WTK's concessions. In these areas WTK appears to have logged outside the concession boundary, in buffer zones along river banks and roads,

and on steep slopes, which normally is not permitted in Sarawak. Such areas are normally set aside to protect habitats and to reduce erosion, the pollution of waterways and landslides. In one of the license areas, the Council has estimated that the area which has been illegally logged amounts to about 4,000 hectares. WTK seems also to have started re-entry logging without approved environmental impact assessments as required by law. The Council's knowledge is to an extent limited, as information about requirements and maps have not been available. It is possible that the company is exempted from requirements and that concession boundaries have been changed. The Council has requested such information from WTK, but WTK has not responded. The Council therefore takes the available information as its point of departure and finds it probable that WTK's logging practice is in conflict with government requirements. The Council attaches importance to the fact that this practice is found in all the researched areas, and that the assumed illegal logging appears to have caused extensive environmental damage, particularly in the timber license area studied by the Council. In addition, the Council considers that illegal logging in itself is unacceptable and in clear breach of both national and internationally accepted norms.⁶⁴

The Council has assessed WTK's actions to prevent or mitigate environmental damage. The company claims that it is committed to sustainable forest management in accordance with laws and requirements, but does not explain what this means in practice. A large part of WTK's operations include the conversion of tropical rainforest to plantations. In connection with operations of this kind, it has become more usual for companies to identify, protect and manage areas within the license area which are of particular ecological importance, so-called High Conservation Value Forest. The Council attaches importance to the fact that WTK neither seems to have carried out such assessments, nor has implemented other measures to mitigate the environmental impacts associated with the conversion of forest. The same applies to the company's logging practices, where the company has adopted few measures to reduce environmental damage from logging or road building, which in the Council's view aggravates the environmental damage. The Council finds that WTK does little to reduce the environmental damage associated with its forest operations.

Finally, the Council has assessed the future risk of environmental damage. WTK's licenses are all in operation. The timber licenses will expire in 2020, but may be extended beyond then. The licenses for planted forest will run until 2060. This means that WTK will be logging for many years to come. There is no indication that the company will end these operations or substantially change the way in which they are run. The company's unwillingness to share information strengthens the assessment that the practice will continue.

7 Recommendation

The Council on Ethics recommends the exclusion of the Malaysian company WTK Holdings Berhad from the investment universe of the Norwegian Government Pension Fund Global because of an unacceptable risk of the company being responsible for severe environmental damage.

Ola Mestad

Chair

(sign.)

Dag Olav Hessen

(sign.)

Ylva Lindberg

(sign.)

Gro Nystuen

(sign.)

Bente Rathe

(sign.)

Notes

- 1 http://www.regjeringen.no/en/sub/styrer-rad-utvalg/ethics_council/ethical-guidelines.html?id=425277 .
- 2 In previous recommendations, the Council has elaborated on the criteria for severe environmental damage, see for example the Council's recommendations concerning Freeport McMoRan and Samling Global, available at www.etikkradet.no.
- 3 Financing the Heart of Borneo: A Partnership Approach to Economic Sustainability, Oct 2010 , available at http://assets.panda.org/downloads/sustainable_financing_hob.pdf.
- 4 Conservation International, http://www.conservation.org/where/priority_areas/hotspots/asia-pacific/Sundaland/Pages/default.aspx.
- 5 The concept was introduced by the biologist Norman Myers in 1988. Information on Biodiversity Hotspots is available at the homepage of Conservation International, http://www.conservation.org/WHERE/PRIORITY_AREAS/HOTSPOTS/Pages/hotspots_main.aspx.
- 6 FAO 2011: State of the World's Forests. Comparison of yearly deforestation per country, 2000-2010. In 2005-2010, the early deforestation rate in Brazil and Indonesia was 0.5 percent. In Sarawak it was 2 percent.
- 7 The Government of Norway's International Climate and Forest Initiative, see <http://www.regjeringen.no/en/dep/md/Selected-topics/climate/the-government-of-norways-international-/why-a-climate-and-forest-initiative.html?id=547202>.
- 8 The Council on Ethics sent a letter to WTK on 9 December 2010, and approached the company again by email on 25 January 2011.
- 9 The SPOT image has a 2.5 metre spatial resolution and is dated 6 January 2011.
- 10 WTK Group, <http://www.wtkholdings.com/index.html>
- 11 Sarawak Timber Industry Development Corporation is a forestry company owned by the authorities in Sarawak, <http://www.sarawaktimber.org.my/>.
- 12 WTK's subsidiary Piramid Intan Sdn Bhd has a logging contract with STIDC in area A of STIDC's license T/3401. The concession area covers 91,882 hectares.
- 13 A recent study of major timber companies in Sarawak concluded that WTK Holdings held 320,000 hectares of timber concessions, see Feah, D. 2011: Development of Global Timber Tycoons in Sarawak, East Malaysia: History and Company Profiles, The Bruno Manser Funds, http://stop-timber-corruption.org/resources/bmf_report_sarawak_timber_tycoons.pdf.
- 14 WTK's announcements to the stock exchange: : <http://announcements.bursamalaysia.com/EDMS%5Cannweb.nsf/LsvAllByID/482568AD00295D07482573A70031FDE4?OpenDocument>, and <http://announcements.bursamalaysia.com/EDMS/.../Notes-2Q2002.doc>, and [http://announcements.bursamalaysia.com/EDMS/subweb.nsf/7f04516f8098680348256c6f0017a6bf/89521c3731a5ee6648256e8600139bbe/\\$FILE/WTK-AnnualAuditedAccounts.pdf](http://announcements.bursamalaysia.com/EDMS/subweb.nsf/7f04516f8098680348256c6f0017a6bf/89521c3731a5ee6648256e8600139bbe/$FILE/WTK-AnnualAuditedAccounts.pdf) and http://www.bursamalaysia.com/website/bm/listed_companies/company_announcements/announcements/archives.jsp.
- 15 Concession boundary information is drawn from maps from Environmental Impact Assessments (EIAs) and from a presentation given by the Sarawak Forests Department in October 2010. Precise boundaries of T/3401 Area C and T/3476 (dotted red lines) are uncertain. T/3401 Area C is licensed to STIDC, but WTK Holdings subsidiary Piramid Intan Sdn Bhd is contracted to carry out harvesting.
- 16 Ecosol Consultancy Sdn Bhd 2004: Environmental Impact Assessment for Oya-Kanowit-Katibas Forest Plantation under License for Planted Forest No. LPF/0032, and Plantacia Sdn Bhd 2003: Environmental Impact Assessment Report for Tree Planting Project at Bukit Raya Area (LPF/0022). According to the EIA the plantable area is 71,755 hectares or 55 percent of the license area (131,032 hectares). In addition 5,240 hectares will be used for oil palm plantations.
- 17 WTK Holdings Annual Report, 2011. This includes 6,500 hectares of timber plantations and more than 8,500 hectares of oil palm plantations.
- 18 See footnote 17.
- 19 Dipterocarpaceae is a large family of primarily evergreen leaf trees which dominate the rainforest in Malaysia. The trees can grow to be very old and reach their normal height at 40-70 metres. Many species are economically valuable as timber, but they are also used in the production of etheric oils, balsam and plywood.
- 20 In Sarawak protected species are listed under the Sarawak Wildlife Ordinance. The EIA confirms the presence of 19 protected fauna species, of which 6 totally protected under the Wildlife Ordinance. Five of these are listed on the IUCN Red List of threatened species, see below.
- 21 The IUCN Red List of threatened species classifies species at high risk of global extinction. The EIA for LPF/0032 identified among others, the following species: Bornean Gibbon (*Hylobates muelleri*), Box-tortoise (*Geochelone emys*), Giant Squirrel (*Ratufa affinis*), White-fronted Langur (*Presbytis frontata*) and Sun Bear (*Helarctos malayanus*). The two first mentioned are classified as endangered, the next as vulnerable and the last two as near threatened. Endangered species face a very high risk of extinction in the wild, vulnerable species are species facing a high

- risk of extinction, and near-threatened species are likely to become vulnerable or endangered in the near future, see <http://www.iucnredlist.org/>.
- 22 Ecosol Consultancy Sdn Bhd, 2004: Environmental Impact Assessment for Oya-Kanowit-Katibas Forest Plantation under License for Planted Forest No.LPF/0032, p. C4-5.
 - 23 See footnote 22, p. C4-26.
 - 24 See footnote 20 p. C3-17.
 - 25 See for instance Berry et.al. 2010: The high value of logged tropical forests: Lessons from northern Borneo in *Biodivers Conservation* (2010) 19:985–997, DOI 10.1007/s10531-010-9779-z.
 - 26 The Lanjak Entimau Wildlife Sanctuary is an IUCN protected area, management category IV area, a category of protected areas typically designated to protect specific species and habitats.
 - 27 <http://whc.unesco.org/en/tentativelists/1988/>.
 - 28 See footnote 22 p. C3-22.
 - 29 Orangutan distribution from WWF Germany 2005: Borneo: Treasure Island at Risk – Maps on Status of Forests, Wildlife and related Threats on the Island of Borneo, <http://www.worldwildlife.org/what/wherewework/borneo/WWFBinaryitem7590.pdf> Heart of Borneo boundary from WWF Kalimantan Landcover map, 2010, supplied to the Council by WWF.
 - 30 The Orangutan (*Pongo pygmeus*) is classified as an endangered species on the IUCN Red List of threatened species.
 - 31 See footnote 29.
 - 32 Wildlife Conservation Society: Orangutan Nest Count Surveys at the Proposed Extension Areas of Lanjak-Entimau Wildlife Sanctuary. Interim Report submitted by the Wildlife Conservation Society (WCS)-Malaysia Program to the US Fish and Wildlife Service (USFWS) on 15th October 2011.
 - 33 Plantacia Sdn Bhd 2003: Environmental Impact Assessment Report for Tree Planting Project at Bukit Raya Area (LPF/0022). The EIA lists 12 totally protected species and 20 protected species according to the Sarawak Wildlife Protection Ordinance 1998, First Schedule, part 1. This includes the Bornean Gibbon (*Hylobates muelleri*), Pangolin (*Manis javanica*), Western Tarsier (*Tarsius bancanus*), Giant squirrel (*Ratufa affinis*) and many species of Hornbills.
 - 34 See footnote 21. Bornean Gibbon and Pangolin are classified as endangered, Western Tarsier and Tufted Ground Squirrel are listed as vulnerable, Giant Squirrel, Rhinoceros Hornbill, Helmeted Hornbill and Crested Fireback Pheasant are near threatened species according to the IUCN.
 - 35 See footnote 33, p. 57.
 - 36 The EIA estimated the plantable area to be 71,755 hectares.
 - 37 Ecosol Consultancy Sdn Bhd 2004: Environmental Impact Assessment for Oya-Kanowit-Katibas Forest Plantation License for Planted Forest No.LPF/0032, p. C5-9.
 - 38 See footnote 37 p. C2-19.
 - 39 Maps showing the boundaries for the 4 different areas (A-D) in the concession were included in the EIA for LPF/0032. For each of these areas the maps show areas where logging is permitted and areas which shall be protected.
 - 40 Confirmed in a meeting between the Council's secretariat and the Sarawak Forest Department, NREB, the Forestry Corporation and other government bodies in Kuching, Sarawak on 17 October 2011.
 - 41 See the Council on Ethics recommendation to exclude Samling Global for a list of forest management requirements.
 - 42 In this concession the EIA classifies slopes in excess of 33 degrees as steep terrain, while Sarawak authorities seem to have applied 35 degrees in other concessions.
 - 43 See footnote 37, p. C3-7.
 - 44 The SPOT image has a spatial resolution of 2.5 metres and is dated 6 January 2011.
 - 45 Sidle et al. 2006: Erosion processes in steep terrain – Truths, myths and uncertainties related to forest management in Southeast Asia; in *Forest Ecology and Management* 224 (2006) pgs. 199-225. According to the Authors, timber harvesting with subsequent regeneration of secondary forests reduces rooting strength for up to two decades after initial cutting.
 - 46 Estimate based on elevation above sea level as provided by Google Earth Pro.
 - 47 Confirmed in a meeting between the Council's secretariat and the Sarawak Forest Department, NREB, the Forestry Corporation and other government bodies in Kuching, Sarawak on 17 October 2011.
 - 48 See the Council on Ethics recommendation to exclude Samling Global for more information about forest management requirements in Sarawak.
 - 49 The Malaysian Insider, 8 October 2010: *State minister says Rajang logjam an ecological disaster*, <http://www.themalaysianinsider.com/mobile/malaysia/article/state-minister-says-rajang-logjam-an-ecological-disaster/>.
 - 50 Borneo Post, October 9, 2010: *One missing in river; two buried in mud*, <http://www.theborneopost.com/2010/10/09/one-missing-in-river-two-buried-in-mud/>.

- 51 Borneo Post, October 11, 2010: *CM: We will probe cause of logjam*, <http://www.theborneopost.com/2010/10/11/cm-we-will-probe-cause-of-logjam/>.
- 52 The Borneo Post, 9 November 2010: *Logjam triggered by various factors*, <http://www.theborneopost.com/2010/11/09/%E2%80%98logjam-triggered-by-various-factors%E2%80%99/>.
- 53 Borneo Post, 21 Oct 2010: *Massive debris not due to logging activities – Len*, <http://www.theborneopost.com/2010/10/21/massive-debris-not-due-to-logging-activities-%E2%80%93-len/>.
- 54 Sarawak Indigenous Community News, 8 October 2010: *Rajang a river of logs!*, <http://sarawaknews.wordpress.com/2010/10/08/kapit-a-river-of-logs/>; image copyright yadiputra9 photography.
- 55 New Straits Times, 14 October 2010: *Sarawak area a ‘war zone’ owing to excessive logging*, http://www.nib.com.my/archives/text/view/54673262?pos=1&hide_header=1&resultset=nstpec%3Awww/cross-search/search.php%3A_1340086914%3Aresultset.
- 56 Suara Sarawak 15 March 2011: *Ex-forestry director was lying about logjam, says colleague*, <http://www.barubian.net/2011/03/ex-forestry-director-was-lying-about.html>.
- 57 A presentation by the Sarawak Forest Corporation on the logjam in October 2010 showed the number of the license areas in the Melatai River Basin.
- 58 Ecosol Consultancy Sdn Bhd 2009: *Environmental Impact Assessment for the Re-entry Timber Harvesting of Hill Forest within the Entuloh-Melatai FMU under Timber License No. T/3148*.
- 59 Ecosol Consultancy Sdn Bhd. 2009: *Environmental Impact Assessment for the Re-entry Hill Logging under Timber License No. T/3433*, p. C2-17 (map with T/3080, T/3081, T/3064 all labelled as re-entry logging); EIA for T/3148 (see footnote 58), October 2009, pg. C2-17 (map with T/3132 labelled as re-entry logging).
- 60 Confirmed in a meeting between the Council’s secretariat and the Sarawak Forest Department, NREB, the Forestry Corporation and other government bodies in Kuching, Sarawak on 17 October 2011.
- 61 WTK *Annual Report 2011*, <http://www.wtkholdings.com/report.html>.
- 62 WTK *Annual Report 2009*, <http://www.wtkholdings.com/report.html>.
- 63 The World’s 10 Most Threatened Forest Hotspots, <http://www.conservation.org/newsroom/pressreleases/Pages/The-Worlds-10-Most-Threatened-Forest-Hotspots.aspx>.
- 64 A number of international, comprehensive efforts are made to combat illegal logging in Asia and elsewhere, under the auspices of the EU, the World Bank and individual States. Such initiatives include the EU Forest Law Enforcement, Governance and Trade (FLEGT), and regional FLEG processes supported by the World Bank and the Asia Forests Partnership (AFP), as well as numerous national initiatives aimed at halting the trade of illegal timber and wood products. Malaysia is partner to both EU FLEGT and AFP. See for example <http://ec.europa.eu/environment/forests/flegt.htm> and <http://www.asiaforests.org/>.

To the Ministry of Finance

27 June 2012

UNOFFICIAL ENGLISH TRANSLATION

Recommendation to exclude AngloGold Ashanti Ltd. from the investment universe of the Government Pension Fund Global

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1 Summary

The Council on Ethics recommends the exclusion of the South-African company AngloGold Ashanti Ltd. (AGA) from the Government Pension Fund Global (GPGF) due to an unacceptable risk that the company through its mining activities in Ghana is responsible for severe environmental damage and contributes to serious and systematic human rights violations. The recommendation focuses on the company's mining operations in Ghana (Obuasi and Iduapriem). As of 31 December 2011, the GPGF held shares in the company with a market value of NOK 1,344 million, representing 1.37 per cent of the company's shares.

Both Obuasi and Iduapriem are wholly owned by the company. AngloGold Ashanti was established in 2004 through the merger of AngloGold (AG) and Ashanti Goldfields Company (AGC), and the new company continued AGC's operations at Obuasi and Iduapriem. For more than 100 years, there has been commercial gold mining at Obuasi, affecting large areas. The concession at Obuasi covers more than 470 km², including some 130 villages and around 240,000 inhabitants, a large number of old open pit mines (not in use), old tailings storage facilities (partially in use) and waste rock dumps (not in use), underground mines, as well as other infrastructure and facilities that are still in operation. The company's Iduapriem mine was established in 1991. The mining concession covers an area of 107 km², including six open pit mines with associated waste rock dumps and tailings storage facilities, as well as a processing plant. Within the concession, there are 14 villages with some 5,200 inhabitants. The company's mines in Ghana have received extensive criticism related to two of the criteria in the GPGF's Ethical Guidelines,¹ severe environmental damage and human rights violations.

With regard to environmental damage, the Council on Ethics has concentrated its research on the Obuasi mine. The surveys show that the mine causes extensive and very severe water pollution involving hazardous substances such as arsenic, heavy metals and cyanide. The pollution stems partly from discharge points at the mining facilities and partly from more diffuse runoff from older plants and contaminated areas. Concentrations several times higher than the maximum levels for drinking water defined by the World Health Organization (WHO) and Ghanaian authorities (more than 100 times the maximum value) are regularly measured in the rivers near the mining operation. Such contamination has serious health effects and is very toxic to freshwater organisms. Ghanaian environmental authorities have repeatedly asked AGA to temporarily suspend the operation and implement measures aimed at reducing the pollution. The mining operation at Obuasi has also led to extensive pollution of river sediment, soil, vegetation and agricultural crops.

The pollution problems and the mining operation in general have a bearing on the human rights situation in the affected areas. Deterioration of the local population's health as a result of the pollution at Obuasi constitutes the main basis for assessing health as a human rights issue. The company's contamination of rivers and soil has reduced the inhabitants' access to clean water, fish and agricultural produce and has caused health problems. Arsenic and heavy metals contamination has serious long-term negative effects

on people's health, for instance an increased risk of various types of cancer and damage to the nervous system, especially in vulnerable groups such as children.

The Council on Ethics' research has also shown that a significant proportion of the involuntary resettlements at Obuasi and Iduapriem have previously been carried out in contravention of international standards, but the company now seems to be addressing this issue. On the whole, the pollution and the involuntary resettlement have led to a significant deterioration in the quality of life and livelihoods of a substantial part of the local population.

In its dialogue with the Council on Ethics, AngloGold Ashanti has been forthcoming and shared large amounts of information. The company recognizes that there is extensive contamination at Obuasi, claiming that this is primarily due to naturally high levels of arsenic in bedrock and soil, combined with more than 100 years of mining activities without adequate attention to the environment, chiefly before the merger of AG and AGC in 2004. AGA stresses that the company since 2004 has invested large resources in the reduction, elimination and prevention of environmental damage. The company also emphasizes that it has plans for extensive studies of the environmental and health conditions at Obuasi in the next three years and that it is working on various measures to handle existing and future pollution.

AGA also acknowledges that the mining operation may have led to the loss of farmland, and that the compensation has been insufficient and/or been paid too late. The company points out that many issues date far back in time and that AGA today offers both compensation and alternative livelihood programmes in order to improve the conditions. In recent years AGA has allocated more resources to improve the situation, and in 2009 and 2010 the company carried out studies to map the social conditions at the mining sites. Based on these studies AGA has created new guidelines and new measures to handle outstanding claims, and the company says it will take steps to address future social and health related challenges.

The Council on Ethics considers the environmental damage from the Obuasi mine to be very serious and extensive. The Council takes as its point of departure that the damage caused has long-term consequences for ecosystems and people's health and livelihoods. A number of surveys have measured the concentrations of arsenic and heavy metals in water as being very high by international standards. The increased risk of many kinds of adverse effects is well documented internationally, also for levels far below those measured at Obuasi. The naturally high arsenic content in the bedrock is a contributing factor to the pollution, but areas that are not affected by AGA's activities or plants have much less contamination. The Council also emphasizes that various types of severe pollution of soil, fish and crops have been documented. This is particularly serious in areas with high population concentrations.

Overall, the company's measures have had limited effect on the pollution situation at Obuasi. This underscores the complexity and scale of the problems, and that the effects only become sizeable when several measures are implemented over a long period of time. The Council on Ethics sees it as likely that the very serious contamination will continue for a considerable number of years. Further studies in the coming three years

will probably also uncover new issues that will require new measures. In the Council's view, it is reasonable to expect that the company reduce the pollution towards natural background levels for the region.

The Council on Ethics stresses that severe pollution has made living conditions worse and reduced the access to clean water, fish and agricultural produce. The involuntary resettlement carried out before 2004 and AGA's failure to deal with the serious socio-economic problems in the wake of the forced relocations have also led to a significant deterioration in the livelihoods of the people of Obuasi and Iduapriem. The Council finds it positive that the company in recent years has carried out studies of social conditions with a view to mapping and improving the conditions. Given that a number of key environmental and health studies have not been initiated, and that the problems are both extensive and complex, the Council finds it likely that it will take a significant amount of time before the affected population will have its livelihood restored.

2 Introduction

In September 2009, the Council on Ethics decided to assess the Fund's investment in the South African gold mining company AngloGold Ashanti Limited (AGA)² against the Guidelines for the observation and exclusion of companies from the Government Pension Fund Global's (GPFG) investment universe (Ethical Guidelines)³. The assessment was initiated after multiple aspects of the company's operations had been criticized locally, nationally and internationally.⁴

As of 31 December 2011 the GPFG held shares in the company worth USD 231 million, representing 1.37 per cent of the company's shares.

Through a stepwise evaluation process, the Council has collected and assessed a large amount of information. In 2009 and 2010, the Council conducted an initial assessment of a number of AGA's gold-mining operations in different countries. Based on the obtained information, in June 2010 the Council decided to carry out a detailed survey of the company's operations at Obuasi and Iduapriem in Ghana. Subsequently, the Council contacted the company and initiated a dialogue aimed at obtaining information on the mining operations in Ghana. The Council has had extensive contact with the company in 2010, 2011 and 2012. AGA has provided the Council with information throughout the assessment process. The Council has also been in contact with representatives from the Ghanaian government and other affected stakeholders in Ghana.

2.1 WHAT THE COUNCIL HAS CONSIDERED

The Council on Ethics has assessed whether there is an unacceptable risk that AngloGold Ashanti is responsible for severe environmental damage and/or contributes to serious or systematic human rights violations pursuant to section 2(3)(a and c) of the Ethical Guidelines.

2.1.1 SEVERE ENVIRONMENTAL DAMAGE

The Council has assessed a number of environmental issues at Obuasi and Iduapriem, where various forms of pollution, damage to protected areas and loss of biodiversity have received criticism. The Council has concentrated its recommendation on a very limited selection of serious problems at Obuasi.

A number of studies show that groundwater and surface water at Obuasi have concentrations of arsenic, cyanide and various heavy metals that exceed the recommended maximum levels considerably. The Council has assessed measurements at different locations collected over a period of more than 10 years. In the recommendation, the Council mainly presents data for concentrations of arsenic in the two rivers of Nyam and Kwabrafo, which appear to be the most affected by the mining operations. Arsenic is a hazardous substance. These pollution problems appear to be typical for the environmental situation at Obuasi and are also among the most serious problems. Measurements from contaminated locations are compared with locations that have not been affected by the mining operations, as these are assumed to be in a relatively natural state, representing background levels without mining activities.⁵ Data are compared to national and international standards for drinking water and process water from mines.

A number of serious issues have been excluded in order to narrow the scope of the recommendation. Some issues have been left out because it has been difficult to obtain acceptable documentation, and others have been omitted because they probably do not constitute a breach of the Ethical Guidelines.

In each recommendation, the Council on Ethics considers what constitutes severe environmental damage, based on an overall assessment of specific projects, operations or activities. The Council gives particular emphasis to whether:

- the damage is significant;
- the damage causes irreversible or long-term adverse effects;
- the damage has considerable negative impact on human life and health;
- the damage is a result of violations of national laws or international standards;
- the company has failed to act in order to prevent the damage;
- the company has implemented adequate measures to rectify the damage;
- it is probable that the company's unacceptable practice will continue.

2.1.2 SERIOUS OR SYSTEMATIC HUMAN RIGHTS VIOLATIONS

With regard to human rights, the Council has considered a number of issues in Obuasi and Iduapriem. Some issues have been omitted due to difficulty in obtaining solid evidence or because the allegations have not been deemed sufficiently credible. In this recommendation the Council has focused on allegations that the company, through involuntary resettlement⁶ and severe pollution, is responsible for significantly deteriorating the health and livelihoods of local people at Obuasi and Iduapriem.

In recent years, several initiatives have been introduced reflecting an international agenda of giving companies an increased responsibility for human rights, such as the work of the UN General-Secretary's Special Representative on Business and Human rights, John Ruggie. These initiatives demand companies to ensure that they do not violate

the human rights of individuals affected by their operations.⁷ This entails that companies must comply with national law, even if it is not enforced by local authorities, and that companies must respect the principles of relevant international instruments in the absence of national law. This requires not only a passive responsibility on the part of companies, but also active measures designed to ensure that they do not violate the fundamental rights of people in the areas in which they operate. The UN Global Compact and the OECD's Guidelines for Multinational Enterprises now base their work relating to business and human rights on the UN's Guiding Principles on Business and Human Rights.⁸ The main elements are also incorporated into the ISO 26000, a new standard for corporate social responsibility adopted by the International Standards Organization (ISO).⁹

The point of departure for these initiatives, as well as for the Council's previous recommendations on human rights, is that companies can contribute to human rights violations even though states, rather than companies, are obliged under international human rights conventions.¹⁰ The Council does not evaluate to what extent the state is responsible for any human rights violations. It is sufficient to establish that the company's actions contribute to serious or systematic violations of internationally recognized human rights.¹¹

In its assessment of whether AGA contributes to serious or systematic violations of internationally recognized human rights, the Council has considered two main issues, namely the right to health and the practice of forced relocation. These issues have been considered against the UN Covenant on Economic, Social and Cultural Rights' article 12 on the 'right to health'¹² and international standards for involuntary resettlement.¹³

Based on previous recommendations regarding human rights violations, the Council has arrived at a series of factors that will form the basis for the specific assessment of whether there is an unacceptable risk of a company contributing to human rights violations. First, there must be an actual link between the company's operations and the violations in question. The violations must have been committed with a view to serving the company's interests or facilitating its operations, and the violations must either be ongoing or there must be an unacceptable risk that they will occur in the future. Whether the company's operations have caused extensive and long-term negative impacts on those affected, to what extent particularly vulnerable groups have been affected, and what the company has done to improve the conditions will be of significance in the assessment.

2.2 SOURCES

The Council has obtained and evaluated comprehensive and detailed information and documentation from AGA, researchers, Ghanaian authorities, national and international non-governmental organizations and the media. The company has provided the Council with a significant amount of documentation. In its dialogue with the Council, AGA has been forthcoming and has on several occasions responded in detail to the Council's questions. Overall, there is a considerable degree of consistency between the information and documentation from the various parties. The quality of the available information varies substantially, but with regard to key areas it is considered to be good. Information has also been obtained from affected individuals at Obuasi and Iduapriem. Discussions with

employees at AGA have provided additional details and have been useful for the interpretation of the extensive material.

In March 2011, representatives from the Council on Ethics visited a number of locations at the Obuasi and Iduapriem mining operation sites. The Council's representatives had very good access to company employees during the field visit, ranging from the international top management via various middle managers to the operational level at the mine. In addition to meetings with the company, the Council arranged meetings with authorities, local organizations and local communities without the company being present. Meetings were held at both the mining operations and in Ghana's capital Accra.

3 Background

3.1 ABOUT ANGLOGOLD ASHANTI LTD.

AngloGold Ashanti Ltd. was established in 2004 with the merger of AngloGold Ltd. (AG) and Ashanti Goldfields Company Ltd. (AGC). AG was established in 1998 through the consolidation of the gold mining interests of the company Anglo American. The precursor to the company AGC dates back to 1897 and has been a key player in Ghana's gold industry for a long time. In the 1990s AGC owned mines in a number of African countries, including the mining operations at Obuasi and Iduapriem in Ghana. When AG and AGC combined their operations, many executives from AGC were transferred to key positions at AGA's mine in Obuasi.¹⁴ The mining operations at Obuasi and Iduapriem both continued.

Today, AngloGold Ashanti is headquartered in Johannesburg, South Africa, and is listed on the stock exchanges of Johannesburg, New York, Ghana, London and Australia.¹⁵ As of 31 December 2011, the overwhelming majority of ordinary shares in the company were owned by investment managers, among whom the largest one held nearly 8.5 per cent. Over time the Ghanaian government has reduced its ownership stake and as of 31 December 2011 owned 1.67 per cent of the shares.¹⁶

In 2011 the company produced 4.33 million ounces of gold,¹⁷ which makes it the world's third biggest gold mining company in terms of production.¹⁸ The company also produces some silver and uranium as by-products. At the end of 2011 the company had in excess of 61,000 employees, including contractors, and 20 producing mines in ten countries spanning four continents.¹⁹

3.2 THE MINING OPERATION AT OBUASI

Gold has been mined for hundreds of years in the former colony known as the Gold Coast, now Ghana, which in previous periods has been responsible for the major share of the world's gold production.²⁰ In recent years Ghana's share of global gold production has been around three per cent, and the country ranks among the ten top producing countries in the world. Gold is Ghana's most important source of export earnings.

Large-scale commercial extraction of gold at Obuasi started at the end of the 19th century. The company Ashanti Goldfields Corporation Limited was a very important economic player in the British colony of the Gold Coast and later – after 1957 – in the

independent country of Ghana. Today, gold mining is continued by AGA. At Obuasi, gold mining and important socio-economic structures are exceptionally closely interconnected, both directly and indirectly.

Historically, mining at Obuasi has primarily been based on underground operations in several mines. In the 1990s large-scale open pit mines were also in operation at various locations, resulting in many of the problems that AGA still struggles with today. In the past, different plants have been used for processing different types of ore and tailings, including conventional 'carbon-in-leach' (CIL)²¹, 'heap leaching'²² with cyanide, biological oxidation and roasting. These processing methods have caused widespread pollution.

The gold production has decreased sharply since the 1990s. Nevertheless, the production at Obuasi is still significant and will probably continue at least at the same production level as today, i.e., more than 300,000 ounces per year. Obuasi is a productive and important mine for AGA.

In 2004, at the time of the merger of AG and AGC, Obuasi was a large mining operation²³ in need of considerable investment that faced economic, technological, environmental and social challenges. The company has made significant investments to improve these areas, including closing down old infrastructure and rehabilitating some affected areas. Much work remains and the full extent of the problems and damage has not been mapped.

The financial results since the merger have been below budget. A comparison between planned and actual production volumes and expenditures in AGA's own annual reports shows that for each year in the period 2005–2010 the production, on average, has been some 11 per cent lower than planned, whereas the expenditures have been approximately 26 per cent higher.²⁴ Obuasi has been running at a loss every year in the said period, except for 2009. In 2011, Obuasi made a profit.

Still, Obuasi is home to one of the world's largest known gold reserves. Estimated mineral resources²⁵ are close to 30 million oz²⁶. and the ore reserve²⁷ totals nearly 9 million oz²⁸. Obuasi holds approximately 13.4 per cent of AGA's 220 million oz. of mineral resources and about 12.6 per cent of its 71.2 million oz. ore reserve.²⁹

Currently, gold production at Obuasi is based on underground mines that operate down to 1,500 m below ground. The ore consists of two main types, one that is made up of quartz veins containing free gold and another one with sulphide minerals such as arsenopyrite, in which the gold is bound so that the ore requires special treatment. The mine is an important employer, and in 2010 around 4,200 people were employed at Obuasi, in addition to a staff of some 1,500 among contractors.³⁰

Until recently, Obuasi had three processing plants: one for sulphide ore and tailings, one for oxide ore, and one for tailings.³¹ In 2009, the oxide ore processing plant was closed because of damage to parts of it. The tailings reprocessing plant was permanently closed in October 2010. Today only one plant is operating (South Treatment Plant).

The processing of sulphide ore at the South Treatment Plant (STP) consists of several phases. First, sulphide ore is crushed and finely ground before flotation.³² The next step is the biological oxidation (BIOX®)³³ of the concentrate from the flotation, and finally the conventional use of cyanide to extract the gold. The process also releases other chemical substances, such as iron, sulphur, and arsenic.

The water from this process contains cyanide, arsenic and heavy metals. AGA treats the water through a combination of ‘carbon-in-solution’ (CIS) and Actiflo™ to eliminate substances such as arsenic and heavy metals,³⁴ as well as ‘rotating biological contactors’³⁵ aimed at breaking down the cyanide. These systems became fully operational in June 2009.

The mining operation itself is located in the municipality of Obuasi, where more than 240,000 people live in urban and rural settlements. Within the whole concession area, there are many villages situated in close vicinity to old and more recent mining facilities (see image 1). Until recently, considerable open pit mining was going on, totalling 37 pits. Only a few of these have been rehabilitated. Some open pit mines can be reopened in the future. AGA’s objective is to halve the physical area occupied by the mine site and separate the mining operation from the local communities by 2020.³⁶ In the meantime, however, the area occupied by the mine will be extended through the construction of the Sansu North Tailings Storage Facility, which requires the involuntary resettlement of the Dokiwa village.³⁷

Because of the mining operation, Obuasi has seen some incoming migration in recent years. While 24 per cent of the population has not lived in Obuasi for more than five years, 56 per cent have lived in the area for more than ten years.³⁸

The 130 villages within AGA’s concession are to varying degrees affected by AGA’s mining operation. Twenty-five villages are directly affected by forced relocation. Others are strongly affected by sound and air pollution (blasting), reduced access to clean water sources and loss of farmland, whereas other villages are not much affected by such factors.

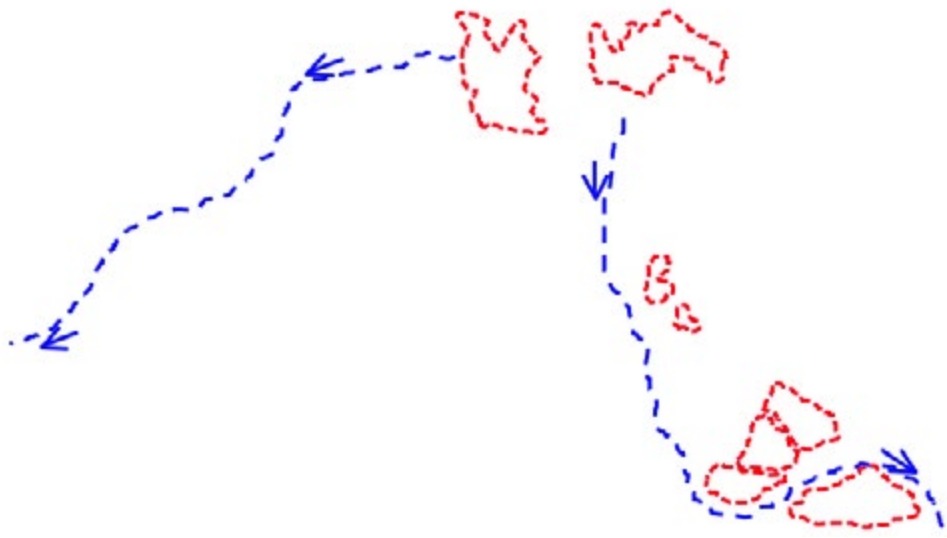


Image 1: Satellite image of part of Obuasi (August 2011) showing the overlap between polluted areas (water, soil and crops) and densely populated areas (lighter areas). Older tailings dumps (currently not in use) are marked with red dotted lines. Highly polluted rivers flowing through populated areas are shown with blue lines, and the blue arrows also show the direction of the river flow. Sansu tailings deposition, currently in use, and surrounding rivers are located west/southwest of this satellite picture. (The image is from Google Earth and has been modified by the Council on Ethics to identify tailings depositions and rivers).

3.3 THE MINING OPERATION AT IDUAPRIEM

AGA's mine at Iduapriem has a 107 km² concession situated in the Tarkwa region in West Ghana. Informal gold mining has been going on in the area for more than 400 years, but commercial large-scale gold mining has only been pursued in the last 20 years. AGA's concession at Iduapriem consists of six open pit mines with ancillary waste rock dumps and tailings depositions. The mine has 721 employees and 1,024 contractors.³⁹ Within AGA's concession there are 14 rural settlements with approximately 5,200 inhabitants, often concentrated along roads or in the vicinity of mining infrastructure such as waste rock dumps.

4 Key issues and the Council on Ethics' findings

4.1 ENVIRONMENTAL ASSESSMENTS

As mentioned above, the Council on Ethics has concentrated its environmental assessment on Obuasi and the hazardous substance arsenic in particular. Below is a presentation of AGA's reporting of serious environmental incidents, followed by an assessment of arsenic pollution levels in two rivers at Obuasi (Nyam and Kwabrafo). The Council has compared natural background levels of arsenic with pollution emanating from the Obuasi mine and associated facilities.

4.1.1 SEVERE ENVIRONMENTAL INCIDENTS

AngloGold Ashanti publishes information on severe environmental incidents at its mines. The definition of 'environmental incident', as well as the format and level of detail in the reports, have varied over time. The introduction of environmental management systems has led to increased awareness and improved registration, resulting in a higher number of registered environmental incidents in the period 2004–2008.⁴⁰ Table 1 below is based on the company's reported environmental incidents, corrected for changes in definition over time.

Table 1 Number of environmental incidents at the Obuasi mine and total number for AGA in the period 2004–2010, as well as Obuasi's percentage of the company's environmental incidents.*

	2004 ⁴¹	2005 ⁴²	2006 ⁴³	2007 ⁴⁴	2008 ⁴⁵	2009 ⁴⁶	2010 ⁴⁷	2011 ⁴⁸
Obuasi	3	3	3	9	8	10	6	14
AGA total	16	25	25	33	55	51	27	27
Obuasi (%)	18.8	12.0	12.0	27.3	14.5	19.6	22.2	51.9

* The Council on Ethics has not found systematic information on the number of environmental incidents at Obuasi before 2004.

Table 1 shows that in the period 2004–2011 a large share of the company's environmental incidents (12–52 per cent) occurred at Obuasi, which is a significantly higher proportion than Obuasi's share of AGA's total production (4–8 per cent).

For the period 2008–2013 the company's objective was to reduce the number of environmental incidents by 60 per cent (from 55 to 22 incidents), and in the long term to eliminate such incidents. Later the goal was updated to 18 incidents in 2015, which is a 30 per cent reduction from the 27 incidents in 2010. The total figure for registered environmental incidents at AGA has been reduced from 55 to 27 (51 per cent) in the period 2008–2011.

The number of environmental incidents at Obuasi was reduced from eight to six (25 per cent) in the same period, but increased to 14 incidents in 2011. According to AGA, Obuasi has, for a number of years, been one of the operations with the largest number of repeated environmental incidents.

The number of severe environmental incidents and descriptions of these incidents are indicators of the quality of the environmental management systems and the scope of the environmental problems. This reporting, however, provides only an overall picture of the environmental situation at the mine. A few key results from the Council on Ethics' detailed assessment are presented below.

4.1.2 ARSENIC CONTAMINATION AT OBUASI

Brief introduction to arsenic

The semi-metal arsenic is a naturally occurring element found in small quantities practically everywhere, in soil, water, and air. There are a series of arsenic compounds and these have different properties. Inorganic arsenic compounds, such as arsenic trioxide (As_2O_3), are reactive and may have very harmful effects on the body. Organic arsenic compounds, which may be found in high concentrations in fish and shellfish, are less harmful and not very reactive. Inorganic arsenic is easily soluble in water and spreads through surface and groundwater. In natural conditions there is a much higher probability of elevated arsenic concentrations in groundwater than in surface water.

Natural concentrations of arsenic in freshwater vary from near zero (non-traceable) to several milligrams per litre (mg/l) under very special circumstances. Particularly high natural levels are generally found in groundwater where the bedrock has a naturally high content of arsenic minerals. Natural arsenic concentrations are normally below 0.01 mg/l, which also correspond to the WHO and Ghana's maximum level for drinking water, and the concentrations are often below 0.001 mg/l.⁴⁹ Globally, arsenic is known as one of the most harmful types of inorganic pollution in drinking water.

High concentrations of arsenic often occur in connection with sulphide minerals, especially those which also contain gold. This is the case at Obuasi. In such areas the natural arsenic content in groundwater may also exceed the WHO maximum level, depending on a number of physical and chemical conditions in the groundwater.⁵⁰

Effects of arsenic

In high concentrations inorganic arsenic (As_2O_3) is acutely toxic, and it is lethal in very high doses.⁵¹ More relevant for mining pollution are the long-term effects of exposure to lower arsenic concentrations over time. Inorganic arsenic increases the risk of various types of cancer, for example liver, lung, bladder and skin cancer. Many national and international organizations that work with human health and the environment have classified arsenic as carcinogenic.⁵² A number of skin afflictions and damage to various parts of the nervous system are also known effects of arsenic. Arsenic is considered to be a very serious health threat. Vulnerable groups such as children are particularly at risk. Inorganic arsenic is very harmful to freshwater organisms.

Even if exposure to arsenic statistically increases the health risk, it is often difficult to prove that individual cases of for example cancer or skin afflictions are caused by arsenic in the drinking water, as there may also be other factors causing cancer or skin problems.

Historical problems

The area around the Obuasi mining operation is known for its naturally high level of arsenic in bedrock and soil, which partly originates from minerals such as arsenopyrite.⁵³ Arsenic seeps naturally into the water and soil of the area. Moreover, long-time mining activity has caused large amounts of arsenic to be released, adding to the current pollution. Obuasi ore occasionally contains very large amounts of arsenic.⁵⁴ The crushing and grinding of ore, as well as the processing and exposure of ore to air and water, result in sharply increased amounts of arsenic in soil, air and water. For decades there has been information available about very high pollution levels at Obuasi.⁵⁵ Small-scale illegal gold mining has also resulted in pollution, for example from mercury.

Following the merger of AG and AGC, the company AngloGold Ashanti carried on the mining operation with old infrastructure (e.g. weakened pipelines for transport of tailings, a tailings storage facility without lining to prevent pollution) and a processing plant lacking sufficient treatment of process water. The mine also lacked adequate handling of a positive water balance, which meant that it regularly discharged polluted water into the water systems in the vicinity. The mine at Obuasi had a number of environmental problems that required mapping and clean-up. Previous ore roasting plants designed to increase gold yields spread large amounts of arsenic to Obuasi and the surrounding areas through air pollution.⁵⁶ Ghana's Environmental Protection Agency (EPA) has repeatedly called attention to the environmental problems and on some occasions instructed the company to suspend the gold production in order to reduce the pollution and implement adequate measures.⁵⁷ The pollution in Obuasi originates partly from discharge points and partly from more diffuse runoff from older installations and polluted areas for which AGA is responsible.

The company acknowledges that the problems have been more complex than initially expected.⁵⁸ This is also illustrated by the fact that AGA, in light of a better analysis of the complexity at Obuasi, steeply raised the estimated costs for closures and rehabilitation from USD 28 million in 2006 to USD 51.3 million in 2007.⁵⁹ After moderate yearly increases in the period from 2007 to 2010, the cost estimate increased significantly from USD 63.6 million in 2010 to 143.9 million in 2011. Obuasi thus became the AGA mine with the highest estimated rehabilitation costs related to future closures.⁶⁰

4.1.3 ARSENIC POLLUTION IN THE NYAM RIVER

Factors that contribute to current pollution

A naturally high level of arsenic in bedrock and soil contributes to the arsenic pollution of the Nyam River. Previous mining operations and facilities that the company is responsible for are an even greater cause of pollution. Current mining operations and facilities, for instance leakage from the Sansu Tailings Storage Facility in the southern part of the

mining site and the periodic discharge of process water, also contribute to elevated pollution levels in the river. The processing plant for sulphide ore at the South Treatment Plant (STP), established in the early 1990s, has generated discharge of contaminated process water into the environment for a long time, especially into the Nyam River during the rainy seasons.⁶¹

The mine is located in an area of relatively high precipitation (1,600 mm/year).⁶² Limited capacity to handle both the rain that enters the tailings storage facility and the water balance in other parts of the mining site has also increased the discharge of polluted water, especially in the rainy seasons that typically occur in March–July and October–November.

The Sansu Tailings Storage Facility receives tailings and water from the STP. The storage facility is built on relatively flat terrain and has high artificial dam walls. An unknown quantity of seepage from the storage facility, which does not have a sealed membrane, has contributed to the contamination of surrounding areas. The pollution has probably been reduced since the seepage through the dam walls of the Sansu TSF increasingly has been collected and pumped back into the storage facility. The way in which the storage facility is filled up by tailings (including process water) and controlled seems to have improved, bringing down leakage and pollution, as well as making the geotechnical stability of the facility better and thus reducing the risk of damage to the dam walls or any rupture or collapse.

Measured values of arsenic over time

For over 10 years, Ashanti Goldfield Company and later AngloGold Ashanti have collected and analysed water samples from the Nyam River several times a month. The company admits that the results in some cases have shown high concentrations of arsenic, exceeding the WHO and Ghana's maximum limit for arsenic in drinking water (0.01 mg/l) as well as the maximum level for discharge water from mines in Ghana (0.1 mg/l).⁶³ Researchers and organizations have also collected and analysed data over a longer period of time and confirmed pollution levels far above the maximum limits.⁶⁴

Monitoring stations with natural conditions (unaffected by mining) show significantly lower levels of arsenic in the water than areas affected by mining. However, some locations that seem to be unaffected by mining can still have concentrations of arsenic above the WHO and Ghana's maximum limit. This is assumed to be the result of high arsenic content in bedrock and soil and possibly of previous pollution, for example arsenic deposition from past atmospheric pollution.

4.1.4 ARSENIC POLLUTION IN THE KWABRAFO RIVER

Factors that contribute to pollution

A naturally high level of arsenic in bedrock and soil contributes to the arsenic pollution of the Kwabrafo River, but the river is even more affected by infiltration water and surface runoff from the Pompora Treatment Plant (PTP), which formerly received material from the Tailings Treatment Plant (TTP) in the northern part of the mine site. In the 1990s and

well into the 2000s, some 10,000 tons of arsenic trioxide was stored at Pompora without adequate protection. This added to previous pollution by arsenic, and even if the stockpile of arsenic trioxide is now eliminated, there will be traces of arsenic in soil and river sediments that still contribute to pollution. From time to time there have been discharges of polluted water from the Pompora swamp, which receives water from the Pompora Tailings Treatment Plant, and some episodes of discharge from the pumping stations at Kokoteasua and Boete, where tailings were taken out for retreatment. This has affected the Kwabrafo River. Additionally, there have been arsenic emissions to air from an old roasting plant, which was closed down in 2000. All facilities belong to AGA. AGA has installed water treatment plants that treat some of the water in the area, something that will lead to a reduction in the pollution.

Measurement results for arsenic over time

Several assessments show that the Kwabrafo River has had very high concentrations of arsenic, a fact also acknowledged by the company. As with the Nyam, AGC and later AGA have collected water samples several times a month in the Kwabrafo for more than ten years. The results show levels that are much higher than the WHO and Ghana's maximum limit for drinking water (0.01 mg/l) and Ghana's maximum limit for discharge water from mines (0.1 mg/l). Other studies also show very high levels of arsenic.⁶⁵

Locations unaffected by mining show levels that are significantly lower than values at locations affected by the mining operation. However, some monitoring stations unaffected by mining also show values that exceed the WHO and Ghana's maximum limits, something that is believed to be caused by elevated arsenic content in bedrock and soil, as well as past pollution, such as large air emissions from the roasting of sulphide ore until the year 2000.

The Ghana Environmental Protection Agency (EPA) publishes annual assessments of various environmental and socio-economic factors related to mining, based on the figures reported by the mining companies and the agency's own audits (AKOBEN). Although the EPA does not make specific measurements public, its assessment shows that the pollution levels in Obuasi are higher than the maximum limits mentioned above. Surveys obtained and reviewed by the Council show measurements more than 100 times the maximum limits in a number of rivers at Obuasi.⁶⁶

4.1.5 BRIEF DISCUSSION OF OTHER POLLUTION

In relation to the Nyam and the Kwabrafo Rivers, the Council on Ethics has also gone through extensive series of measurement data for other water quality parameters than arsenic. The analysis has shown that in a number of cases the concentrations of cyanide⁶⁷ are higher than Ghana's maximum limit for drinking water (0.01 mg/l). Similar findings have been made in the case of several heavy metals, including cadmium, manganese, lead and copper,⁶⁸ all of which can cause severe damage to the environment and people's health.

Criticism has been raised against the contamination of fruit, agricultural crops and fish in and around Obuasi.⁶⁹ A limited number of studies have been conducted, finding varying

and sometimes elevated concentrations of, for example, arsenic in food. Several studies have also shown pollution by heavy metals in soil and sediments at the Obuasi mining site.⁷⁰

4.2 HUMAN RIGHTS ASSESSMENTS

Human rights assessments are here limited to the right to health, including people's reduced access to clean water, fish and agricultural products, as well as health problems due to pollution from the mines, and also involuntary resettlement that is not performed in accordance with international standards.

4.2.1 IMPACTS ON PEOPLE'S HEALTH

Local people living in Obuasi and Iduapriem report a series of health problems that they believe are related to pollution from the mining operations. This includes skin pigment changes, open wounds that do not heal, respiratory health problems and early death. There are very few studies of possible and actual health effects caused by mining pollution at Obuasi and Iduapriem. Internationally it is well documented that arsenic increases the risk of health problems.

In 2009, AGA initiated a consultancy study designed to identify the social issues at the mines. The study shows that the company has not dealt with health problems in local communities as it should have done. This applies primarily to health problems related to pollution, especially water pollution. In Obuasi, the company's work on health issues has mainly focused on malaria. Malaria has been a huge challenge in the area for a long time. Until 2010, around 4/5 of AGA's 'Community Relations' budget was earmarked for malaria. The malaria programme also includes the population of Iduapriem. At Iduapriem, there has been no follow-up or monitoring of health-related issues, and health investments per capita in Iduapriem are significantly lower than in Obuasi.

4.2.2 LIMITED ACCESS TO CLEAN WATER, FISH AND AGRICULTURAL PRODUCTS

There is a general perception among locals that AGA through its mining activities has caused contamination of water and soil, resulting in quantitatively and qualitatively inferior crops. This understanding is especially prevalent in settlements linked to the rivers Jimi, Akrofuom and Wamase in Obuasi. Villages near AGA's tailings disposal sites claim that the soil is destroyed by cyanide spills and contaminated water. According to locals, this has affected them significantly, as agriculture is the main activity in the area.

AGA has informed all the villages in Obuasi and Iduapriem that the water from streams, rivers or ponds must not be used because of severe pollution. Local fish reportedly contain high levels of heavy metals. To prevent the locals from fishing in ponds of contaminated process water, AGA has put up signs near several ponds, but access is not physically blocked.

All settlements are supposed to have access to wells provided by the company or local authorities, but these often fall into disrepair over time. Consequently, a number of villages use water from polluted rivers.

According to the UN Committee on Economic, Cultural and Social Rights, the right to clean water⁷¹ is a necessary part of the recognized human right to health, which is enshrined in, among others, the UN Covenant on Economic, Social and Cultural Rights, Article 12. In its internal human rights policy, AGA has recognized the right to clean water for affected locals.⁷² This is in line with, for example, the statements of the UN High Commissioner for Human Rights that companies' pollution of water, soil and air may violate local people's right to health under article 12 of the UN Covenant on Economic, Social and Cultural Rights.⁷³

4.2.3 INVOLUNTARY RESETTLEMENT OF THE LOCAL POPULATION AT OBUASI AND IDUAPRIEM IN THE 1990S 2000S

After Ghana's Economic Recovery Programme (ERP) was initiated in 1983, sweeping reforms were implemented in the mining sector.⁷⁴ A new Mining Act was introduced in 1986⁷⁵, with two additions on tax (*Additional Profit Tax Law*) and royalties (*Minerals and Royalties Regulations*). The acts included generous tax incentives for foreign investors, and the reforms led to a substantial increase in investor interest in the country's gold mining sector. Once the gold mining concessions were granted to foreign mining companies during the following years, large areas, including forest reserves and settlements, were sequestered in favour of the mining companies and to the detriment of the original users of the land.⁷⁶ In the 1990s and early 2000s, AGC, AGA's predecessor, brought about extensive physical and economic displacement⁷⁷ of the local population to allow for land-intensive open pit mining at Obuasi and Iduapriem.

In the period 1990–2001, Ghanaian Australian Goldfields Ltd. (GAG) and AGC carried out the involuntary relocation of eight settlements within the area that today makes up AGA's concession at Iduapriem. The involuntary resettlements affected more than 2,000 people, who were subjected to physical and economic displacement. The process was characterized by various conflicts, such as disagreement over compensation rates for housing construction,⁷⁸ farmland and crops, differences of opinion on where the settlements should be moved to, as well as reduced access to clean water sources. The underlying reason for the conflicts was chiefly linked to compensation practices that often resulted in farmers being offered cash compensation for their agricultural land. This was in accordance with the national legislation at the time,⁷⁹ but for indigent communities primarily engaged in subsistence agriculture, and who were only able to make a living as farmers, in reality it led to the deterioration or permanent loss of their livelihood. The percentage of poor people in the local population is higher than the average for Ghana, as more than 70 per cent of the households in the concession area earn less than USD 584 a year, USD 127 below the national average.⁸⁰ The villagers accused the company of deliberately protracting the negotiations about compensation to force the most economically vulnerable to accept low compensation rates.⁸¹ A study conducted by the University of Ghana in 1999 points out that GAG and AGC were the mining companies in the Tarkwa region that had the worst relationship with the population, despite the fact that other companies in the area had carried out much larger involuntary resettlement schemes.⁸²

In connection with opencast operations in Obuasi, AGC performed a significant

number of forced economic displacements of the local population.⁸³ At Obuasi, villages like Nhyieso, Sanso, Anyinam and Dokyiwa are situated in the vicinity of mining facilities and have been deprived of considerable farmland. The involuntary resettlements from the 1970s and 1980s resulted in allegations of pending compensation for expropriated farmland,⁸⁴ whereas the resettlement processes from the 1990s were characterized by insufficient compensation for lost harvests and land, lost farming opportunities due to pollution, in addition to inadequate alternative livelihoods programmes (ALG programmes).⁸⁵ In total, 25 villages at Obuasi are affected by the involuntary resettlements.⁸⁶

A consultancy survey initiated by AGA in 2009 shows that 26 villages in Obuasi have outstanding claims related to previous and ongoing involuntary resettlements. At Iduapriem it was established that 21 villages have similar claims. The majority of the claims refer to insufficient information and consultation prior to the involuntary resettlement, loss of land and livelihoods without adequate compensation, including inadequate compensation for crops. At local and national levels in Ghana, five lawsuits are currently underway against AGA.⁸⁷

In recent years, government agencies, non-governmental organizations and independent experts⁸⁸ have established that the involuntary resettlement processes at Obuasi and Iduapriem to a great extent were carried out in contravention of the World Bank/IFC standards for involuntary resettlement that existed at the time. Today these standards state that companies should improve, or at least restore, the livelihoods of the displaced.⁸⁹ The IFC guidelines assume that lost land generally shall be compensated for with equivalent land and not cash. The guidelines also define a more detailed framework for compensation depending on how badly affected the displaced are. The Office of the United Nations High Commissioner for Human Rights (OHCHR) expresses the same principle in its guidelines for ‘development based resettlement’:⁹⁰

‘Cash compensation should under no circumstances replace real compensation in the form of land and common property resources. Where land has been taken, the evicted should be compensated with land commensurate in quality, size and value, or better.’⁹¹

A comprehensive human rights study of the mining sector in Ghana performed by the Ghanaian Commission on Human Rights and Administrative Justice (CHRAJ) in 2008 shows that, according to national regulations and the World Bank/IFC standards, AGA has paid the local population inadequate compensation in connection with the involuntary resettlements.⁹²

4.2.4 AGA’S RELATIONSHIP WITH LOCAL COMMUNITIES

In 2004, when AGA continued mining in Obuasi and Iduapriem, the company’s Community Relations Department (CR Department) was responsible for informing and consulting local communities, initiating social investment projects,⁹³ providing alternative livelihoods, conducting forced relocations and paying compensation to the affected settlements. The department’s objective was the company’s vision: ‘The communities and societies in which we operate will be better off for AngloGold Ashanti having been there’. Until 2010, the IFC standards, especially ‘Performance Standard’ 1 and 5 were the applied

norms. At that time, the department had inadequate internal systems and processes, and lacked the resources to work systematically. In fact, this led to the CR department's initiation of extensive ad hoc reparative measures to address acute socioeconomic needs.

In 2003, 173 farmers in the village of Teberebie, at Iduapriem, were promised replacement farmland in return for the expansion of a waste rock dump (as an illustration, see figure 2 below). A total of 248 fields of 849,660 m² were expropriated to allow for the expansions of the deposit site.⁹⁴ AGA compensated the farmers in the form of cash payments for lost crops, but AGA did not fulfil the requirement in the 'Resettlement Action Plan' from 2003 about compensation in new farmland.⁹⁵ The 173 farmers who have not received replacement farmland claim to have been deprived of their livelihood since they neither have the qualifications to make a living from other occupations, nor are they able to acquire new land in the area.

In 2011, AGA decided to identify individuals with outstanding claims against the company in Teberebie, and in February 2012 AGA promised to give farmland to the aggrieved parties, nine years after the forced relocation.



Image 2: Taken from the waste rock dump located next to the village of Teberebie (March 2011). The red arrows show deposit sites that now cover former agricultural land, and the blue arrows show the settlements in the village, March 2011.

Since 2005, AGA has paid more than NOK 10 million in cash compensation for seized farmland in Obuasi and Iduapriem.⁹⁶ To the Council's knowledge, AGA has not offered the population new farmland, except for the ongoing involuntary displacements from the Dokyiwa village in Obuasi and the Ajopa village in Iduapriem.

World Bank funded projects involving involuntary resettlement show that restoring the livelihoods of the displaced is among the greatest challenges of involuntary resettlement processes.⁹⁷ Since 2005, AGA has launched various ALG projects at Iduapriem, including projects run by a non-governmental organization (OICI).⁹⁸ The results of these projects have been mixed and have included vegetable cultivation, corn growing, bread and soap production, palm oil extraction, meat production and mushroom growing. In 2010, 396 persons were employed through the projects. In Obuasi, there have been ALG programmes in textile production, aquaculture and pig farming.

Until 2011, AGA did not have a comprehensive plan or separate budget for ALG programmes in Obuasi and Iduapriem. The funds allocated to such projects were being taken ad hoc from the company's total budget and not from a fund, which the company was required to establish under the concession contract signed with Ghana's authorities

in 2004.⁹⁹ In 2011, AGA has planned a series of new ALG programmes to be implemented over a three-year period.

In their assessment report, the Ghanaian Commission on Human Rights (CHRAJ) argued that AGA has offered ‘unacceptable alternatives’ for the lost livelihood of residents.¹⁰⁰

4.2.5 LOCAL PEOPLE’S OPINION OF AGA TODAY

The CHRAJ’s 2008 study of human rights in the mining industry in Ghana compared the local population’s contentment in the concession areas of different companies. The study found that people living within AGA’s mining concessions were the least satisfied.¹⁰¹ However, local people’s relationship with AGA has improved over the past two years, mainly because of increased information sharing and consultation.¹⁰² Since 2009, when AGA commissioned comprehensive studies of social conditions in the communities, the company’s CR department has changed internal guidelines and systems. Today, local communities report that they are being heard by the company, but they question AGA’s actual implementation of measures. According to a survey carried out in 2010 at Obuasi and Iduapriem, only 30 per cent of the local population was of the opinion that ‘the communities and societies in which we (AGA) operate will be better off for AngloGold Ashanti having been there’.¹⁰³ More than 40 per cent thought they would have been better off without AGA. The majority thought that AGA only to a small extent had responded to the local population’s requests.

5 Information from the company

5.1 INTERNATIONAL INITIATIVE AND COOPERATION

AngloGold Ashanti takes part in a number of voluntary initiatives and cooperation efforts for corporate responsibility in general and responsible mining in particular, both on a national and international level. These include the International Council on Mining and Metals (ICMM), the International Cyanide Management Code for the Manufacture, Transport and Use of Cyanide in the Production of Gold, the Voluntary Principles on Security and Human Rights, and the UN Global Compact. In addition, the company has *inter alia* adopted several standards that define environmental management systems, recommended maximum limits for different types of pollution and standards for involuntary resettlement.

5.2 AGA’S ENVIRONMENTAL SYSTEMS AND STANDARDS

The Council has limited information regarding environmental systems and standards before the merger of AG and AGC. Annual reports from AGC in the period 2000–2004 contain limited information about social conditions and even less about the environment. The Annual Report for 1999 states: ‘Environmental audits were undertaken at all mines and there were no significant out-of-compliance reports relating to the environment within the Group’.¹⁰⁴ Well-known problems caused by long-term mining at Obuasi, including

large-scale quarries in the 1990s, are not mentioned.

Since 2004, the company's environmental reporting has improved significantly. AGA has implemented and improved a number of environmental systems and standards. As a minimum, the company is seeking to comply with the laws, regulations and license terms in the countries where it operates.

5.2.1 AGA'S OWN STANDARDS

The company has an integrated environmental and local community policy that is brief and general.¹⁰⁵ In 2009 the company developed standards for its own operations in areas such as water, air quality and chemicals. The Council finds these standards comprehensive; they include many important issues and are fairly detailed.¹⁰⁶ The standard for water includes among other things responsibilities, regulations, surface water and groundwater, water balance models, water quality and quantity, risk assessments and monitoring programmes. When it comes to maximum limits for discharges, the standard refers to international agreements, national regulations, environmental permits for mines and other binding commitments.

The company has identified five focus areas relating to the environment: water, energy and greenhouse gas emissions, land, hazardous materials and air quality.¹⁰⁷ The company clearly acknowledges that water is one of the main issues in its mining operations.

Based on AGA's environmental plan for Obuasi, the Ghanaian Environmental Protection Agency (EPA) issued the Obuasi mine a three year Environmental Certificate in March 2011. The license includes several requirements, such as requirements for water purification and management of tailings and other waste. The company has developed plans to meet the requirements.

5.2.2 ISO 14001 STANDARD FOR ENVIRONMENTAL MANAGEMENT SYSTEMS

Like AGA's other mining operations, Obuasi has an environmental management system certified to the ISO14001 standard.¹⁰⁸ The certification is voluntary and is carried out by an independent third party. Obuasi was certified in December 2006.¹⁰⁹ The certification was extended after a review in December 2009¹¹⁰ and is valid until 2012.

5.2.3 THE CYANIDE MANAGEMENT CODE

AngloGold Ashanti was involved in developing the international cyanide management code for the gold mining industry,¹¹¹ being among the first companies to sign it in November 2005.¹¹² This voluntary code requires that an independent third party conducts an audit of the mining operations documenting that these are in compliance with the international code in order ensure that public health and the environment are protected against the damage cyanide may inflict. In 2006 AGA had planned that Obuasi would be subject to an audit by the end of 2008.¹¹³ In 2008, the date for certification was altered to 2010.¹¹⁴ Obuasi was among the operations that in 2009 withdrew temporarily from the certification process pending changes in the physical infrastructure necessary to transport, receive and handle cyanide in accordance with the code.¹¹⁵ Funds have been allocated for

this purpose, and a detailed planning process is underway. In 2011, 16 of the company's mining operations have been certified.¹¹⁶ In 2011, Obuasi was reportedly scheduled to be certified in 2012.

The gold mining operation at Obuasi is dependent on cyanide to isolate gold from other ore components. The use of cyanide at Obuasi decreased from 2006 (4,924 tons)¹¹⁷ to 2010 (3,562 tons),¹¹⁸ but increased in 2011 (3,888 tons) despite a 24 per cent reduction in processed ore volume.¹¹⁹

5.3 AGA'S SYSTEMS AND STANDARDS REGARDING SOCIAL CONDITIONS

The Council has limited information about guidelines and systems concerning the handling of local communities before 2004. According to AGA's annual reports from 2004 onwards, the company's standards for involuntary resettlement are based on IFC standards.¹²⁰ Furthermore, the company states that involuntary displacement issues are the biggest challenge for its CR department. In 2007, when AGA joined the 'Voluntary Principles on Security and Human Rights', it also initiated an internal human rights policy. Following consultancy studies that mapped the social conditions around the mines in 2009 and 2010, the company developed further guidelines on social conditions, processes and reporting systems, including 'Stakeholder Engagement Action Plans and Integrated Development Action Plans'. In 2011, new communication lines were established between different departments handling aspects pertaining to local people. AGA is also recruiting new personnel to its CR department.¹²¹

5.3.1 AGA'S OWN STANDARDS

In addition to its integrated and short environmental and local community policy from 2009, the company adopted supplementary standards for working with communities (AGA Management Standards) in 2010. These standards are guiding the work of the CR department and will be implemented in the course of 2012 and 2013.¹²² The standards provide detailed information on communication with various parties in the local community, socio-economic development, land use, involuntary resettlement, and handling of complaints. AGA's aim is to respond to all complaints within 48 hours, and all complaints are to be recorded.¹²³

AGA's policy is to adhere to the IFC standards. In this context, Performance Standard (PS) 1 'Assessment and Management of Environmental and Social Risks and Impacts' and PS 5 'Land Acquisition and Involuntary Resettlement' are particularly relevant. PS 1 provides general requirements for corporate operations concerning social and environmental issues (see Text box 1), whereas PS 5 describes minimum requirements that companies must fulfil in cases of involuntary resettlement (see Text box 2).

Text box 1 Performance Standard 1, Objectives:²⁴

- To identify and evaluate environmental and social risks and impacts of the project.
- To adopt a mitigation hierarchy to anticipate and avoid, or where avoidance is not possible, minimize, and, where residual impacts remain, compensate/offset for risks and impacts to workers, Affected Communities, and the environment.
- To promote improved environmental and social performance of clients through the effective use of management systems.
- To ensure that grievances from Affected Communities and external communications from other stakeholders are responded to and managed appropriately.
- To promote and provide means for adequate engagement with Affected Communities throughout the project cycle on issues that could potentially affect them and to ensure that relevant environmental and social information is disclosed and disseminated.

Text box 2 Performance Standard 5, Objectives:²⁵

- To avoid, and when avoidance is not possible, minimize displacement by exploring alternative project designs.
- To avoid forced eviction.
- To anticipate and avoid, or where avoidance is not possible, minimize adverse social and economic impacts from land acquisition or restrictions on land use by (i) providing compensation for loss of assets at replacement cost and (ii) ensuring that resettlement activities are implemented with appropriate disclosure of information, consultation, and the informed participation of those affected.
- To improve, or restore, the livelihoods and standards of living of displaced persons.
- To improve living conditions among physically displaced persons through the provision of adequate housing with security of tenure at resettlement sites.

5.4 THE COUNCIL'S CONTACT WITH AGA

The Council on Ethics has had extensive contact with AGA in 2010, 2011 and 2012. The company emphasizes the historical and institutional context in which its mines in Ghana operate, its corporate strategies for handling the repercussions of the mines, its progress in various areas since 2004, and the measures the company has committed itself to implementing.

With regard to the environment, AngloGold Ashanti acknowledges that there is extensive contamination by, *inter alia*, arsenic at Obuasi. The company claims that the contamination primarily is a result of naturally high levels of arsenic in bedrock and soil, combined with more than 100 years of mining activities without adequate attention to the environment, chiefly before 2004. AGA stresses that the company has invested more than USD 800 million in its Ghanaian operations in order to change old infrastructure, upgrade mining methods and remedy both social and environmental problems in accordance with corporate values. This has included significant changes in operational strategies aimed at

increasing productivity and results and at addressing environmental and social problems.

The company points out that it will invest in further measures to deal with existing pollution and to reduce and eliminate pollution from future mining (including the construction of a new tailings disposal unit and the installation of new treatment plants). The company is also working on the introduction of additional standards, both their own and international ones. The company is hiring more people at the local, national and international level to handle the challenges in an integrated fashion. Among the measures implemented by the company are for example the handling of 10,000 tons of arsenic (As_2O_3 , arsenic trioxide), the closure of the Pompora ore-roasting plant, and tailings retreatment at various deposit sites. The company has also installed treatment plants to remove cyanide and other types of contamination from the process water, and has thus increased the recycling of water in the processing. Clean water from the surrounding areas near the Pompora tailings storage facility has been cut off and led away to prevent this water from entering the storage facility and be contaminated before flowing into the water system downstream.

In its replies to the Council, AGA has acknowledged that the company's operations may have led to loss of farmland, and that the compensation has been based on inadequate compensation rates and/or has been paid too late. The company points out that many of the issues date far back in time and that AGA today has increased its consultations with the local population. Compensation will be paid to households with outstanding claims against the company,¹²⁶ and compensation is being offered in the form of farmland. ALG programmes are also being implemented, and wells are being built to provide clean water. The company has paid compensation for some types of damage, for instance loss of crops, flooding, and silt deposition in local rivers. Based on the consultancy studies commissioned by AGA in 2009 and 2010, the company is planning social measures that will be implemented at Obuasi and Iduapriem over the next three years. The company has allocated more resources to improve the situation in the local community and is planning to pay USD 4.8 million by the end of 2013 to individuals with outstanding claims relating to involuntary resettlement. The sums will be paid through the state-run Land Valuation Board.¹²⁷ In 2011 AGA initiated a dialogue with important local organizations in an attempt to solve the deep social conflicts in the local community, and in 2012 AGA will initiate studies, in cooperation with consultants and the Ghanaian Ministry of Health, aimed at mapping environmental and health risks at Obuasi and Iduapriem. The company has announced that in the future it may be necessary to carry out further involuntary resettlement owing to the safety of the population and/or health risks.

The company admits that the process of bringing the operations up to the desired level is slow, and slower than it had planned, but stresses that it is a goal-oriented process, to which the company is committed and in which it is investing. The company's goal is to be among the best in the world as far as environmental and social sustainability is concerned. AngloGold Ashanti will draw on experiences from other major company turnarounds and spend considerable resources on turning around the operations at Obuasi and Iduapriem, making them economically, environmentally and socially sustainable. For the next three years, the company is planning extensive studies of the environmental and

health conditions in order to identify problems and define further actions. These studies will be carried out by independent experts, be based on scientific methods and involve affected interests. When serious problems requiring an immediate response are identified, the company will take continuous measures before the studies have been concluded. The company says it is willing to make the necessary resources available, and considers that the risk of future environmental damage and human rights violations is smaller than what the Council on Ethics believes.

6 The Council on Ethics' assessment

In accordance with section 2 of the Ethical Guidelines, the Council on Ethics has assessed whether AGA is responsible for severe environmental damage and/or contributes to serious or systematic human rights violations through its mining operation in Ghana.

6.1 SEVERE ENVIRONMENTAL DAMAGE

The Council on Ethics sees the environmental damage from the Obuasi mine as very serious and believes that the damage has long-term consequences for both the ecosystems and people's health and livelihoods. The arsenic concentrations measured at Obuasi are very high by international standards and far exceed Ghanaian regulations and international guidelines. A number of surveys consistently show very high readings, often more than a hundred times the maximum values.

The increased risk of a number of serious adverse effects is well documented internationally for arsenic values that are much lower than the levels measured at Obuasi (e.g. different types of cancer, damage to the nervous system, skin afflictions). Several surveys also show severe water pollution from heavy metals and cyanide, far above national and international maximum values. The adverse health effects caused by pollution have so far been little studied at Obuasi, but the Council on Ethics takes as its point of departure that international studies show such pollution to have harmful effects, especially on vulnerable groups such as children.

A naturally high level of arsenic in the bedrock is a contributing factor to the current widespread contamination. Still, areas that are not affected by the company's activities or facilities, and that can be said to represent approximate natural levels of background pollution, have much lower contamination levels. There is a big difference between the naturally high background concentrations of arsenic and the exceedingly high arsenic concentrations caused by the mining operations, facilities and areas for which AGA is responsible. It is particularly unfortunate that the severe pollution of water, soil, fish and crops occurs in areas with high population concentrations.

Overall, the pollution levels that existed when the merged company continued the operations in 2004 have changed little despite the measures taken by the company so far, and which have had local effect in smaller areas. This does not mean that the steps taken have been in vain, but that Obuasi is exceptionally problematic and that the effects of the initiatives only become sizeable when even more measures are carried out over a long

period of time. The Council finds that the company repeatedly has underestimated and misjudged the scope and complexity of the problems and what is necessary to address these. The company is open about the problematically high levels of pollution, recognizing that the complexity of the operation is greater than expected, both technically and environmentally, and that the company has not come as far as it wished in addressing the environmental problems. The company is planning further studies and measures in the coming years. Taking effective steps to dramatically reduce the pollution is challenging in a situation where there is both old and new pollution at many facilities and locations, as well as technological solutions and facilities that are not adapted to current environmental standards. The Council on Ethics considers it very likely that the extremely severe pollution will continue for a considerable number of years due to the large scope and complexity of the problems.

Moreover, the extent of the problems has not been sufficiently identified. Further studies over the next three years will most likely uncover new issues that the Council has not yet assessed, for instance severe pollution at other tailings storage facilities that are currently not in use. The Council finds it probable that following these studies further studies and measures will be necessary for several years. The severe pollution is expected to continue in this period. The Council believes that it is reasonable to expect the company to reduce the pollution towards the natural background level for the region.

6.2 SERIOUS OR SYSTEMATIC HUMAN RIGHTS VIOLATIONS

In this case, the environmental damage also represents human rights problems. The Council on Ethics finds that AGA and its predecessor AGC have acted in a way that implies contribution to serious and systematic violations of internationally recognized human rights, making particular reference to the UN Covenant on Economic, Social and Cultural Rights, Article 12, on the 'right to health'. The mining operation affects people in the vicinity through both pollution and forced relocation, which lead to the deterioration or loss of both livelihood and health.

Inside AGA's concession at Obuasi and Iduapriem there are 130 and 14 villages respectively. More than half of the population lives by subsistence farming. Both those who have ceded land to AGA at Obuasi and Iduapriem and those who are affected by the company's operations through pollution have had their livelihoods deteriorated. The severe pollution has reduced the population's access to clean water, fish and agricultural produce. The health situation is adversely affected. Today, clean food and clean water must to a great extent be bought, something that is challenging to a population of limited means. It will take a long time to reduce the pollution so that the natural resources can be explored safely by the inhabitants of all affected areas.

In the last 20 years, ever larger areas of farmland have been taken over by the mines. Farmers who cultivated these areas have generally received compensation that does not meet the standards of the World Bank/IFC. The Council attaches importance to the fact that through this compensation practice thousands of people have lost or had their livelihoods severely deteriorated. This is particularly serious because it has affected a population already subject to poverty, especially at Iduapriem. In the Council's view, the

company has created a most uncertain future for a population who was very vulnerable from the outset.

At the time of the continuation of the mining operation in 2004, the company lacked an overview of how its activities affected the population in terms of health and otherwise. The company implemented ad hoc measures that addressed certain acute socio-economic needs, but did not follow a strategic plan based on surveys and consultations with the population. The Council takes as its point of departure that this is the reason why the conditions for the population have not improved despite various initiatives such as alternative livelihood programmes.

In the past two years, the company has allocated more resources to improve the conditions and carried out mapping studies as a basis for implementing further measures. The Council regards these as appropriate initiatives both to get a better overview of the situation and to reduce the risk that the company's operations will cause similar problems in the future.

The Council sees it as positive that the company now seems to comply with IFC standards in connection with involuntary resettlement. To the Council on Ethics, it seems as if AGA places greater emphasis on following procedures that safeguard human rights now than before. AGA also has concrete plans for correcting previous inadequate compensation, and if this is carried out according to the plan, outstanding compensation claims will be settled by the end of 2013. Thus, in the view of the Council on Ethics, the greatest future risk now in the area of human rights seems primarily to be linked to the extensive pollution problems. These problems are both widespread and complex, and a number of new environmental and health studies have not been conducted yet. It is also expected that new health issues will be uncovered in future studies. The Council therefore finds it likely that it will take a considerable amount of time before the affected population has its livelihood restored.

7 Recommendation

The Council recommends the exclusion of AngloGold Ashanti Ltd. from the investment universe of the Government Pension Fund Global due to an unacceptable risk that the company's operations may cause severe environmental damage and contribute to serious or systematic human rights violations.

Ola Mestad
Chair
(Sign.)

Dag Olav Hessen
(Sign.)

Ylva Lindberg
(Sign.)

Gro Nystuen
(Sign.)

Bente Rathe
(Sign.)

Notes

- 1 Section 2, third subsection, of the Guidelines for the Observation and Exclusion of Companies from the Government Pension Fund Global's Investment Universe (www.etikkradet.no).
- 2 Company Issuer Id: 107614.
- 3 http://www.regjeringen.no/en/sub/styret-rad-utvalg/ethics_council/ethical-guidelines.html?id=425277
- 4 AGA has been criticized by local and international NGOs, e.g. through several reports by the Wassa Association of Communities Affected by Mining (WACAM) on environmental issues and human rights. Other reports and materials include ActionAid 2006. Gold Rush – The impact of gold mining on the poor people in Obuasi in Ghana. ActionAid Johannesburg: Amnesty International Ghana (Please refer to example <http://www.amnestyghana.org/>) or FIAN International <http://www.fian.org/news/press-releases/ghana/?searchterm=anglogold>.
- 5 It cannot be ruled out that also these 'reference areas' further upstream are affected by previous mining activities, for instance large emissions of arsenic to air from the plant at Pompora, which was closed down in 2000 and extended across large areas around Obuasi (see for example Amase, S.K. 1975. Arsenic pollution at Obuasi Goldmine, town and surrounding countryside. *Environmental Health Perspectives* 12, p. 131–135).
- 6 'Involuntary resettlement' in this recommendation refers to both physical and economic displacement. The International Finance Corporation (IFC) defines economic displacement as 'loss of assets or access to assets that leads to loss of income sources or other means of livelihood' and physical displacement as 'Relocation or loss of shelter.' (IFC Performance Standard 5 Land Acquisition and Involuntary Resettlement, p. 1).
- 7 The UN's Guiding Principles on Business and Human Rights (<http://www.business-humanrights.org/SpecialRepPortal/Home/Protect-Respect-Remedy-Framework/GuidingPrinciples>).
- 8 UN Global Compact: http://www.unglobalcompact.org/Issues/human_rights/Tools_and_Guidance_Materials.html.
- 9 <http://www.iso.org/iso/home/standards/management-standards/iso26000.htm>.
- 10 The Council on Ethics' recommendations regarding Wal-Mart, of 15 November 2005, and Monsanto, of 20 November 2006 (www.etikkradet.no).
- 11 See section 3.2 in the Council on Ethics' recommendation on Wal-Mart of 15 November 2005 and section 5.1 in its recommendation on Monsanto of 20 November 2006. (www.etikkradet.no).
- 12 UN Covenant on Economic, Social and Cultural Rights of 16 December 1966.
- 13 The IFC's Performance Standards (<http://www.ifc.org/ifcext/sustainability.nsf/Content/PerformanceStandards>; <http://www.ifc.org/performancestandards>) and the UN's High Commissioner for Human Rights. Basic principles and guidelines on development-based evictions and displacement. A/HRC/4/18(UN).
- 14 Mark Curtis. The Impact of Mining on Poor People in and around Obuasi, Ghana, 29 June 2005.
- 15 AGA. Annual Financial Statements 2011, p. P324.
- 16 AGA. Annual Financial Statements 2011, p. P323
- 17 AngloGold Ashanti Annual Financial Statements 2011, p. P4. 4.33 million ounces correspond roughly to 134.7 tons of gold (1 (troy) ounce = 31.1035 grams).
- 18 <http://www.barrick.com/Company/Profile/default.aspx>, <http://www.newmont.com/about/company-glance>, <http://www.anglogoldashanti.co.za/About+our+business/Corporate+Profile.htm>
- 19 AGA. Annual Financial Statements 2011, p. P6.
- 20 Hilson, G. 2002. Harvesting mineral riches: 1000 years of gold mining in Ghana. *Resources Policy* 28, p. 13–26.
- 21 'Carbon-in-leach' is a method for extracting gold and silver from crushed and finely ground ore, constituting one step in a longer process. The valuable metal is adsorbed onto the carbon, typically in a large tank of finely ground ore mixed with liquid, which is stirred. The gold is isolated during a later stage in the process.
- 22 'Heap leaching' is a method for extracting metals from ore. Crushed ore is placed in a large heap, which is irrigated with a liquid that often contains cyanide if the purpose is to extract gold from the ore. The liquid is collected after having percolated through the heap of ore, as it contains gold that is dissolved from the ore. The liquid is further processed in order to isolate the gold.
- 23 In addition to extensive infrastructure in the form of underground mines, Obuasi also had 40 old open pit mines, more than 25 old waste rock disposal sites, in excess of 10 tailings depositions, multiple dams and storage facilities for ore that may be processed later. Most of these facilities are not in use and several are in different stages of rehabilitation.
- 24 Based on numbers from AGAs annual reports for this period.
- 25 Mineral resource: economically interesting material of a kind, quantity and quality, which makes it probable that it may be extracted profitably (based on specific geological documentation).
- 26 As of 31 December 2010, 29.52 million oz. (AngloGold Ashanti Mineral Resource and Ore Reserve Report 2010, p. P85).
- 27 Ore reserve: the economically viable part of a mineral resource in light of technological, economic, market, environmental, social and legal conditions (based on detailed and comprehensive studies).

- 28 As of 31 December 2010, 8.92 million oz. (AngloGold Ashanti Mineral Resource and Ore Reserve Report 2010, p. P88).
- 29 Figures as of 31 December 2010 (AngloGold Ashanti Mineral Resource and Ore Reserve Report 2010, p. P4–P5).
- 30 AngloGold Ashanti. Form 20-F 2010, p. 77.
- 31 AngloGold Ashanti. Form 20-F 2010, p. 76.
- 32 Flotation is a method for separating components that have different properties, in this case to separate ore particles with gold from uninteresting parts of the rocks. This process generates a concentrate that contains gold.
- 33 BIOX[®] is a method for treating the concentrate of the sulphide ore through biological oxidation with three types of bacteria (*Thiobacillus ferrooxidans*, *Thiobacillus thiooxidans*, *Leptospirillum ferrooxidans*). The bacteria break down the sulphide minerals that have bound the gold, thereby making the gold more easily accessible for further processing and increasing the efficiency of gold extraction.
- 36 Actiflo is a patented sedimentation process that reduces the content of arsenic, heavy metals and other chemical compounds in the process water, preventing the accumulation of these substances. In this way the water may be recycled during the processing.
- 37 Rotating biological contactors (RBCs), also called biosdiscs, is a biological treatment process used to reduce or eliminate various kinds of pollution from effluent or process water. These often consist of microorganisms growing on a rotating contactor partially immersed in polluted water where they break down the pollutants. At Obuasi the focus is on cyanide.
- 38 AGA's reply to the Council, March 2011.
- 39 The Council on Ethics' notes from the field trip in March 2011.
- 40 AngloGold Ashanti. Report to Society 2008, p. 166.
- 41 The number for Obuasi is reported as 3 in two reports (AGA. Report to Society 2004, p. E10–E12, and AGA. Form 20-F 2004, p. 103), and as 1 in AGA. Country Report Ghana Obuasi 2004, p. 8. Total number for AGA (16) is found in e.g. AGA. Report to Society 2004, p. E10–E12.
- 42 Number for Obuasi (3) is from AGA. Country Report Ghana Obuasi 2005, p. 8, and AGA. Report to Society 2005, p. EN8. Total number for AGA (25) is from AGA. Report to Society 2008, p. 166. Please note that AGA's Report to Society 2005, p. EN7, states the total number for AGA as 24.
- 43 Number for Obuasi (3) is from AGA. Country Report Ghana Obuasi 2006, p. 19. Total number for AGA (25) is from AGA. Report to Society 2008, p. 166.
- 44 Number for Obuasi (9) is from AGA. Report to Society 2007, pp. 165–168. Please note that AGA's Country Report Ghana Obuasi 2007, p. 23, states 8 environment incidents. Total number for AGA (33) is from AGA. Report to Society 2008, p. 166. Please note that AGA's Sustainability Review 2009, p. P33, and AGA's Sustainability Report 2011, p. P48, state 48 and 49 incidents respectively for 2007.
- 45 Number for Obuasi (8) is from AGA. Obuasi Country Report 2008, p. 38. Total number for AGA (55) is from AGA. Report to Society 2008, p. 166, and AGA. Sustainability Report 2010, p. P3. The number 104 is stated in AGA. Report to Society 2008, p. 166. Approx. 88 environmental incidents are referred to in the document AGA Environmental Incidents for the year ending 31 December 2008. Please note that AGA's Sustainability Review 2009, p. P33, states 160 and 55 environmental incidents for 2008, based respectively on old and new methods for registration of severe incidents.
- 46 The number for Obuasi (10) is from AGA's Reportable environmental incidents during 2009 and AGA's Sustainability Report: Supplementary information 2010, p. P72. The total number for AGA (51) is from AGA's Sustainability Report: Supplementary information 2010, p. P72, adjusting the 2009 numbers up from 50 incidents as reported in 2009. Please note that AGA's Sustainability Review 2009, p. P33, refers to 195 and 50 incidents for 2009, based respectively on old and new methods for registration of severe incidents.
- 47 AGA. Sustainability Report: Supplementary information 2010, p. P72.
- 48 AGA. Sustainability Report: Supplementary information 2011 (<http://www.aga-reports.com/11/sustainability-report/supplementary-information/environment/compliance>).
- 49 Smedley, P.L. & Kinniburgh, D.G. 2002. A review of the source, behaviour and distribution of arsenic in natural waters. *Applied Geochemistry* 17, p. 517–568.
- 50 Nordstrom, D.K. 2002. Worldwide occurrences of arsenic in ground water. *Science* 296, p. 2143–2145. Smedley & Kinniburgh 2002.
- 51 A lethal dose of arsenic is in the order of 1–3 mg/kg body weight or about 100–300 mg for an adult (Olsen, V. & Mørland, J. 2004. Forgiftning med arsen. *Tidsskrift for Den Norske Lægeforening* nr. 21 (124), p. 2750–3. The US Agency for Toxic Substances and Disease Registry (ATSDR) says that more than 60 mg/l in drinking water may be lethal (ATSDR 2007. *Toxicological profile for arsenic*, p.7).
- 52 International Agency for Research on Cancer (IARC), undated. Arsenic in drinking water. *IARC Monographs volume 84*. ATSDR 2007. *Toxicological profile for arsenic*. World Health Organisation (WHO) 2008. *Guidelines for drinking-water quality. Second addendum to third edition. Volume 1 Recommendations*. WHO, Geneva.
- 53 Arsenopyrite contains elements such as iron, arsenic and sulphur (FeAsS).

- 54 Ahmad & Carboo (2000) found an average of 8.305 mg/kg arsenic in the tailings. (Ahmad, K. & Carboo, D. 2000. Speciation of As (III) and As (V) in some Ghanaian gold tailings by a simple distillation method. *Water, Air and Soil Pollution* 122, p. 317-326.
- 55 Amase, S.K. 1975. Arsenic pollution at Obuasi Goldmine, town, and surrounding countryside. *Environmental Health Perspectives* 12, p. 131-135; Amonoo-Neizer, E.H., Nyamah, D. & Bakiamoh, S.B. 1996. Mercury and arsenic pollution in soil and biological samples around the mining town of Obuasi, Ghana. *Water, Air, and Soil Pollution* 91, p. 363-373; Smedley, P.L. 1996. Arsenic in rural groundwater in Ghana. *Journal of African Earth Sciences* 22(4), p. 459-470; Smedley & Kinniburgh 2002.
- 56 Amase 1975.
- 57 See for example 'Enforcement notice' from Ghana Environmental Protection Agency (EPA) September 2007.
- 58 AngloGold Ashanti Obuasi Country Report 2008, p. 37.
- 59 AngloGold Ashanti Report to Society 2007, p. 169-170.
- 60 AngloGold Ashanti Sustainability Report: Supplementary information 2011 (<http://www.aga-reports.com/11/sustainability-report/supplementary-information/mine-lifecycle>).
- 61 The gold extraction at the STP occurs over several stages and is based on methods such as biological oxidation (BIOX) and the use of cyanide at a later stage in the processing. Recycling of polluted process water with cyanide will be detrimental to the highly cyanide-sensitive bacteria that oxidize sulphide (BIOX). Since the STP for a long time lacked a treatment plant for cyanide that could have made considerable recycling of water possible, the facility required continuous supply of new water without cyanide. A significant excess of polluted process water was therefore produced resulting in contaminated discharge. Water treatment has gradually been introduced during recent years, something that has reduced but not eliminated the pollution.
- 62 Smedley 1996.
- 63 Ghana's maximum level for dissolved arsenic in wastewater is 0.1 mg/l, while the maximum level for total arsenic is 1 mg/l. The International Finance Corporation (IFC) operates with a maximum level of 0.1 mg/l for total arsenic and has not stated maximum values for dissolved arsenic.
- 64 See for instance Obiri, S. 2009. *Determination of heavy metals in water bodies in the Tarkwa and Obuasi mining areas*. The Wassa Association of Communities Affected by Mining (WACAM), Tarkwa.
- 65 See for instance Obiri 2009.
- 66 <http://www.epaghanaakoben.org/rating/listmines2>.
- 67 The measurements have included three types of cyanide: free cyanide, WAD cyanide and total cyanide. The Council on Ethics has focused on free cyanide since this is the most harmful form of cyanide in water.
- 68 See for example Obiri 2009; Obiri, S., Doodoo, D.K., Armah, F.A., Essumang, D.K. & Cobbina, S.J. 2010. Evaluation of lead and mercury neurotoxic health risk by resident children in the Obuasi municipality, Ghana. *Environmental Toxicology and Pharmacology* 29, p. 209-212; Akabzaa, T.M., Banoeng-Yakubo, B.K. & Seyire, J.S. Not dated. *Impact of Mining Activities on Water Resources in the Vicinity of the Obuasi mine*; Tay & Momade, not dated. *Trace Metal Contamination in Water from Abandoned Mining and Non-Mining areas in the Northern Parts of the Ashanti Gold Belt, Ghana*.
- 69 See for example Amonoo-Neizer, E.H. & Amekor, E.M.K. 1993. Determination of Total Arsenic in Environmental Samples from Kumasi and Obuasi, Ghana. *Environmental Health Perspectives* 101(1), p. 46-49; Kumi-Boateng, B. 2007. *Assessing the spatial distribution of arsenic concentration from goldmine for environmental management at Obuasi, Ghana*. M.Sc. thesis, International Institute for Geo-information Science and Earth Observation, Enschede.
- 70 See for example Antwi-Agyei, P., Hogarh, J.N. & Foli, G. 2009. Trace elements contamination of soils around gold mine tailings dams at Obuasi, Ghana. *African Journal of Environmental Science and Technology* 3(11), p. 353-359.
- 71 UN Committee on Economic, Cultural and Social Rights, General Comments No. 15 (<http://www.righttowater.info/progress-so-far/general-comments-2/>).
- 72 AGA's reply to the Council, January 2012.
- 73 Office of the United Nations High Commissioner for Human Rights (OHCHR) and WHO *The Right to Health* fact sheet no. 31, p. 30 (<http://www.ohchr.org/Documents/Publications/Factsheet31.pdf>); Norad *Retten til helse* (<http://www.norad.no/no/tema/menneskerettigheter/retten-til-helse>).
- 74 International Monetary Fund. 'Ghana—Enhanced Structural Adjustment Facility Economic and Financial Policy Framework Paper, 1998–2000'; <http://www.imf.org/external/np/pfp/ghana/ghana0.htm>.
- 75 This regulation was replaced by the *Minerals and Mining Act* in 2006.
- 76 Thomas M. Akabzaa, 2000. 'Boom and dislocation, the environmental and social impacts of mining in the Wassa West District of Ghana', p. 74.
- 77 See footnote 6 for the definition of physical and economic involuntary displacement.
- 78 In the 1990s, it was common practice to use the value-for-value principle when companies erected new housing for the dislocated persons. Since the new constructions were of a considerably better quality than the original dwellings, the number of rooms per house was significantly reduced, so that the value of the old and the new house

- corresponded. This led to a number of challenges for large families, who ended up lacking space and did not have permission to add more rooms.
- 79 The Ghanaian Minerals and Mining Act requires companies to compensate landowners and residents ('occupiers') for activities causing damage on land, buildings, livestock, crops or trees. If the owner/resident is deprived of other rights of use, these should also be compensated. The law further states that the amount of compensation shall be determined by the parties concerned, i.e. the company and the villagers.
- 80 AGA's reply to the Council in March 2011.
- 81 Akabzaa, T.M. 2000. *Boom and dislocation, the environmental and social impacts of mining in the Wassa West District of Ghana*. p. 84. The Council's interviews with the local population of Teberebie in March 2011.
- 82 Akabzaa, T.M. 2000, p. 92.
- 83 In addition, two involuntary resettlements have been carried out (AGA's reply to the Council in January 2012).
- 84 In this recommendation, compensation is to be understood as payment in cash or kind (land) for values or resources acquired or affected by a project at the time the value is to be compensated.
- 85 AGA's reply to the Council in March 2011 and interviews in Obuasi in March 2011 during the Council's field visit.
- 86 AGA's reply to the Council in January 2012.
- 87 AGA's reply to the Council in March 2011.
- 88 Commission on Human Rights and Administrative Justice (CHRAJ) 2008. *The State of Human Rights in Mining Communities in Ghana*. Reports from WACAM and AGA's reply to the Council in March 2011.
- 89 The IFC's *Performance Standard* 1 and 5.
- 90 United Nations Office of the High Commissioner for Human Rights (OHCHR). *Development based resettlements* (<http://www.ohchr.org/EN/Issues/Housing/Pages/ForcedEvictions.aspx>).
- 91 Basic principles and guidelines on development based evictions and displacement. A/HRC/4/18(UN) Chapter 6 (A): Compensation (http://www2.ohchr.org/english/issues/housing/docs/guidelines_en.pdf).
- 92 CHRAJ 2008. *The State of Human Rights in the Mining Communities in Ghana*, p. 18.
- 93 Education projects, leisure projects, infrastructure, etc.
- 94 The company's reply to the Council, December 2010.
- 95 The company's reply to the Council, December 2010.
- 96 The company's reply to the Council in December 2010
- 97 World Bank 2004. *Involuntary resettlement sourcebook. Planning and implementation in development projects*. World Bank, Washington, D.C.
- 98 Opportunities Industrialization Centres International (<http://www.oici.org/>).
- 99 AGA's reply to the Council in December 2010.
- 100 CHRAJ, 2008.
- 101 CHRAJ, 2008.
- 102 Talks between the Secretariat and the local population, March 2011.
- 103 The survey was based on individual and group interviews in selected villages at Obuasi and Iduapriem in 2009 (AGA's reply to the Council in March 2011).
- 104 AGC. *Annual Report 1999*, p. 14. A similar formulation may be found in AGC. *Annual Report 2000*, p. 14.
- 105 'Integrated environment and community policy', June 2009 (<http://www.anglogold.com/NR/rdonlyres/B9E007AA-848C-46B8-A904-815E82207D68/0/EnvironmentalandCommunityPolicy.pdf>).
- 106 'Community and Environment Management Standards' June/ July 2009 (<http://www.anglogold.com/NR/rdonlyres/81011574-92AB-47EA-99B9-2F6CAF7CF010/0/CommunityandEnvironmentManagementStandards.pdf>).
- 107 AngloGold Ashanti Sustainability Report 2010, p. 46.
- 108 AngloGold Ashanti Report to Society 2007, p. 159.
- 109 AngloGold Ashanti Report to Society 2006, p.144.
- 110 AngloGold Ashanti Annual Financial Statements 2009, p.77.
- 111 'International Cyanide Management Code For The Manufacture, Transport and Use of Cyanide In the Production of Gold' (<http://www.cyanidecode.org/>).
- 112 AngloGold Ashanti Report to Society 2006, p. 86.
- 113 AngloGold Ashanti Report to Society 2006, p. 92.
- 114 AngloGold Ashanti Obuasi Country Report 2008, p. P40. AngloGold Ashanti Report to Society 2008, p. P172.
- 115 AngloGold Ashanti Sustainability Review 2009, p. 41.
- 116 AngloGold Ashanti Sustainability Report 2011, p. 7.
- 117 AGA. *Report to Society 2007*, p. 173.
- 118 AGA. *Sustainability Report Supplement 2010*, p. 75.
- 119 AGA. *Sustainability Report 2011. Supplementary information* (<http://www.aga-reports.com/11/sustainability-report/supplementary-information/environment/materials-waste>).
- 120 IFC Performance Standard 1 and 5.

- 121 AGA's reply to the Council in January 2012.
- 122 AGA's reply to the Council in January 2012.
- 124 IFC Performance Standard 1, from IFC's revised standards, effective from 1 January 2012. The substance of the standards before and after *revision is the same*.
- 125 IFC Performance Standard 5, 1 January 2012.
- 126 AGA's reply to the Council in December 2010.
- 127 As of January 2012, 42 per cent of the outstanding claims at Obuasi and 66 per cent of the claims at Iduapriem had been settled (AGA's reply to the Council in January 2012).
- 128 The local population of Obuasi has previously accused the Land Valuation Board of taking bribes to pay compensation (AGA's reply to the Council in January 2012).

To the Ministry of Finance

3 December 2012

UNOFFICIAL ENGLISH TRANSLATION

Recommendation to exclude Ta Ann Holdings Berhad from the investment universe of the Government Pension Fund Global

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1 Summary

The Council on Ethics for the Norwegian Government Pension Fund Global (GPF) recommends the exclusion of the Malaysian company Ta Ann Holdings Berhad (Ta Ann) from its investment universe due to an unacceptable risk of the company being responsible for severe environmental damage.

Ta Ann is a logging and plantation conglomerate that is involved in the logging and conversion of tropical forest into oil palm and timber plantations. Its principal operations are located in Sarawak in Borneo, Malaysia. Ta Ann also runs plantations and sawmills in Tasmania, Australia.

The Council has assessed the environmental impact of the logging and clearing of forests in Ta Ann's licence areas in Sarawak. In its assessment, the Council has emphasised the scale of the damage and to what extent it has long-term and irreversible impacts, whether the damage is a result of violations of national laws or international norms, and what the company has done to mitigate impacts. The Council has focused particularly on the extent to which the company's licence areas overlap with areas containing important ecological values, and what consequences the conversion of forest will have for endangered species and their habitats.

The Council has communicated with Ta Ann on several occasions since 2010, and the company has provided documents pertinent to the licence areas. Nevertheless, the recommendation is based on limited information, as the company has not provided details of important aspects of its operations.

Ta Ann's timber licence areas cover 360,000 hectares, of which more than 300,000 hectares overlap with plantation licenses. At least one-third of this area, and probably more, will be cleared and converted to acacia plantations and oil palm plantations. A third of Ta Ann's licence areas are situated within the Heart of Borneo, and all of the licences overlap with the Sundaland Biodiversity Hotspot, which is considered to be one of the most biodiverse regions on earth. Ta Ann's own environmental impact assessments show that the forest contains important ecological values and is home to a number of protected species, including many on the red list of threatened species maintained by the International Union for Conservation of Nature. These species are declining quickly because their habitats are disappearing due to logging and the conversion of forests into plantations. In the Council's view, there can be no doubt that the destruction of more than 100,000 hectares of tropical rainforest in one of the world's most biodiverse regions will have serious, irreversible consequences for biodiversity and the ecosystem services delivered by the forest. The Council considers it likely that the remaining forest will also be strongly affected due to edge effects and the increased fragmentation of forests and habitats.

Ta Ann has pointed out that the company is implementing a number of measures to reduce environmental damage. For example, the company has stated that better planting methods mean the removal of less forest. The company has also emphasised that buffer zones along waterways are being set aside as wildlife corridors, that logging is avoided in steep terrain, and that biologically important areas are being protected. The Council considers it positive that Ta Ann is taking such steps, which indicate that the company is

seeking to steer its operation in a more environmentally friendly direction.

The Council is nevertheless of the opinion that these measures appear insufficient to protect the habitats of endangered species and ecosystems. Even though patches of forest, buffer zones along waterways and wildlife corridors are important for biodiversity and ecological functions locally in these areas, the Council does not regard it as proven that the areas that are being set aside will in fact function as sustainable habitats for endangered or wide-ranging species, or that they will help to maintain the rich biodiversity that has been documented in the licence areas. The Council has also given weight to the documented risk that orangutans and other endangered species may have their habitats in Ta Ann's licence areas. Two of the company's licence areas border on the Lanjak Entimau Wildlife Sanctuary. In the Council's opinion, this proximity to the sanctuary demands that a precautionary approach be taken. The surveys conducted by Ta Ann appear to lack the systematic approach needed to confirm that Ta Ann's operations will not destroy valuable habitats. The Council takes the view that this increases the risk of severe environmental damage.

The Council considers it positive that Ta Ann conducts surveys of conservation values in forest areas before logging. The Council has only had access to one such report, relating to two coupes. The report does not make it clear how the conservation values were identified, or how they are evaluated in a larger landscape context. Based on the information Ta Ann has provided to the Council, the Council finds it unlikely that the assessments undertaken by Ta Ann ensure the protection of important conservation values.

Given that the conversion of tropical forests involves the complete, irreversible alteration of affected ecosystems, that the scale of deforestation is large, and that these operations are being pursued in areas with a particularly rich biodiversity as regards species, habitats and ecosystems, the Council has concluded that the measures implemented by Ta Ann to reduce the adverse effects are insufficient to secure a material reduction in the risk of severe environmental damage now and in the future. The Council therefore recommends the exclusion of Ta Ann Holdings Berhad from the investment universe of the GPFG.

2 Introduction

At its meeting in April 2010, the Council on Ethics decided to assess the Fund's investment in Ta Ann against the Guidelines For the observation and exclusion of companies From the GPFG's investment universe (the Ethical Guidelines)¹.

As of 31 December 2011, the GPFG owned 1,738,212 shares in the company worth USD 3.15 million.

2.1 WHAT THE COUNCIL HAS ASSESSED

The Council on Ethics has assessed whether there is an unacceptable risk of Ta Ann being responsible for severe environmental damage pursuant to section 2(3)(c) of the Ethical Guidelines.

In previous recommendations regarding severe environmental damage, the Council has given particular emphasis to whether:²

- the damage is significant;
- the damage has irreversible or long-term effects;
- the damage has a considerable negative impact on human life and health;
- the damage is a result of violations of national laws or international norms;
- the company has neglected to act to prevent the damage;
- the company has implemented adequate measures to rectify the damage; and
- it is probable that the company's unacceptable practice will continue.

In the present draft recommendation, the Council has focused particularly on the environmental damage associated with Ta Ann's logging and clearing of tropical forest in Sarawak, Malaysia.

The Council has not considered Ta Ann's alleged close links with Sarawak's Chief Minister Taib, who is currently being investigated for corruption and money laundering in several countries. Nor has the Council considered claims by the Penan people that Ta Ann, in some of its licence areas, is operating in territories belonging to this indigenous people group without having obtained their informed consent.

Environmental damage associated with the logging and clearance of tropical forests

The commercial logging and conversion of tropical forest into plantations is considered to be one of the greatest threats to ecosystems and biodiversity, and contributes significantly to greenhouse gas emissions. According to the Intergovernmental Panel on Climate Change, deforestation and forest degradation contribute to some 17 per cent of global greenhouse gas emissions.³

In Sarawak, companies require a licence to convert rainforest into plantations (called a "license for planted forest" or "oil palm plantation license"). Conversion involves trees being felled and other vegetation being removed (deforestation), so that the land can be used to establish plantations for the production of palm oil, timber or other crops. The amount of vegetation removed in a licence area will depend on factors such as topography and planting methods. The clearance of rainforest is considered to have devastating effects on biodiversity, natural habitats and ecosystem services. Plantations are monocultures which are of little ecological value compared to tropical rainforests.

The southern and eastern parts of Sarawak is part of an area called the "Heart of Borneo", a WWF initiative supported by the authorities in Indonesia, Malaysia and Brunei, who have all committed to managing the area in a sustainable manner. The area

is the largest transboundary tropical forest expanse remaining in South East Asia. Home to an astounding 6 per cent of the world's total biodiversity, from the orangutan to the world's largest flower, and containing the headwaters for 14 of Borneo's 20 major rivers, it is one of the richest treasure-houses on the planet. More than 600 new species have been discovered within the Heart of Borneo since 1995, an average of 3 per month.⁴

Initially, the “Heart of Borneo” zone covered more than 75 per cent of Ta Ann’s licence areas. However, at the request of the Sarawak government, the boundaries of the Heart of Borneo were adjusted to exclude some forest licences,⁵ and Ta Ann has informed the Council that the Heart of Borneo area now covers 35 per cent of the company’s licence areas (see Figure 3).⁶

Sarawak is also part of the Sundaland Hotspot.⁷ A hotspot is characterised by an exceptional biodiversity, by a high level of endemic species⁸ (at least 0.5 per cent or 1,500 of the world’s plant species), and by being threatened by ongoing and rapid habitat loss. To be a hotspot, a region must have lost 70 per cent or more of its primary vegetation.⁹ The Sundaland Hotspot contains 25,000 plant species, of which 60 per cent are not found anywhere else in the world. Some 100,000 km² remain of the original vegetation cover of 1.5 million km². A large number of birds, mammals and amphibians are threatened by extinction. The destruction of habitats through commercial logging and the conversion of forests into plantations is the greatest threat to this hotspot.

Sarawak’s deforestation rates are among the highest in the world. Between 2005 and 2010, about 10 per cent, or more than 865,000 hectares, of the state’s forests were cleared. This is more than three times the deforestation rate for the whole of Asia over the same period, and is one of the highest tropical deforestation rates anywhere in the world.¹⁰

The UN, the World Bank and national governments have recognised the need to reduce deforestation and forest degradation, for example through the establishment of the United Nations Collaborative Initiative on Reducing Emissions from Deforestation and Forest Degradation (REDD and REDD+), which is supported by the World Bank and others. The Norwegian Government has also given support to these initiatives, allocating up to NOK 3 billion a year to efforts to reduce greenhouse gas emissions from deforestation in developing countries. In these efforts, the Government also emphasises the need for conservation and sustainable development.¹¹

The Council’s point of departure is that the tropical rainforests of Borneo are among the most biodiverse ecosystems on earth. In addition to supporting this biodiversity and providing habitats for many endangered species, the tropical rainforest also plays an important role in providing vital fundamental ecosystem services, such as carbon storage, watershed protection and soil stabilisation. Tropical forests are important for the state of the global environment, and logging and forest conversion are a major threat to their future existence. Considering the many international and national initiatives to reduce deforestation and forest degradation, the Council has assessed the environmental damage associated with the logging and clearing of tropical forests. In its assessment, the Council has emphasised the scale of the logging and clearing, the extent to which the company’s licence areas overlap with areas containing high ecological values, and the consequences of forest conversion for endangered species and their habitats.

2.2 SOURCES

Limited public information is available on Ta Ann's forest operations. At the request of the Council, however, Ta Ann has provided a number of documents, including copies of environmental impact assessments for two licences, selected individual coupe maps, permits to enter coupes, harvesting plans, tree planting plans and a forest management plan, as well as information about the company's sustainable forest management practices, including one High Conservation Value Forest (HCVF) assessment report covering two coupes in one licence area. The Council has also obtained publicly available documents from the library of the Natural Resources and Environment Board (NREB) in Kuching and Sibul in Sarawak.

The Council has twice sent its draft recommendation to Ta Ann for comment, in March 2011 and September 2012. Ta Ann responded extensively to the first draft, and provided the Council with additional information. Members of the Council's secretariat met with representatives of Ta Ann in Sibul in October 2011, and also participated in a one-day field visit to Ta Ann's LPF/0010 licence near Song.

The recommendation is primarily based on the sources mentioned above and referred to in footnotes.

3 Background

3.1 COMPANY BACKGROUND

Ta Ann is a Malaysian logging and plantation conglomerate, founded in the mid-1980s and listed on the *Bursa Malaysia* in 1999. Ta Ann is among the five largest logging and plantation companies in Malaysia. In addition to logging, the company is converting large forest areas into plantations for the production of timber and palm oil. Its principal operations are located in Sarawak in Borneo, Malaysia. In 2007, the company expanded overseas, setting up plantations and sawmills in Tasmania, Australia.¹²

3.2 TA ANN'S LOGGING AND PLANTATION LICENCES IN SARAWAK

Ta Ann is a holding company, and all of its logging and plantation operations are conducted by 100 per cent subsidiaries, which also hold the related licences. Ta Ann's current licences are listed in Table 1 below. Timber licences (T/) cover areas where Ta Ann is permitted to carry out selective timber logging.¹³ Ta Ann currently has five timber licences covering around 350,000 hectares. Two of these licences overlap wholly or partly with Ta Ann's licences for planted forests (LPF/), where the forest will be cleared after the commercially valuable timber has been logged (see Figure 1 below).

Table 1: List of Ta Ann timber (T – Timber Licences) and plantation licences (LPF – licenses for planted forests) in Sarawak¹⁴

License no.	Type	Name of subsidiary	Area (hectares)	Area under LPF (hectares)	Licence valid until
T/3135	Timber	Pasin Sdn. Bhd.	49,858	0	2015
T/3346	Timber	Woodley Sdn. Bhd.	83,307	0	2017
T/0560	Timber	Raplex Sdn. Bhd.	72,251	72,251	2017
T/3491	Timber	Tanjong Manis Holdings S/B	125,000	125,000	2021
T/0342	Timber	Borlin Sdn. Bhd.	32,023	0	2025
LPF/0002	Plantation	Zumida Sdn. Bhd.	7,703	-	2057
LPF/0010	Plantation	Ta Ann Plywood Sdn. Bhd.	108,125	-	2058
LPF/0040	Plantation	Ta Ann Plywood Sdn. Bhd.	197,250	-	2065

Ta Ann cuts timber in all of its timber licences, with the exception of the Borlin licence, T/0342, and has also begun converting forests falling under the plantation licences. Ta Ann's plantation licences cover an area of more than 300,000 hectares. About half of this area is plantable.¹⁵ Ta Ann also holds licences for oil palm plantations corresponding to an area of around 66,700 hectares.¹⁶ According to the company's 2011 annual report, it has thus far planted some 31,200 hectares of acacia and 30,900 hectares of oil palm.¹⁷



Figure 1: Map showing the locations of Ta Ann timber licence areas and licence areas for planted forests in Sarawak. The location of LPF/0002 is not known to the Council.¹⁸

4 Environmental impact of Ta Ann's operations

Most of Ta Ann's licence areas are located between the Rajang River and the Indonesian border (see Figure 1). These licences cover areas of natural rainforest where Ta Ann has carried out selective logging for the last 15 to 30 years, and where logging still is ongoing. The forest that is being cleared in these licence areas is made up of mixed dipterocarp forest.¹⁹ Although the forest has been selectively logged previously, available information suggests that the vast majority of the area concerned, continues to meet the definition of "continuous, closed canopy forest".²⁰

Little information is available on the condition of the forest that is being logged. The Council has had access to the environmental impact assessments (EIAs) for the forest plantation established under LPF/0040 and the tree planting conducted under LPF/0010. These reports do not include any detailed assessment of the ecological value of the natural forest areas planned for clearance, beyond stating that they have been degraded by prior logging. Nevertheless, the assessments do confirm that the forest still contains important ecological values, particularly in certain areas. This is elaborated on below. No EIAs are available for the other timber licences (T/3135, T/3346 and T/3491), and hence there is no information on areas that are not included in the LPF licenses (see Figure 1).

4.1 LOSS OF BIODIVERSITY AND HABITATS

Clearance of LPF/0010 and the Melekun Division of LPF/0040

The licences for planted forests were issued to Ta Ann in 1998 (LPF/0010) and 2005 (LPF/0040). With its 197,250 hectares, LPF/0040 is one of the largest plantation licences in the whole of Sarawak.²¹ LPF/0010 covers 108,125 hectares (see Figure 1), and comprises seven separate areas in different locations. One particularly valuable area is Area F (Pasin), which runs along the border with Indonesia. The area is adjacent to the Indonesian Bentuang Karimun National Park to the south, and borders the Lanjak Entimau Wildlife Sanctuary (Sarawak) to the west. The sanctuary is the largest protected area in Sarawak, and is home to around 1,400 orangutans (*Pongo pygmeus*). The government has nominated it as a Unesco World Heritage Site due to its significance as a habitat for orangutans and a number of other endangered species.²² The Sarawak government has proposed an extension of the national park eastwards because it is assumed that the orangutans may have a presence outside the protected areas. Timber licence T/3135 is also contiguous with the wildlife sanctuary, see Figure 2.

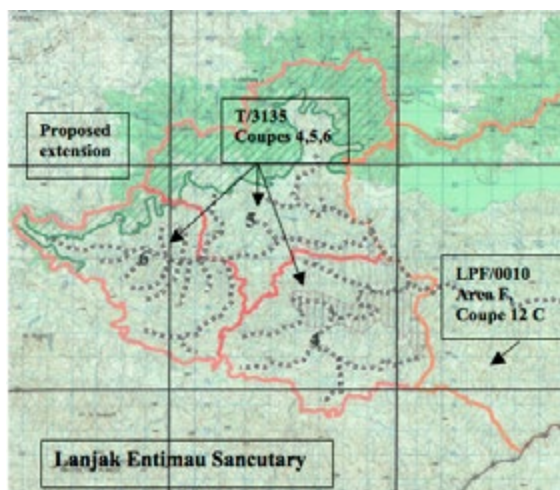


Figure 2: The location of Coupes 4, 5 and 6 of T/3135 and Coupe 12C of LPF/0010 in relation to the Lanjak Entimau Wildlife Sanctuary. Red lines are coupe boundaries. Coupe 12C of LPF/0010 and Coupes 6 and 4 of T/3135 are contiguous with the Wildlife Sanctuary, while Coupe 5 and also Coupe 6 of T/3135 are contiguous with the proposed extension of the Sanctuary.²³

The EIA noted that large numbers of large-diameter trees and stretches of virgin forest remained in Area F of LPF/0010²⁴, along with a broad range of wildlife. Neither flora nor fauna diversity are described in any detail, but the EIA states that: ‘There are 8 totally protected mammals, including Orang Utan which is found in the Area F, but are confined to the Lanjak Entimau Wildlife Sanctuary and the Indonesia border. Other totally protected mammals are the Bornean Gibbon, Hose’s Langur, Maroon Langur, Clouded Leopard, Western Tarsier, Slow Loris and Giant Squirrel.’²⁵ The EIA lists 18 species of mammal and 19 species of bird that are protected under national legislation.²⁶ Of these, 18 are classified as endangered on the red list of the International Union for Conservation of Nature (IUCN).²⁷ According to the IUCN, these species are all declining rapidly, due particularly to loss of habitat through logging and deforestation.

A map showing the distribution of orangutans in Borneo indicates that, in around the year 2004, orangutan habitats overlapped with the western parts of T/3135 and Area F (see Figure 3). The map also shows that the distribution of orangutans was considerably reduced between 1989 and 2004 in many of the areas in which Ta Ann has had logging operations in the last 10 to 15 years. Maps provided by the ‘Great Apes Survival Partnership’ suggest that orangutans are still found in areas that overlap with Ta Ann’s licence areas (Area F and T/3135),²⁸ as do recently published estimates of orangutan populations in Borneo.²⁹

According to the EIA for LPF/0010, the clearance of forest in licence areas A to F will have severe negative impacts. The EIA concluded that ‘major adverse impacts are envisaged for flora and fauna factors, since their habitats will be destroyed.’³⁰ The EIA also predicted further major adverse impacts in terms of increased soil erosion and resulting reduction of water quality in streams and rivers. According to the EIA, the most crucial measures to mitigate these impacts are to set aside areas of forest along river banks, on steep slopes and in areas of poor soil quality. The EIA does not mention any specific mitigation measures to protect the orangutan or other protected species, other than preventing workers from hunting them and recommending the progressive clearing of land to allow migration of animals to adjacent forested areas. ‘Care must be taken to ensure that rare and endangered species have moved out of an area before clearing begins.’³¹



Figure 3: Overlay of boundaries of Ta Ann’s licence areas, orangutan distribution 1989 and 2004, and boundary of the ‘Heart of Borneo’ area. The black dotted line indicates the border with Indonesia.³²

Almost half of the species identified in the EIA are classified as endangered by the IUCN, indicating that these species face a very high risk of extinction in the wild in the near future. The migration of wildlife populations to other areas will not ensure their protection. Generally speaking, and in ecological terms, there are no “empty” territories nearby that a surplus can occupy. The temporary migration of individuals is therefore likely to result in a loss of individuals proportionate to the loss of habitat area.

Since 2010, Ta Ann has carried out High Conservation Value Forest (HCVF) assessments, which entail the identification, conservation and management of particularly important conservation values in a licence area (see section 5). These assessments are not required by law. According to Ta Ann, the company carries out such assessments for all licence areas prior to logging and clearing. Ta Ann has provided the Council with only one HCVF report, covering two coupes in the northern part of LPF/0010 (not falling within Area F), where the forest will be converted into oil palm plantations.³³ This assessment also confirms a rich floral and faunal biodiversity in the area, including a number of protected and endangered species. ‘As a whole, the licensed forest provides an important refuge for a rich diversity of mammal, birds, reptiles, amphibian and fish.’ The orangutan was not found in the study area. It ‘is confined to the Lanjak Entimau Wildlife Sanctuary.’³⁴ The report states that the mere presence of such species is not a compelling reason to stop clearance, and the consultant did not see the plantation development as an ‘imminent unequivocal threat to the biological richness’.³⁵ One of the suggested mitigation measures is to set aside a wildlife corridor. However, ‘The wildlife corridor does not cater specifically to the wildlife found in Coupes 13 and 17; it could be used by species in the entire licence area, serving a link between the major salt licks found in the region [...] Animals that are disturbed by plantation activities will be able to take refuge in the corridor.’³⁶ The wildlife corridor comprises the riparian buffer zone along a stream which runs through the coupes, and is 140m wide. Other recommended measures include setting aside an area of 15 hectares to serve as a gene bank for commercial tree species, three salt licks, and areas used for shifting cultivation and as burial sites by local people. While these measures are likely to have some positive effects, they are not documented, and appear unlikely to offset the major negative impacts of clearance.

Clearance of LPF/0040 – Raplex Division

According to the forest management plan for timber licence T/0560 (which covers the same area as LPF/0040), more than 90 per cent of the area was old-growth stand of mixed dipterocarp forests at the time the plan was written.³⁷ Ta Ann has confirmed that the area was covered by virgin forest when the license was issued to Ta Ann in February 1977. Since then, logging has been carried out by the same company (Raplex), which was incorporated into the Ta Ann group in 2002.³⁸

The description in the EIA of the state of the forest 30 years later, in 2006, establishes that the areas must have undergone at least two cycles of timber harvesting in the last 20 to 30 years (the forest management plan requires a cutting cycle of 25 years). As a consequence, the areas have been ‘intensely disturbed by heavy logging in the last few decades,’ to such an extent that “much of the existing vegetation on-site has lost its conservation

value.’ This is used as an argument to justify the conversion of forest into plantations, and it is also claimed that the plantations will not differ greatly from the forest that has been felled: ‘The ‘no-project’ option is therefore difficult to justify, especially when the present Project is proposing to establish a forest plantation that is not too different from the secondary forests, but which will be more productive and accrue a much higher economic return during the span of the project.’³⁹

Despite the fact that the forest is considered heavily degraded, the EIA mapped a rich biodiversity of species, including 30 birds and 8 mammal species that are protected in Sarawak.⁴⁰ The EIA noted that the clearing of the natural forest will have negative impacts on existing flora and fauna because their natural habitats will be removed and later replaced by an “artificial forest plantation.” The loss of biodiversity and habitats is expected to occur throughout most of the planting area. ‘Numerous species of animal and bird life that are dependent on the natural forests for shelter food and breeding ground will be adversely affected due to the clearing of the forest [...] Although the past logging activities had greatly reduced the conservation value of the remnant forests, the planted forest will further simplify the existing ecosystem and reduce the existing biodiversity.’⁴¹ Nevertheless, the EIA concluded: ‘The EIA study has shown that with proper planning and implementation of the mitigation measures recommended, any significant adverse impacts on the environment could be reduced to acceptable levels.’⁴² The most important mitigation measures are minimising soil erosion, including through the retention of riparian vegetation, confining planting to slopes of less than 35 degrees, and implementing soil conservation measures in connection with road building and planting activities.

4.2 RE-ENTRY LOGGING WITHOUT AN EIA

According to the Natural Resources and Environment (Prescribed Activities) (Amendment) Order 1997, First Schedule, Article 2(i), companies in Sarawak must have completed an EIA approved by the Natural Resources and Environment Board (NREB) before undertaking re-entry logging in areas larger than 500 hectares. EIAs are required by the NREB also when forests are converted into plantations. These requirements have existed in Sarawak law since 2005.

The EIA must contain a detailed assessment of all potentially important environmental impacts resulting from logging or the establishment of plantations, and prescribe the preventive and protective measures the company must implement to reduce the damage.

A number of documents provided by Ta Ann confirm that re-entry logging is being carried out in licences T/3135, T/3491 and T/0560 even though no EIAs exist for re-entry logging in any of these licences.⁴³ Ta Ann has pointed out that the Permits to Enter Coupe for the re-entry logging have the requirement for the submission of an EIA crossed out. It cannot be ruled out that the company has been exempted from these requirements, although the NREB has informed the Council that no such exemptions are allowed.⁴⁴

The majority of the area concerned (T/3135, T/3491 and T/0560), overlaps with the licences for plantation forest, and EIAs have been produced for these LPFs. Hence it may be argued that environmental impacts have been assessed also for areas where re-entry logging is occurring. However, there are areas under timber licence T/3135 and T/3346

which do not overlap with LPF licence areas and for which no impact assessments have been carried out prior to logging. This applies, for example, to the western part of T/3135, which borders the Lanjak Entimau Wildlife Sanctuary, meaning that neither possible impacts due to logging nor mitigation measures in this potentially ecologically valuable area have been identified.

5 Information provided by the company

5.1 TA ANN'S CONTACT WITH THE COUNCIL

The Council has communicated with Ta Ann on several occasions since July 2010, most recently in October 2012. Ta Ann has provided numerous documents pertaining to its licences, which have been useful for the Council's assessment. Nevertheless, there is still a lack of information about several aspects of the company's operations on which Ta Ann has not provided documentation. This concerns, particularly, timber licences, forest management plans and a number of HCVF assessment reports.

Members of the secretariat had a meeting with Ta Ann in Sibul (Sarawak) in October 2011, including a one-day field visit to LPF/0010. The coupes visited were near Song and had been recently planted.

The Council has twice sent draft recommendations on exclusion to Ta Ann for review, the first time in March 2011, the second time in November 2012. Ta Ann has commented on both drafts, as elaborated on below.

5.2 TA ANN'S POSITION

Ta Ann has stated that, 'In managing our forest harvesting and the development of forest plantation, we believe that sustainability is the only way forward in long term natural resource management.' With regard to the environment, the company is committed to:

- Formulating and implementing forest management plans that are compatible with the best logging practices, upkeep and maintain for long-term sustainable supply of commercial timber.
- Complying with the regulatory requirements, mitigating measures and environmental management plan set out in the Social and Environmental Impact Assessment while excluding environmentally sensitive areas from operation.
- Identifying, managing, conserving and enhancing the High Conservation Value Forests.⁴⁵

Ta Ann does not agree with the Council that its forest operations cause severe environmental damage.

'We disagree that our operations will cause severe and irreversible impacts on the environment as claimed. In carrying out our operation, Ta Ann adheres strictly to all relevant rules and regulations governing forest plantation establishments. In addition, we are implementing various measures and continuously refine our ground operations to ensure proper environmental safeguard.'

Moreover, Ta Ann has stated:

‘It is regrettable that the Council has arrived at a conclusion that our operation poses an unacceptable risk of environmental damage. Moreover, it is presumptuous of the Council to make similar conclusions on the future of our operation without giving a fair consideration to the mitigating measures that have been implemented by us and also the ones that are underway’⁴⁶

Ta Ann has criticised the Council for failing to take into account that plantations are very important for the social and economic development of Sarawak, and that the conversion of forests into plantations is an important element in the authorities’ forestry and land policy. Ta Ann emphasised this in its most recent letter to the Council:

‘We wish to reiterate that the establishment of forest plantation is the only way to sustain timber resources and to elevate the standard of living of communities in which we operate [...] Conversion of low income yielding forest land into productive forest plantation is a formula adopted by many developing countries for transformation to a developed country. Sarawak is no exception. Ta Ann is committed to supporting the State Government in realizing this noble vision in a sustainable and responsible way [...] Forest plantation, being an industry that is central to our economic development will greatly benefit the poor, especially those in the rural area by creating employment opportunities where jobs with steady incomes are scarce. With the 7000 employment created through our business activities, we have contributed greatly to the livelihood and welfare of our workers and their families.’⁴⁷

In its communications with the Council, Ta Ann has given particular emphasis to the following:

- Deforestation will not affect the entire licence area. Vegetation will be removed from 30 per cent of the land; 70 per cent will remain.
- The HCVF assessments are conducted before logging and deforestation begin, and HCVF areas are protected.
- Wildlife corridors are preserved, and other measures are implemented to protect biodiversity.
- There are no orangutans in the company’s licence areas.

The clearance of forests

In its communications with the Council, Ta Ann has repeatedly claimed that only 30 per cent of the land covered by a plantation licence will be deforested.⁴⁸ This claim is based on its experiences regarding how much of a coupe is planted. ‘On a geographic unit level or coupe level, the cumulative planted area (i.e. also the clear-felled/converted area) is set against the areas of the PEC [Permit to enter Coupe] approved coupes to arrive at this average percentage of 30 %. So out of the gross total area of 299,933 ha, we estimated that less than 90,000 ha will be cleared for establishment of forest plantations.’⁴⁹

Moreover, Ta Ann states that the actual clearing rate can vary between licence units and coupes, and that the rate for oil palm plantations generally exceeds 30 per cent. The revised Tree Planting Plan for LPF/0010 shows that the plantable area for the different parts of the licence varies from 79 per cent (oil palm) to 38 per cent.⁵⁰ Information provided by Ta Ann for the coupes in LPF/0010 shows that planted areas totalled as little as

6 per cent in one coupe, but up to 80 per cent of the gross area in another. In the coupes where planting has been completed, the average clearing rate in different parts of the licence varies from 25 to 42 per cent.⁵¹

In its most recent letter to the Council, Ta Ann wrote that the company had improved its planting methods further, including by planting on terraces in the terrain without removing the vegetation between the terraces. According to Ta Ann, this helps to maintain natural habitats for local fauna and reduces deforestation by 80 per cent compared to conventional planting methods.⁵² Ta Ann also stated that areas outside the planting fields are logged in accordance with requirements and good logging practice. Logging is not undertaken in HCVF areas (see below), agricultural areas or areas reserved for the local population.

Setting aside High Conservation Value Forests

Ta Ann has informed the Council that

‘Formal High Conservation Value Forest (HCVF) assessments commenced in 2010 and was implemented as a pre-operational requirement for all forthcoming Timber Licences-coupes, License for Planted Forests-coupes and oil palm areas in 2011. The HCVF assessments conducted by external consultants are based on the WWF- HCVF National Toolkit for Malaysia 2009 including all the 6 principles of HCV. On-ground assessments also include consultation with local communities/stakeholders having interest in the operational coupes concerned.’

Ta Ann has further explained that due to operational scheduling and the time required, these assessment are carried out on a coupe-by-coupe basis. Timber licence area T/0342, which Ta Ann aims to have FSC-certified, is the only area being assessed as one entity.⁵³

HCVF areas that are set aside for conservation purposes require management and monitoring to ensure that conservation values are maintained. Ta Ann has stated that, ‘On ground, the allocated HCV areas are demarcated, GPS and updated in our GIS systems [...] Frontline operations are then briefed on the HCVF areas and non-operation in these areas. Regular inspections are also conducted to detect any encroachment or non-compliance to the rule.’⁵⁴

High conservation value forest assessments⁵⁵

All forests contain environmental and social values, such as habitats, protection against erosion as well as areas important for securing basic needs and cultural sites for the local population. Where these values are deemed to be particularly important, a forest can be defined as a *High Conservation Value Forest* (HCVF). A forest or area with high conservation value has one or more of the following characteristics:

- **HCV 1:** Concentrations of biological diversity including endemic species, and rare, threatened or endangered species, that are significant at global, regional or national levels.
- **HCV 2:** Large landscape-level ecosystems and ecosystem mosaics that are significant at global, regional or national levels, and that contain viable populations of the great majority of the naturally occurring species in natural patterns of distribution and abundance.
- **HCV 3:** Rare, threatened, or endangered ecosystems, habitats or refugia.
- **HCV 4:** Basic ecosystem services in critical situations, including protection of water catchments and control of erosion of vulnerable soils and slopes.
- **HCV 5:** Sites and resources fundamental for satisfying the basic necessities of local communities or indigenous peoples (for livelihoods, health, nutrition, water, etc.), identified through engagement with these communities or indigenous peoples.
- **HCV 6:** Sites, resources, habitats and landscapes of global or national cultural, archaeological or historical significance, and/or of critical cultural, ecological, economic or religious/sacred importance for the traditional cultures of local communities or indigenous peoples, identified through engagement with these local communities or indigenous peoples.

An HCV assessment is an extensive process in which conservation values are surveyed, and management and monitoring plans are developed to ensure that the conservation values are maintained or improved. International guidelines have been developed on how this process should be conducted. The guidelines are often adapted for individual countries.⁵⁶ The FSC and other certification schemes demand HCVF assessments to ensure that the logging or conversion of forests do not destroy important conservation values.

Ta Ann has informed the Council that it has completed HCVF Assessments for 18 coupes. The Council has requested these assessment reports, but Ta Ann has only provided one such report, covering two coupes in one licence.⁵⁷ Consequently, no information is available on how these assessments have been carried out, or on what values have been identified in other parts of the licences.

Wildlife corridors and other mitigation measures

In its communications with the Council, Ta Ann has stressed that the low average clearing rates provide significant conservation values for biodiversity. 'Exclusions from forest clearing include alienated lands and reserves, gazetted communal reserves, Native Customary Rights lands (including farming land, fruit orchards, settlement sites), forest islands, HCVF sites (such as watershed for local communities, salt licks, burial grounds, religious sites), special sites such as tagang community conservation zones, EIA riparian buffers and wildlife areas/corridors.'⁵⁸

With regard to protected fauna species, mitigation measures 'include erection of No-hunting signages, "protected flora and fauna species" posters, education talks, ban on guns, and no selective logging or land clearing in wildlife corridors and HCV areas.'⁵⁹ According to Ta Ann, riparian buffer zones will also ensure the conservation of protected tree species.

Orangutans in the licence areas

Ta Ann rejects the possibility that orangutans are present in the licences bordering the Lanjak-Entimau Wildlife Sanctuary (LEWS). The company claims that buffer zones

are delineated between the license areas and the LEWS, and that there are also defined exclusion areas which are not logged. ‘No orang utan have been sighted or identified in preoperational or operational work for selective logging and forest plantation clearance in coupes that were worked by TA ANN. Excluded areas within LPF coupes i.e., international buffer, steep terrain and conservation belts have not been surveyed by TA ANN.’⁶⁰ Moreover:

‘With regard to our operational areas adjacent/contiguous to LEWS, HCVF assessment carried out for Pasin T/3135 Coupes 05A and 06A, and LPF/0010 Coupes 14C and 15C reported that no orang utan or their nests were sighted. At the same time, our survey crew has also combed the areas to further ascertain the presence or absence of orang utan. Should there be a sighting by our workers, it would be referred to the relevant authorities for their re-assessment and recommendation of mitigating measures.’⁶¹

Ta Ann has also stated that the proposed extension to the Lanjak Entimau Wildlife Sanctuary does not include any part of T/3135 or LPF/0010.

In response to the Council’s queries, Ta Ann has confirmed that, so far, no scientific studies on wildlife and supporting habitats have been carried out in the licence areas that will be converted into plantations.

6 The Council on Ethics’ assessment

The Council on Ethics has assessed whether there is an unacceptable risk of Ta Ann, through its forestry operations, being responsible for severe environmental damage pursuant to section 2(3) of the Ethical Guidelines. In the present case, the Council has given weight to environmental damage linked to logging and the conversion of tropical forests into plantations in Sarawak, Malaysia.

In its assessment, the Council has emphasised the scale of the damage and to what extent it has long-term or irreversible impacts, whether the environmental damage is a result of violations of national laws or international norms, and what the company has done to mitigate adverse effects. The Council has focused particularly on the extent to which the company’s licence areas overlap with areas containing important ecological values, and what consequences the conversion of forest will have for endangered species and their habitats.

Ta Ann’s licence areas cover around 360,000 hectares. Ta Ann holds plantation licences totalling 300,000 hectares. At least one-third of this area, and probably more, will be converted into plantations. All of Ta Ann’s licence areas are located in the Sundaland Biodiversity Hotspot, and a third is also situated within the Heart of Borneo. These areas contain particularly important ecological values that are strongly threatened by deforestation and forest degradation.⁶² The hotspot is ranked as one of the most threatened due to past and ongoing deforestation. In the Council’s view, there can be no doubt that the destruction of more than 100,000 hectares of tropical rainforest in one of the world’s most biodiverse regions will have serious, irreversible consequences for biodiversity and

ecosystem services. The Council considers it likely that the remaining forest will also be strongly affected due to edge effects and the increased fragmentation of forests and habitats.

The majority of Ta Ann's licence areas have been logged previously. Nevertheless, the company's own EIAs show that the forest contains important ecological values. The forest provides habitats for many species that are protected in Sarawak, including many on the IUCN red list of threatened species. These species are declining quickly because their habitats are being destroyed or degraded by logging and the conversion of forests into plantations. When habitats are further reduced on the scale seen in the present case, the risk increases that rare and local species will become extinct. In this context, the Council would also mention the UN and World Bank REDD initiatives, which express international agreement on the importance of stopping the deforestation and degradation of tropical forests, as a way to mitigate climate change and biodiversity loss. Ta Ann's conversion of tropical rainforest into plantations is highly inconsistent with international initiatives to prevent deforestation.

Ta Ann's own reports point out that the loss of biodiversity and destruction of habitats will be unavoidable when forests are turned into plantations. In its communications with the Council, Ta Ann has emphasised that the company has implemented a range of mitigation measures designed to reduce the environmental damage caused by its operations (see section 5). For example, the company has stated that less forest will be removed (as little as 30 per cent of the gross coupe area), through better planting methods and more environmentally friendly logging methods (referred to as "reduced impact logging"). The company has also emphasised that buffer zones along waterways are being set aside as wildlife corridors, that logging is avoided in steep terrain, and that biologically important (HCVF) areas are set aside. The Council considers it positive that Ta Ann is taking such steps, which indicate that the company is seeking to steer its operation in a more environmentally friendly direction.

The Council is of the opinion that these measures appear insufficient to protect the habitats of endangered species and ecosystems. How much of the forest area that is cleared, varies between different coupes and licence areas. Much of the forest that will be protected appears to be located in areas where logging is normally prohibited. Even though patches of forest and buffers zones along waterways are important for biodiversity and ecological functions locally in these areas, it is not given that the measures will help to protect key areas for endangered species or rare ecosystems. There can be no doubt that Ta Ann's operations are increasing the fragmentation of habitats in the licence areas. The long-term impacts of degraded and fragmented habitats on biodiversity and ecosystems can be serious, and are well-documented in relevant literature.⁶³ In the Council's view, the company has not taken sufficient account of this aspect.

According to Ta Ann, the areas that are set aside can function as wildlife corridors. Generally speaking, wildlife corridors are intended to be functional, i.e. they are supposed to connect the remaining pieces of previously contiguous habitats to simplify migration between forest fragments and areas of contiguous forest.⁶⁴ Wildlife corridors can play an important role in protecting species, but their importance – particularly for larger

mammals – is not well-documented, and they clearly cannot be the only instrument for protecting biodiversity. The effect of such corridors depends on the size and width of a given corridor and the size of the habitats the corridor connects. It is also important to consider what animals the corridor is to serve, the animals' movements and how effective the corridor will be in maintaining various wildlife populations.⁶⁵ Ta Ann has not responded to the Council's enquiry regarding the intended function of the corridors. Nor has it been documented how the corridors are connected to areas of contiguous forest, or what species the corridor is supposed to serve. The Council does not dispute that wildlife corridors can be valuable elements in a strategy for protecting various wildlife species. However, the information available to the Council did not demonstrate that the corridors would in fact function as sustainable habitats for endangered or wide-ranging species, or that they would help to maintain the rich biodiversity that has been documented in the licence areas and is also identified in Ta Ann's own HCVF assessment.

It is worth noting that Ta Ann conducts surveys of conservation values in forests, and that it has thus far completed such HCVF assessments for 18 coupes. Ta Ann does not publish these assessments. In HCVF assessments, which are normally undertaken in accordance with defined principles and processes, set criteria are evaluated to ensure that conservation values are identified.⁶⁶ It is unclear from the single report to which the Council has had access, how the process was conducted and how the conservation values in the two examined coupes were identified. For example, it is not clear how much consideration was given to conservation values in a landscape context, or how important the forest is in a global, regional or national context due to a particular concentration of biodiversity.⁶⁷ The conversion of forests is an irreversible intervention in nature. The purpose of an HCV process is to ensure that important conservation values are not lost when a forest is altered. Based on the information provided to the Council by Ta Ann, the Council considers it unlikely that the assessments undertaken by the company ensure this.

The Council has emphasised the documented risk that orangutans and other endangered species may have their habitats in Ta Ann's licence areas. The location of two of the company's licence areas, which include several coupes bordering on the Lanjak Entimau Wildlife Sanctuary, presents a risk that orangutans and other critically endangered species may have their habitats within the licence boundaries. No EIAs have been carried out for the logging licence that borders on the sanctuary. Accordingly, the company has engaged in logging without surveying ecosystems, habitats and species. In the Council's opinion, this proximity to the sanctuary demands that a precautionary approach be taken, which must include a professional and thorough assessment of whether the habitats of these animals overlap with Ta Ann's licence areas. The surveys conducted by Ta Ann appear to lack the systematic approach needed to confirm that Ta Ann's operations will not damage valuable habitats. The Council finds that this increases the risk of severe environmental damage.

Given that the conversion of tropical forests involves the complete, irreversible alteration of affected ecosystems, the scale of the deforestation, and that these operations are being pursued in areas with a particularly rich biodiversity as regards species, habitats and ecosystems, the Council has concluded that the measures implemented by Ta Ann

to mitigate the adverse effects are insufficient to secure a material reduction in the risk of severe environmental damage now and in the future.

7 Recommendation

The Council recommends the exclusion of Ta Ann Holdings Berhad from the investment universe of the Government Pension Fund Global due to an unacceptable risk that the company's operations may cause severe environmental damage.

Ola Mestad
Chair
(Sign.)

Dag Olav Hessen
(Sign.)

Ylva Lindberg
(Sign.)

Gro Nystuen
(Sign.)

Bente Rathe
(Sign.)

Notes

- 1 Hereafter the Ethical Guidelines, http://www.regjeringen.no/en/sub/styrer-rad-utvalg/ethics_council/ethical-guidelines.html?id=425277.
- 2 In previous recommendations, the Council has elaborated on the criteria for severe environmental damage, see for example the Council's recommendations concerning Freeport McMoRan and Samling Global, available at www.etikkradet.no
- 3 IPCC 2007: *Fourth Assessment Report: Climate Change 2007*: available at http://www.ipcc.ch/publications_and_data/publications_and_data_reports.shtml. This estimate has been reduced in a new study dated 2012, which has calculated that deforestation of tropical forest accounted for around 10 per cent of global greenhouse gas emissions in the period 2000–2005, see N. L. Harris, S. Brown, S. C. Hagen, S. S. Saatchi, S. Petrova, W. Salas, M. C. Hansen, P. V. Potapov, A. Lutsch. Baseline Map of Carbon Emissions from Deforestation in Tropical Regions. *Science*, 2012; 336 (6088): 1573 DOI: 10.1126/science.1217962.
- 4 WWF 2010: *Financing the Heart of Borneo: A Partnership Approach to Economic Sustainability*, Oct 2010, available at http://assets.panda.org/downloads/sustainable_financing_hob.pdf.
- 5 Confirmed at a meeting with the Heart of Borneo Initiative in Jakarta on 10 October 2011.
- 6 Ta Ann's reply to the Council on Ethics' draft recommendation of 14 May 2011.
- 7 More information about the Sundaland Hotspot is available at Conservation International: http://www.conservation.org/where/priority_areas/hotspots/asia-pacific/Sundaland/Pages/default.aspx.
- 8 Endemic species are prevalent in or peculiar to a particular locality or region.
- 9 The concept "Hotspot" was introduced by the biologist Norman Myers in 1988. Information on Biodiversity Hotspots is available at the Conservation International website: http://www.conservation.org/WHERE/PRIORITY_AREAS/HOTSPOTS/Pages/hotspots_main.aspx.
- 10 Comparison with annual deforestation country data for 2000–2010 in FAO 2011: *State of the World's Forests*. The annual deforestation rate in both Brazil and Indonesia, for instance, was 0.5 per cent during this period, compared with an average rate of 2 per cent for Sarawak. Close to 10 per cent of the forest and 1/3 of the peatlands in Sarawak were lost in this period, see Sarvision 2011: *Impact of oil palm plantations on peatland conversion in Sarawak 2005–2010*, <http://www.wetlands.org/Portals/0/publications/Report/Malaysia%20Sarvision.pdf>.
- 11 The Government's International Climate and Forest Initiative: <http://www.regjeringen.no/en/dep/md/Selected-topics/climate/the-government-of-norways-international-/why-a-climate-and-forest-initiative.html?id=547202>.
- 12 Ta Ann's website: www.taann.com.my.
- 13 Selective logging means that only trees of a certain type and exceeding a specified minimum size may be logged.
- 14 The list of licences and sizes has been collated from the Ta Ann website: www.taann.com.my. Information on the licence areas has been taken from the environmental impact assessments for LPF/0010 and LPF/0040. Topography and regulations limit the plantable area.
- 15 Information on the licence areas has been taken from the environmental impact assessments for LPF/0010 and LPF/0040. Topography and regulations limit the plantable area.
- 16 <http://www.taann.com.my/bs-oilpalm>. This is additional to the area specified in Table 1.
- 17 Ta Ann Annual Report 2011, available at www.taann.com.my.
- 18 Ta Ann Plywood Sdn.Bhd. 2007: Revised Tree Planting Plan for LPF/0010.

- 19 Dipterocarpaceae is a large family of primarily evergreen broadleaf trees that are dominant in the rainforests of Malaysia. The trees may grow very old and normally reach a height of 40 to 70 metres. Many of the species have considerable economic value as timber, but are also used in the production of ethereal oils, balsam and plywood.
- 20 This assessment is based on Ta Ann's environmental impact assessment reports, management plans, field visits and satellite imagery.
- 21 Ecosol Consultancy Sdn. Bhd. 2006: Environmental Impact Assessment for the proposed Melekun Raplex Forest Plantation under LPF/0040 Kapit Division, Sarawak, p. C2-1. LPF/0040 consists of two separate areas: the Melekun Division (125,000 hectares, overlapping with T/3491) south of the Rajang river, and the Raplex Division (72,250 hectares, overlapping with T/0560), north of the Rajang river, see Figure 3.
- 22 <http://whc.unesco.org/en/tentativelists/1988/>.
- 23 Pasin Sdn.Bhd. Excerpt from the General Harvesting Plan for the license area T/3135. A license area is divided into many coupes. The General Harvesting Plan shows the lay out of coupes and roads in the license area.
- 24 See footnote 21 and Plantacia Sdn Bhd. 1999: *Environmental Impact Assessment Report for Tree Planting under License for Planted Forests LPF/0010 in the Sibü and Kapit Divisions, Sarawak*, pp. 9–10.
- 25 Plantacia Sdn Bhd. 1999: *Environmental Impact Assessment Report for Tree Planting under License for Planted Forests LPF/0010 in the Sibü and Kapit Divisions, Sarawak*, p. 32-35. The Sarawak Wildlife Protection Ordinance 1998, First Schedule provides provisions for the protection of wildlife and states which species that are protected.
- 26 The Sarawak Wildlife Protection Ordinance 1998, First Schedule, Parts 1 and 2.
- 27 The IUCN red list of threatened species classifies species with a high risk of becoming extinct. Critically endangered species have a very high risk of extinction, vulnerable species have a high risk, and near threatened species have a risk of moving into the categories vulnerable or critically endangered in the near future, see <http://www.iucnredlist.org/>. Four of the species listed in the impact assessment are classified as critically endangered. These are the orangutan (*Pongo Pygmeus*), the Bornean Gibbon (*Hylobates muelleri*), the otter civet (*Cynogale bennetti*) and the pangolin (*Manis javanica*). A further eight species are classified as vulnerable, and six as near threatened.
- 28 Great Apes Survival Partnership: <http://www.un-grasp.org/>. The programme receives support from the UN Environment Programme (UNEP) and UNESCO, and is one of the few UNEP initiatives to focus on saving special, threatened species from extinction. An interactive map, the APES mapper, shows the spread of orangutans and is available on the website.
- 29 Wich SA, Gaveau D, Abram N, Ancrenaz M, Baccini A, et al. 2012: *Understanding the Impacts of Land-Use Policies on a Threatened Species: Is There a Future for the Bornean Orang-utan?* PLoS ONE 7(11): e49142. doi:10.1371/journal.pone.0049142.
- 30 See footnote 26, p. 76.
- 31 Plantacia Sdn Bhd. 1999: *Environmental Impact Assessment Report for Tree Planting under License for Planted Forests LPF/0010 in the Sibü and Kapit Divisions, Sarawak*, p. 69.
- 32 Information on orangutan distribution from WWF Germany, 2005, *Borneo: Treasure Island at Risk – Maps on Status of Forests, Wildlife and related Threats on the Island of Borneo*; Heart of Borneo boundary is from Financing the Heart of Borneo, 2010.
- 33 Ecol Consultancy Sdn.Bhd. 2010: *Survey and identification of High Conservation Value Forests /HCVFs) in Coupes 13 and 17 of LPF/0010 near Song, Kapit Division for Ta Ann Plywood Sdn.Bhd.* Final Report (Version II).
- 34 See footnote 33, p. 9.
- 35 See footnote 33, p. 16.
- 36 See footnote 33, p. 16.
- 37 Forest Management Plan for the Rajang-Pila Management Unit, undated. According to the forest management plan the description of the state of the forest is based on aerial pictures taken between 1967 and 1969.
- 38 This licence was awarded to Ta Ann's subsidiary Raplex for the entire period 1977–2017. Ta Ann formally acquired Raplex in 2002. At the time, Raplex's owners included the persons who founded Ta Ann (Datuk Abdul Hamed bin Haji Sepawi, Datuk Wahab bin Haji Dolah, Dato Wong Kuo Hea), and Sepawi was both chairman of Ta Ann and general manager of Raplex. In addition, two Ta Ann directors were also directors of Raplex. The acquisition was notified to the stock exchange as a related-party transaction, see Ta Ann Holdings Berhad Announcement dated 8 April 2002 on Proposed Bonus Issue and Proposed Acquisition of Raplex Sdn Bhd, General Announcement Reference No MM-020408-A4EFE. In its letter to the Council on Ethics of 14 May 2001, Ta Ann wrote that Raplex Sdn. Bhd. (T/0560) 'was owned by parties having no connection to "TA ANN founders" '.
- 39 Ecosol Consultancy Sdn. Bhd. 2006: *Environmental Impact Assessment for the proposed Melekun Raplex Forest Plantation under LPF/0040 Kapit Division, Sarawak*, p. C2-3.
- 40 The EIA for LPF/0040 which covers both the Melekun and Raplex license area, lists more than 200 tree species, 42 species of mammals, 187 bird species, 194 fish species and several hundred insect species. Reptiles were poorly represented in the area, but many species of amphibians were identified. Of these 39 bird species and 8 species of mammals are protected according to the Sarawak Wildlife Ordinance. Some of the species, such as the Bornean Gibbon, is listed on the IUCN redlist.

- 41 Ecosol Consultancy Sdn. Bhd. 2006: *Environmental Impact Assessment for the proposed Melekun Raplex Forest Plantation under LPF/0040 Kapit Division, Sarawak*, p. C4-21.
- 42 See footnote 42, p. ES-6.
- 43 EIA reports for LPF/0010 and LPF/0040 confirm that the western portion of the Pasin Sdn. Bhd. timber licence (T/3135) and the whole of the Tanjung Manis Sdn. Bhd. licence (T/3491) were previously logged. Permits to Enter Coupe for relevant timber licence areas provided by Ta Ann also confirm that the logging being conducted in T/3135, T/3491 and T/0560 is re-entry logging.
- 44 Confirmed in the Council of Ethics Secretariat's meeting with the Sarawak Forest Department, NREBD, the Forestry Corporation and other government bodies in Kuching, Sarawak 17 October 2011.
- 45 Ta Ann's Sustainable Management Policy 19.05.2010, submitted to the Council.
- 46 Ta Ann's letter to the Council on Ethics of 25 October 2012.
- 47 Ta Ann's letter to the Council on Ethics of 25 October 2012
- 48 Ta Ann's reply to the Council on Ethics' draft recommendation of 14 May 2011.
- 49 Ta Ann's response to questions regarding Ta Ann's forest operation to the Council on Ethics, 22 August 2012.
- 50 Ta Ann Plywood Sdn.Bhd. 2007: *Revised Tree Planting Plan for LPF/0010*.
- 51 See footnote 49. Based on information provided by Ta Ann. The planted area was 42 per cent (Woodley Division), 25 per cent (Pasin Division) and 35 per cent (Rejang Division).
- 52 Ta Ann's letter to the Council on Ethics of 25 October 2012.
- 53 The Forest Stewardship Council (FSC) is an international member organisation that has established a third-party certification scheme under which forestry operations must satisfy defined sustainable forestry criteria. More information is available at <http://ic.fsc.org/>.
- 54 Ta Ann's response to question regarding Ta Ann's forest operation to Council on Ethics, 22 August 2012.
- 55 For more information about HCVF assessments, see <http://www.hcvnetwork.org/>.
- 56 The WWF has overseen the development of separate guidelines for HCVF assessments for Malaysia, see http://www.hcvnetwork.org/resources/national-hcv-interpretations/HCVF%20Toolkit%20For%20Malaysia_soft-copy%20version.pdf.
- 57 Coupes 13 and 17 of LPF/0010.
- 58 Ta Ann's letter to the Council, 14 May 2011.
- 59 Ta Ann's response to questions regarding Ta Ann's forest operation to the Council on Ethics 22 August 2012.
- 60 Ta Ann's letter to the Council, 14 May 2011.
- 61 Ta Ann's response to questions regarding Ta Ann's forest operation to the Council on Ethics, 22 August 2012
- 62 The World's 10 Most Threatened Forest Hotspots: <http://www.conservation.org/newsroom/pressreleases/Pages/The-Worlds-10-Most-Threatened-Forest-Hotspots.aspx>.
- 63 See for example Bennett, A.F. 1998, 2003: *Linkages in the Landscape: The Role of Corridors and Connectivity in Wildlife Conservation*. IUCN, Gland, Switzerland and Cambridge, UK. Jackson, ST and DF Sax 2010: Balancing biodiversity in a changing environment: extinction debt, immigration credit and species turnover. In *Trends in Ecology and Evolution*, Vol 25, Issue 3. pp 153-160. DOI: 10.1016/j.tree.2009.10.001 focuses on long-term effects. Also the Malaysian Department of Environment in NREB 2009: *Managing Biodiversity in the Landscape. Guidelines for Planners, Decision-Makers & Practitioners* illuminates the negative effects of fragmentation in its guidelines on the protection of biodiversity.
- 64 Bennett, A.F. 1998, 2003: *Linkages in the Landscape: The Role of Corridors and Connectivity in Wildlife Conservation*.
- 65 NREB 2009: *Managing Biodiversity in the Landscape. Guideline for Planners, Decision-Makers & Practitioners*.
- 66 Proforest 2008: Good Practices Guidelines for High Conservation Value Assessments. <http://www.hcvnetwork.org/resources/folder.2006-09-29.6584228415/HCV%20good%20practice%20-%20guidance%20for%20practitioners.pdf> WWF 2009: High Conservation Value Forest (HCVF) Toolkit for Malaysia.
- 67 See footnote 66.

To the Ministry of Finance

24 January 2013

UNOFFICIAL ENGLISH TRANSLATION

Recommendation on the exclusion of Schweitzer-Mauduit International Inc. and Huabao International Holdings Limited from the investment universe of the Government Pension Fund Global

1 Background

Section 2, paragraph 1(b) of the ethical guidelines for the Government Pension Fund Global (GPFG) states that ‘The Fund’s assets shall not be invested in companies that themselves or through entities controlled by them: [...] produce tobacco’.¹

The Council on Ethics continuously monitors the Fund’s portfolio in order to identify companies engaged in activities that breach the ethical guidelines. The monitoring has shown that two companies in the Fund’s portfolio, Schweitzer-Mauduit International Inc.² and Huabao International Holdings Limited³, are engaged in the production of reconstituted tobacco leaf (RTL).

The Ministry of Finance proposed excluding tobacco producers from the GPFG in the Government Whitepaper no. 20 (2008) on the Management of the Government Pension Fund. The tobacco criterion was further defined in the National Budget for 2010, section 5.4.4, which states that producers of products that contain tobacco shall be excluded from the GPFG.

RTL is made from remnants, dust and other by-products of the processing of tobacco leaves and from parts of the tobacco plant that cannot otherwise be used (stems, etc.).⁴ These are processed through various techniques into a product that is used in the manufacture of cigarettes. RTL can constitute up to 10–15 per cent of the tobacco content of cigarettes.

2 Information provided by the companies

2.1 SCHWEITZER-MAUDUIT INTERNATIONAL INC.

In its investor report for the third quarter of 2012, the company states that it produces some 75,000 tonnes of RTL a year. This amounts to approximately half of the global production of RTL. The company also describes its plans for further expansion, with an annual production of 30,000 tonnes of RTL to begin in China in 2014.⁵

The Council on Ethics has written to the company asking whether it is involved in the production of tobacco but has not received a response.⁶

2.2 HUABAO INTERNATIONAL HOLDINGS LIMITED

In its annual report for 2011–2012, the company states that it is one of the largest producers of RTL in China and is in the process of further expanding its production capacity by building a production line with an annual production of 20,000 tonnes.⁷

The Council on Ethics has written to the company, asking whether it is involved in the production of tobacco, but has not received a response.⁸

3 The Council's assessment

RTL is primarily made from the tobacco plant and must thus be regarded as a tobacco product. The production of RTL therefore constitutes grounds for exclusion from the GPFG.

The two companies in this recommendation state in their annual reports and investor presentations that they produce RTL. The Council on Ethics has based its recommendation on this information.

4 Recommendation

In light of the above, the Council on Ethics recommends that the companies Schweitzer-Mauduit International Inc. and Huabao International Holdings Limited be excluded from the investment universe of the Government Pension Fund Global.

Ola Mestad
Chair

(sign.)

Bente Rathe

(sign.)

Dag Olav Hessen

(sign.)

Marianne Olsson

(sign.)

Ylva Lindberg

(sign.)

Notes

- 1 Guidelines for the Observation and Exclusion of Companies From the Government Pension Fund Global's Investment Universe: <http://www.regjeringen.no/nb/sub/styrrer-rad-utvalg/etikkradet/etiske-retningslinjer.html?id=425277>.
- 2 ISIN, Schweitzer-Mauduit International Inc.: US8085411069.
- 3 ISIN, Huabao International Holdings Limited: BMG4639H1227.
- 4 Note the comments on the *Norwegian Customs Tariffs*, chapter 24, paragraph 6, item 6: <http://www.toll.no//upload/tolltariffen/kommentarer/Kommentarer2012/kom24-2012.pdf>.
- 5 Schweitzer-Mauduit International, Investor Presentation, 5 November 2012: <http://phx.corporate-ir.net/External.File?item=UGFyZW50SUQ9MTYwMzc3fENoaWxkSUQ9LTF8VHlwZT0z&t=1>.
- 6 Letter from the Council on Ethics to Schweitzer-Mauduit International Inc., dated 17 December 2012.
- 7 Huabao International Holdings Limited, Annual Report 2011-2012, http://huabao.todayir.com/attachment/20120629170201001454998_en.pdf.
- 8 Letter from the Council on Ethics to Huabao International Holdings Limited, dated 17 December 2012.

To the Ministry of Finance

20 March 2013

UNOFFICIAL ENGLISH TRANSLATION

Recommendation on the observation of Eni Sp.A

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1 Summary

The Council on Ethics recommends that the Italian energy company Eni Sp.A (Eni) be placed under observation for a period of up to four years due to serious environmental damage caused by oil production in the Niger Delta, Nigeria. As of 31 December 2012, the Government Pension Fund Global (GPF) owned shares in Eni with a market value of NOK 9,137 million, equivalent to 1.87 per cent of the shares in the company.

Eni has produced oil in Nigeria since 1962. Its wholly owned subsidiary Nigerian Agip Oil Company Ltd. (NAOC) is the operator for a joint venture (JV) that consists of the state-owned oil company Nigerian National Petroleum Corporation (NNPC) as the majority shareholder (60 per cent) and NAOC and Phillips Oil Company Nigeria Ltd. (a subsidiary of ConocoPhillips), each with a 20 per cent interest in the JV.

Oil production in the Niger Delta has among other things been criticised for oil-spill pollution and air pollution caused by the flaring of associated gas, as well as for breaches of human rights. The Council on Ethics has assessed oil spills from onshore oil production and their consequences. The Council's assessments have included the NAOC JV and others. The Council has assessed the extent of oil spills and environmental damage, whether oil spills and environmental damage have major consequences for human life and health, whether oil spills and damage are a result of breaches of national legislation or various standards, the company's responsibility, whether the company has implemented adequate measures to prevent and if relevant rectify damage, and whether the company's practice is likely to continue.

The Council on Ethics' assessments have shown that NAOC's oil production has for a long time led to frequent and, in total, extensive oil spills. The frequency and volume of the reported oil spills are minimum figures but are far higher than those which are normal in an international perspective and those which Eni experiences in other operations. This applies to oil spills resulting from both operational failure and sabotage. Sabotage includes both destructive actions and the theft of crude oil, often referred to as 'bunkering'. Oil theft has developed into a billion-dollar industry in the Niger Delta and results in frequent, but to a large extent unquantified, oil spills. The scope of, and technology for, oil thefts vary from the most primitive and polluting small-scale methods to professional and well-equipped operations that tap large volumes of oil from pipelines or wellheads and transport the crude oil to tankers for 'export'. These at times well-organised crimes take place relatively openly.

Oil spills resulting from operational failures are due, for example, to corrosion, equipment failure or human error by the operator. It is a known fact that parts of the infrastructure in the Niger Delta are old or weak and that the replacement of infrastructure is taking longer than is desirable due to the lack of financing in the JV, primarily because NNPC is not given sufficient resources by the state.

From 2000-2010, Eni reported a large number of oil spills. The number of oil spills, especially those caused by sabotage, increased during the period. More than two-thirds of the oil spills during the period were caused by sabotage. Preliminary figures for oil spills in 2011 and parts of 2012 show that the numbers are on a level with the highest annual figures during the 2000-2010 period.

The reported volume of oil spills varies greatly from year to year and is dominated by a few large oil spills, while most of the oil spills are small in volume. The annual oil-spill volume was on average at around the same level in the 2006-2010 period as in the 2000-2005 period. While the oil-spill volume caused by sabotage fell between the 2000-2005 and 2006-2010 periods, the oil-spill volume caused by operational failure increased. Sabotage caused more than 80 per cent of the oil-spill volume during the 2000-2010 period. Preliminary oil-spill figures for 2011 and parts of 2012 show that the total oil-spill volume has fallen from the high figures for 2009 and 2010 and is at around the average for the 2000-2010 period.

The reported oil spills per produced barrel of oil equivalent (boe) fell slightly (<5 per cent) from the 2000-2005 period to the 2006-2010 period. Eni's oil spills per produced boe are much less outside Nigeria.

Oil spills in the Niger Delta affect in part ecologically sensitive and valuable areas and in part densely populated areas. While minor oil spills often have local or short-term consequences, major oil spills that are not properly cleaned up and rehabilitated often cause extensive and long-term damage to land areas, rain forests, wetlands, fresh water, mangroves and coastal zones. This also causes serious harm to the local population's livelihoods.

Eni's control over and responsibility for the operation are regulated by the JV Agreement (JVA) and the way in which it is practised. In the JV, decisions on standards, guidelines, investment and operations budgets, plans, etc., are reached by consensus. Each participant has in principle a right of veto. All the participants are responsible for the decisions and their implementation. The right of veto has been practiced by NNPC but does not seem to have been used by the other companies, either individually or jointly. The oil industry is the Nigerian state's most important source of income and investment costs in joint ventures compete with other expenses in the national budget. In practice, this has for a number of years reduced the investments in oil infrastructure. This contributes to the operator being left with the responsibility for the day-to-day operations without the means to ensure the proper operation of the infrastructure.

The Council on Ethics and Eni have had a dialogue from 2010-2012 in which the company allowed access to a lot of information and made its views known. Eni states that it bases its operations in Nigeria on the same standards as in other countries but underlines the unusually complex conditions under which NAOC operates. The company acknowledges the extensive oil spills and their negative effects on the ecosystem and poverty-stricken local population. Eni stresses that this is a highly undesirable situation for all parties concerned. The company believes that oil spills and pollution are primarily caused by unauthorised third parties through oil thefts and sabotage and that this lies outside the company's control. Eni emphasises that there are on the whole sufficient resources available for the operations, and that oil spills are cleaned up and rehabilitated as quickly as possible. Eni states that it invests a lot of resources in preventive measures, in monitoring pipelines to prevent oil spills and in testing out new methods in several areas to handle the unusual conditions in the Delta.

Eni acknowledges that the current JVA and the way in which it is practised restrict

the freedom to act and that persistent underfunding makes major investments difficult. Despite the enormous challenges involved in producing oil in the Niger Delta, Eni sees opportunities for positive change.

The Council on Ethics has considered recommending exclusion or observation. The Council finds that the frequency and volume of oil spills, both those caused by operational failure and those caused by sabotage, are extremely high for the NAOC JV, despite the fact that the reported figures are minimum figures in relation to the actual oil spills that can be linked to NAOC's oil production and infrastructure, whether caused by operational failure or sabotage. Many ecologically sensitive and very valuable areas have been damaged by large, repeated or inadequately cleaned up and rehabilitated oil spills. The Niger Delta is one of the most oil-influenced large ecosystems in the world and the damage is large and long-lasting in many areas. The local population's livelihoods are also very negatively affected by oil spills. The local people are often poor and have few alternatives other than to utilise the local environment's natural resources that have been damaged or destroyed by oil spills, such as fresh water, fish and agricultural land, to obtain food, drinking water and work. The Council on Ethics believes that this makes the consequences of oil spills very severe in many areas.

There is a clear link between NAOC's operations and the serious damage to the environment. The company has a responsibility for the NAOC JV's unanimous decisions and the implementation and follow-up of these as the operator. The operator also has a special responsibility to propose and implement measures to prevent or reduce damage. The Council on Ethics thus believes that the company has a responsibility for the serious damage to the environment and the local people's livelihoods.

In a situation where the authorities do not sufficiently enforce the national laws, the company must be expected to implement extraordinary measures to ensure that the activities do not breach legislation, norms or standards. Eni tries to base its operations in the Delta on international standards and invests considerable resources in this. As an operator, the company has nevertheless not managed to secure and monitor the infrastructure to a sufficient extent, or to prevent damage to the environment and the local people's livelihoods. The Council on Ethics finds that national legislation, international standards and Eni's own standards have not been followed.

As regards the future risk of damage to the environment and the local people's livelihoods, the Council on Ethics believes it is unlikely that major changes will take place in the short or medium term unless one or more of the following factors change significantly: A) Eni's willingness and ability to use the tools it has in the JV (such as voting on budgets, plans and operations which experience has shown lead to extensive oil spills, and more frequently shutting down production/infrastructure when the situation in the field indicates that this is necessary). B) The form of management within the JV and the financing of important investments in the JV operations. C) The ability and willingness of the Nigerian authorities and Eni to monitor and reduce oil thefts and sabotage.

Despite the serious circumstances, the Council on Ethics does not recommend excluding the company because it believes there is unusually great uncertainty about future developments. Among other things, the long process of revising the legislation

(Petroleum Industry Bill) is also expected to be completed soon and this may change the form of management and other conditions within the JV. In addition, the new government in Nigeria is indicating it will take measures to change the unusually problematic situation in the Niger Delta and weaknesses in the authorities' regulation of the petroleum sector. This has the potential to change factors referred to above. The Council on Ethics thus recommends that the company is put under observation for a period of up to four years. The Council will monitor the situation in the Niger Delta and regularly assess developments in key conditions, with the emphasis on the company's actions and utilisation of its freedom to act in a complex situation. During the observation, the Council will place particular emphasis on whether the extent of the oil spill from Eni's operations and the unacceptable harmful effects have been significantly reduced. The way in which the JV is managed, and in particular Eni's role as the JV operator, are another main issue, together with the authorities' handling of the oil-spill issue and especially Eni's actions in relation to this.

2 Introduction

In March 2010, the Council on Ethics decided to assess the GPFG's investment in the Italian energy company Eni Sp.A (Eni)¹ based on the guidelines for the observation and exclusion of companies from the GPFG's investment universe (the Ethical Guidelines).² The Council on Ethics has monitored the situation related to pollution from oil production in the Niger Delta for several years and started a more thorough assessment of onshore oil production in 2010. This assessment included Eni and its wholly owned subsidiary Nigerian Agip Oil Company Ltd. (NAOC), which is the operator for the NAOC joint venture (the NAOC JV).

2.1 WHAT THE COUNCIL HAS ASSESSED

The Council on Ethics has considered whether there is an unacceptable risk that Eni is responsible for or contributes to serious damage to the environment according to paragraph 2, third subsection, letter c) of the Ethical Guidelines. There has been extensive local, national and international criticism of several circumstances of the company's operations in the Niger Delta. This criticism relates to such things as frequent oil spills leading to major consequences for the environment and local community; the destruction of habitats caused by the building of physical infrastructure or greater access to quite untouched or vulnerable areas due to the creation of, for example, roads, pipelines and channels; various types of pollution from exploration and production activities; the flaring of associated gas which leads to local and global pollution; and complicity in various breaches of human rights. To start off with, the Council assessed the diverse environmental damage in the Niger Delta based on the Ethical Guidelines.³ The Council then decided to concentrate its detailed studies on local environmental damage from oil spills due to onshore oil production. The Council on Ethics considered that the frequency and extent of oil spills were the most serious risk with regard to the Ethical Guidelines. In some areas, other consequences of oil production (such as the building of infrastructure, greater

access to untouched areas and cumulative consequences) may nonetheless be more serious than small oil spills.

The Council on Ethics assesses what is serious environmental damage in each individual company report and based on an overall assessment of specific operations and activities. Among other things, the Council places emphasis on whether:

- the damage is significant,
- the damage results in irreversible or long-term consequences,
- the damage results in significant negative consequences for people's life and health
- the damage is a result of national laws or international norms being breached
- the company has failed to act in order to prevent the damage
- the company has implemented sufficient measures to rectify the extent of the damage,
- it is likely that the company's practice will continue.

2.2 SOURCES

The Council has obtained information and documentation⁴ from the company, researchers, authorities, voluntary organisations and the media that is mainly in the public domain. The company has given the Council access to a lot of documentation. The quality of the available information varies greatly but has been considered sufficient or good for key parts of the recommendation. However, there is significant uncertainty linked to the extent of the oil spills, especially the volume. The assessments are primarily based on the material which the company has made available and other publicly available information from various reports and sources. Discussions with company employees and others have been useful in interpreting the material. The assessments in the recommendation concentrate on the frequency and volume of oil spills caused by sabotage⁵ and operational failure,⁶ factors which lead to oil spills, the cleaning up of oil spills and the management structures for the oil-production operation (NAOC JV), including the responsibilities and controls within the JV operation.

The Council on Ethics has obtained and assessed information and documentation through a step-by-step assessment process. Following introductory studies, the Council on Ethics had extensive contact with the company in 2010, 2011 and 2012. During the Council on Ethics' contact with Eni, the company was very open and replied in writing to several rounds of extensive questions from the Council.

Representatives of the Council on Ethics visited the Niger Delta in February 2011. They have held meetings with Eni in Milan and Abuja. The Council has also held meetings and other contact with various interest groups and experts.

3 Background

3.1 ENI

Eni is an integrated energy company with activities in 85 countries and around 79,000 employees. It has extensive activities in the oil and gas sectors and is an important international player in the oil-exploration and -production sector, especially in Africa. The

company is listed on the Milan and New York Stock Exchanges. As at 31 December 2012, the GPFG owned shares in Eni with a market value of NOK 9,137 million, equal to 1.87 per cent of the shares in the company. The GPFG also owned an interest-bearing instrument in Eni worth NOK 306 million.

Eni has been involved in oil production in Nigeria since 1962. Nigerian Agip Oil Company Ltd. (NAOC) is the operator for the NAOC joint venture (NAOC JV).

3.2 THE NIGER DELTA

3.2.1 NATURAL CONDITIONS

The Niger Delta covers a large area in the south of Nigeria (refer to figure 1). The exact size of the delta depends on the political, ecological or hydrological definition used. The authorities' Niger Delta Development Commission (NNDC) has defined the Niger Delta as an area of around 112,000 km² with a population of over 30 million.

The Niger Delta is exceptionally rich in natural resources and contains many important and sensitive ecosystems and unique biodiversity values in various types of forests (such as mangroves, swamp forests and rain forests), wetlands, fresh water and a productive coastal zone. The delta also has important spawning and nursery areas for fish populations in both Nigeria and along other parts of the coast of West Africa. Productive agricultural areas and rich fishing areas have led to the delta having one of the densest populations in Africa in many places. The areas with the densest populations have lost a lot of their natural value. The delta is supplied with water and food from the large Niger Basin, the ninth-largest area of precipitation in the world and the third-largest in Africa.



Figure 1: Location of Nigeria and the Niger Delta.

The Niger Delta is considered to be one of the ten most important wetland and coastal marine ecosystems in the world⁷ and has among other things a mangrove forest that is the third-largest in the world and the largest in Africa.

The Niger Delta also contains exceptionally large petroleum resources. The delta has been and will probably continue to be a globally very important area for oil and gas production.

3.2.2 SOCIOECONOMIC CONDITIONS AND CONFLICTS

Nigeria and the Niger Delta have a turbulent history that has at times been full of conflict. Since the end of the 1990s, the country has taken important steps towards democracy. Nigeria is now a developing democracy but has major challenges relating to both its form of governance and economic development (such as corruption, the abuse of power and differences in the material standards of living of various groups).⁸ The petroleum sector faces particularly large challenges related to corruption and other problems concerning its form of governance,⁹ something that is also acknowledged by Nigeria's top politicians.

In 1980, 28 per cent of Nigeria's population were categorised as poor. More than 20 years later, 71 per cent were considered to be poor. According to many development indicators, the Niger Delta is below average in Nigeria.¹⁰ Much of the population lacks access to fundamental services such as clean water, electricity and medical assistance. More than 70 per cent of the population of the Niger Delta lives in more or less a subsistence economy in which the local nature comprises the basis for their existence in the form of agricultural areas, fishing resources, fresh water, forests, etc.

Nigeria is extremely dependent on the capital-intensive petroleum sector. Petroleum accounts for around 95 per cent of the country's export revenues.¹¹ In 2010, Nigeria was ranked as no. 182 of the world's 190 countries measured by GDP per person (USD 2,400).

It is a common opinion among the local population that they live in extreme poverty while enormous revenues from the delta do not benefit them. Paradoxically, the poverty in the Niger Delta has increased during the period when huge volumes of oil and gas have been produced.¹² The Niger Delta is characterised by exceptional distrust between various groups and players. The local population feel to a large extent let down by the authorities and oil companies and often have a deep-rooted distrust of these. Distrust and conflicts also exist between various population groups in the delta.

There is a lot of power at federal level and revenues from both the petroleum sector and taxes and duties are to a large extent passed on to the states and local level through the federal level. The forms of governance at federal level, state level and local level, in which traditional government structures are still important, are all of importance to problems linked to the oil industry.

3.2.3 OIL PRODUCTION

Commercial crude-oil production has taken place for more than 50 years since Shell British Petroleum (now Royal Dutch Shell) found oil at Oloibiri in 1956 and started production in 1958. The oil company started production on land and has since moved out into the swampland and shallow areas on the continental shelf and later also to deeper sea areas outside the continental shelf. A number of international oil companies have taken part in these developments and operate in the Niger Delta.

International oil companies are directly involved in exploration and production activities through three main arrangements, of which the oldest and from a production viewpoint clearly biggest is joint-venture agreements with the state-owned oil company Nigerian National Petroleum Corporation (NNPC). NNPC is the majority partner in each joint venture. However, the operator is always an international oil company. Each joint

venture has an Operating Committee (OPCOM) which decides on the frameworks for the joint venture's operations, such as its budget, work schedules, standards, etc. NNPC usually has six representatives while the operator usually has four. Any other partners usually have one representative each. OPCOM decisions must be unanimous.¹³ Gradually, two other types of agreement have also been developed and these do not require the state to contribute direct financing in cash as a joint venture does: Production Sharing Contracts (PSCs) and Service Contracts (SCs). The international oil companies have stronger rights to the oil resources in a joint venture than in a PSC or SC. In Nigeria, a joint venture covers many oil fields and in part very large areas, while in other parts of the world a joint venture often only covers one oil field.

Over the past 50 years, the oil and gas industry has developed into by far the most important sector for the state's revenues and the country's export revenues. More than 25 billion barrels of oil have been produced in the Niger Delta. The crude oil is of high quality for refinement purposes and is in demand. The oil industry currently has a large physical presence in the delta, with thousands of kilometres of pipeline, several thousand wells¹⁴ and a large number of flow stations and other physical infrastructure. The land directly used by these installations is limited when measured as part of the delta, probably less than one per cent, but the area that is directly and indirectly affected is many times greater than this.

Onshore oil and gas production in the Niger Delta often consists of a large number of production wells that, through an extensive network of pipelines, are linked to flow stations that collect oil from a number of wells and separate water and gas from the crude oil. From the flow stations, the crude oil is transported in fewer and larger pipelines to an export terminal (see figure 2). A small volume of oil is refined in Nigeria.

In 2010, Nigeria was ranked number 12 of the world's oil producers measured in production, number 5 measured in exports and number 10 measured in proven reserves. The corresponding figures for natural gas are 26, 11 and 9.¹⁵ Nigeria imports refined petroleum products, partly due to its limited refining capacity but not least due to the low utilisation of its refining capacity. Nigeria has a chronic shortage of fuel, which makes it lucrative to both import fuel and sell locally refined fuel from illegally tapped oil in the black market.

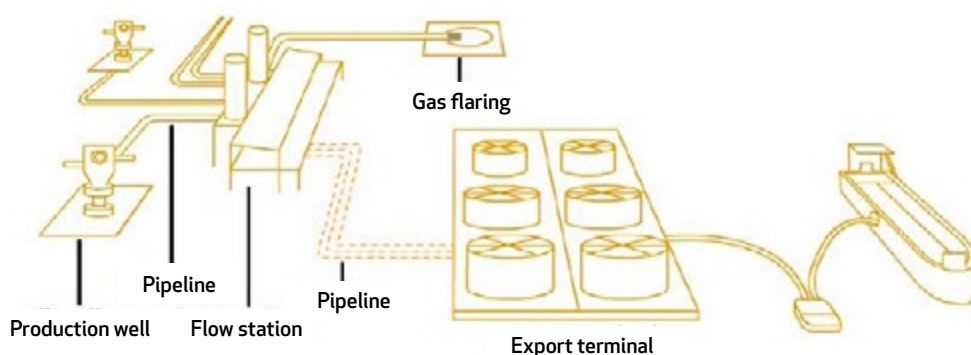


Figure 2: Simplified sketch of typical onshore oil production in the Niger Delta.

The Niger Delta is an unusually challenging and complicated place in which to produce oil. The natural conditions mean that access to parts of the river delta and wetlands is difficult. Even more important are complicated and sophisticated mechanisms to make individuals or groups wealthier, corruption, political and economic power struggles and ethnic and historical conflicts. Extensive organised crime in the form of oil thefts for billions of dollars, often taking place openly and apparently without consequences, is strikingly common. The delta is characterised by massive distrust between many of the players, a great deal of frustration and at times direct aggression towards the state and petroleum industry which makes the safety situation in the delta difficult (such as attacks on oil installations, sabotage and kidnapping). Many local people feel that the state and oil industry have taken most of the enormous oil-production revenues and in many cases weakened their already vulnerable and marginal livelihoods.

The petroleum-sector legislation in Nigeria has been under revision for a long time and been discussed in the national assembly several times. After several long-lasting postponements, there is still a great deal of uncertainty about the content of the new legislation (Petroleum Industry Bill), but many people expect changes to primarily affect offshore operations in deep waters. It is unclear when new legislation will be in place.

3.3 THE NAOC JOINT VENTURE

The NAOC JV has three partners (refer to figure 3). NNPC is the majority partner, while Nigeria Agip Oil Company Ltd. (a subsidiary of Eni) and Phillips Oil Company Nigeria Ltd. (a subsidiary of ConocoPhillips) each have a 20 per cent stake. The NAOC JV is an important oil-production player in the Niger Delta and holds licences which cover an area of around 5,324 km². This area lies in four states (Bayelsa, Delta, Imo and Rivers), contains around 30 producing oil fields, a network of around 800 km of pipeline, more than 200 producing wells, and 12 stations for gathering oil and gas from wells before separation and transfer to export terminals or gas-fired power stations. The large licence area and extensive infrastructure mean that NAOC is in contact with around 350 local communities in the delta. The NAOC JV still has large oil and gas resources that are of high quality and relatively easily accessible.

In addition, NAOC is also a partner in another JV in the Niger Delta, namely the Shell Petroleum Development Company of Nigeria Ltd. (SPDC) JV. Shell is the operator for this JV, while NNPC and Total Exploration and Production Nigeria Ltd. are the other partners. NAOC has a 5 per cent economic interest in this JV, while NNPC, SPDC and Total have a 55, 30 and 10 per cent interest respectively.

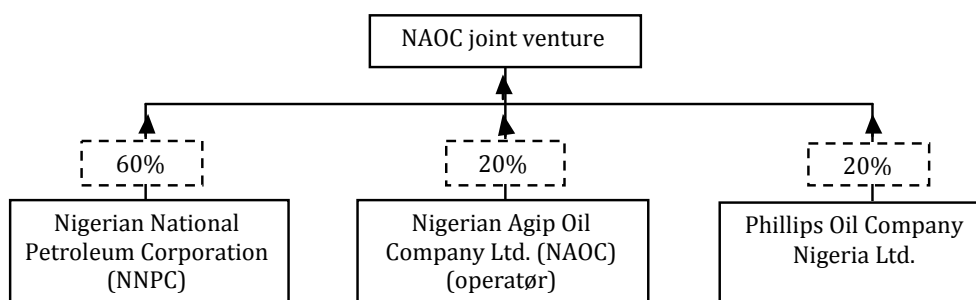


Figure 3: Economic interests in the joint venture for which NAOC (Eni) is the operator.

The relationship between the partners in the JV is governed by a Joint Operating Agreement (JOA). The JV's operations and investments are financed by cash contributions from the partners in proportion to their economic interest in the JV. The JV is not a registered company with limited liability that raises loans and finances its operations and investments with the flexibility that such a company has. The federal authorities in Nigeria do not allocate enough resources to ensure that NNPC contributes its share of the financing in order to safeguard the optimal operation of the JV. In practice, capital-intensive investments in the petroleum sector compete with other social measures for limited resources in the annual state budget. There have been too small annual contributions and too much unpredictability and underfinancing in Nigerian JVs for a number of years, this does not apply only to the NAOC JV.¹⁶

In exceptional cases, the JV has made large investments (such as in a production plant) without NNPC's contribution. The other partners have in such case paid NNPC's share in advance under separate agreements (modified carry agreements). The oil companies want to minimise the use of this model in so far as possible because it in practice deviates from the JOA without other parts of this agreement having been reassessed, and because it is economically risky.

The JV's most important decision-making forum is its Operating Committee (OPCOM), which among other things approves and revises budgets and work schedules and determines the JV's guidelines, standards, procedures and investigations, etc. Various sub-committees provide advice. The OPCOM checks that decisions are carried out. The Council on Ethics assumes that the composition of NAOC JV's OPCOM is as shown in table 1.

Table 1: The number of representatives from – and key tasks for – the members of the NAOC JV's OPCOM.

Joint venture partner	No. of representatives	Key tasks
Nigerian National Petroleum Corporation (NNPC)	6	Appoints the chair. Provides financing equal to its 60 per cent stake.
Nigerian Agip Oil Company (NAOC)	4	Responsible for the day-to-day operation of the joint venture as the operator. Provides financing equal to its 20 per cent stake.
Phillips Oil Company Nigeria Ltd.	1	Provides financing equal to its 20 per cent stake.

OPCOM decisions are made based on consensus. Frequent contact between the JV's partners seems to ensure that proposals which are submitted to the OPCOM are agreed to by all the partners. A partner can in principle unilaterally block a proposal with which the partner disagrees. In practice, NNPC seems to be the one that blocks proposals regarding, for example, major investments that cost more than the state can contribute, or measures that sharply reduce the flow of income (such as shutting down production for lengthy periods). Eni has stated that there are usually sufficient resources in the operating budget, including for cleaning up, rehabilitation and compensation for oil spills. Questions linked to oil spills are regularly discussed by the OPCOM and various sub-committees.

The operator is responsible for the day-to-day running of JV operations within the budget, schedules, standards, etc. that the OPCOM has agreed on. The operator cannot

make unilateral decisions without the acceptance of the OPCOM. This reduces the operator's freedom of action. In an emergency, the operator may implement measures it believes are necessary to safeguard life and property and prevent pollution without the permission of the OPCOM.

Along the pipelines, it is primarily the local population that have contracts with the operator to monitor irregularities and maintain a corridor along the pipelines (a right-of-way), among other things to prevent high vegetation growing in the pipe trenches. The operator also has an infrastructure-monitoring system to discover such things as the illegal tapping of oil or damage which leads to oil spills. The Nigerian authorities are responsible for safety at strategically important installations (such as production plants, export terminals and power stations).

The JVA is different from normal JV agreements in the industry in several areas. For instance, it is not normal in other countries for the state-owned oil company to make decisions alone, even where the state-owned company has the majority interest. In practice, NNPC makes some decisions alone by not providing sufficient financing to ensure that certain investments are carried out. Normally, a JV partner loses rights if it does not fulfill its duties according to the agreement (such as in the form of financial contributions), and may for example lose its right to vote. In the most extreme situations, a partner may lose its stake in the JV in return for financial compensation. In Nigeria, NNPC's failure to provide contributions and make payments does not seem to have significant consequences for NNPC's role in a JV.

4 The main issues and the Council on Ethics' findings

4.1 THE EXTENT OF THE OIL SPILLS

The Niger Delta has been subject to many thousands of oil spills over the past few decades, especially from onshore production. There are no exact figures for oil spills and estimates from various sources vary widely. The figures for and volumes of oil spills are disputed and subject to a great deal of uncertainty. Civil-society groups claim the companies' and state's reports are incomplete, present far-too-low figures and lack independent verification. The Nigerian authorities do not publish complete statistics and figures issued by the authorities also do not always seem to be consistent. The Council on Ethics has reviewed the statistics showing the frequency and volume of the NAOC JV's oil spills to which Eni has given the Council access. The main trends during the 2000-2010 period are explained in further detail below. Preliminary figures for 2011 and parts of 2012 were available during the Council's final discussions on this case and are referred to briefly.

The Council on Ethics has used NAOC's data as a minimum estimate.¹⁷ Various studies point out that the reported figures are minimum estimates, and some claim that the actual oil spills are many times larger than the reported figures.¹⁸ The Council on Ethics has no good indications of the extent of unreported or incorrectly reported oil spills but assumes that the reporting is on the whole incomplete for various reasons.

4.1.1 NUMBER OF OIL SPILLS

From 2000-2010, Eni reported a large number of oil spills in the Niger Delta that were larger than one barrel of oil. The number of oil spills increased during this period, especially after 2006 and especially oil spills caused by sabotage. The annual number of oil spills caused by operational failure almost doubled from the 2000-2005 period to the 2006-2010 period, while the number of oil spills caused by sabotage almost tripled. Around 72 per cent of the oil spills during the 2000-2010 period were caused by sabotage. The preliminary figures for oil spills in 2011 and parts of 2012 show that these figures are on a level with the highest annual figures during the 2000-2010 period, which means that the number is higher than the average for the 2006-2010 period.

4.1.2 VOLUME OF OIL SPILLS

The total volume of oil spills varies widely from year to year and is dominated by a few large oil spills, while most oil spills are small in volume. The major contribution from a few large oil spills leads to there being no clear trend in the volume of oil spills over time, either for the total oil-spill volume or the volume of oil spills divided into those caused by sabotage and those caused by operational failure.

The annual reported oil-spill volume was on average at around the same level in the 2006-2010 period as in the 2000-2005 period. While the annual volume of oil spills caused by sabotage fell from the 2000-2005 period to the 2006-2010 period, the volume of oil spills caused by operational failure increased. Sabotage caused more than 80 per cent of the oil-spill volume in the 2000-2010 period. Preliminary oil-spill figures for 2011 and parts of 2012 show that the total oil-spill volume has fallen from the high figures for 2009 and 2010 and is around the average for the 2000-2010 period.

The reported oil spills per produced barrel of oil equivalent (boe) also varied widely during the 2000-2010 period. The variation has roughly been the same as for the oil-spill volume. The oil spill per produced boe fell slightly (<5 per cent) from the 2000-2005 period to the 2006-2010 period. Eni's oil-spill figures per produced boe are much lower outside Nigeria.

4.2 CAUSES OF OIL SPILLS

The causes of oil spills in the Niger Delta are normally classified as either sabotage or operational failure. The cause of an oil spill is normally determined by a so-called joint investigation team (JIT). Such a JIT is established after an oil spill and consists of representatives of the authorities, operator and local communities that are affected, each of which chooses its own representatives. The JIT tries to achieve consensus on the cause. In the case of disagreement, the authorities will report their conclusions. Eni believes the cause of oil spills is in most cases easy to determine. The operator and authorities seem to agree on the cause in almost all cases.

The classification of cause is at times disputed. According to Nigerian law, compensation is to be paid for damage when the cause is operational failure, but not if it is sabotage. While the local community is interested in classifying the cause as operational failure so that it will receive compensation, the oil companies are interested in classifying oil spills

as sabotage in order to avoid paying compensation. Civil-society groups often claim that companies and authorities under-report operational-failure causes and often erroneously classify causes as sabotage. At a local level, frustration about the lack of benefits from the oil production, many destructive oil spills, etc., may also lead to compensation for oil spills being seen as one of the few mechanisms that can be used to obtain revenues from the oil production, irrespective of the cause of the oil spill.

The information that the Council on Ethics has received from the company indicates that it is often easy to prove the direct cause of an oil spill. Therefore, allegations of significant wrong categorisation seem to be rather unlikely. The Council assumes that the reported ratio of sabotage causes to operational-failure causes is reasonably correct.

4.2.1 SABOTAGE

Sabotage may contain an element of protest against the authorities or the oil company and be an attempt to draw attention to political or other views and demands. During the 2005-2007 period, the number of very destructive sabotage actions, such as the use of explosives to blow up pipelines and other infrastructure, increased. The frequency of such actions declined after the authorities introduced an amnesty for militant groups that carried out such operations in 2009.¹⁹

The theft of crude oil, sometimes referred to as 'bunkering', has developed into a billion-dollar industry in the Niger Delta and results in frequent oil spills that are to a large extent not reported. SPDC estimates that more than 150,000 barrels of oil disappear each day from the JV operations.²⁰ With an oil price of USD 100 per barrel, this represents a value of USD 5.5 billion annually. The figure is probably much higher than that which the company can calculate based on measurements in limited parts of the pipeline network. Others believe the thefts are much greater and increasing sharply.²¹ The scope of, and technology used for, thefts vary from small-scale, primitive and polluting methods to make a hole in pipelines and transport small volumes of oil in open containers for 'local refining' to professional and well-equipped operations that tap large volumes of oil from pipelines or wellheads and transport the crude oil to tankers for 'export'. These at times well-organised crimes take place relatively openly, indicating that they are directly or indirectly, through protection or acceptance, linked to persons or groups with enough influence to prevent the extensive and prolonged thefts from being stopped. It is striking that these take place in this way and to this extent.

At times, sabotage may also be a purely speculative act by groups seeking either compensation for damage from oil spills that they themselves or their accomplices have caused or revenues through local contracts for cleaning up and rehabilitating oil spills.

4.2.2 OPERATIONAL FAILURE

Oil spills caused by operational failure are due, for example, to corrosion, equipment failure, or human error on the part of the operator. It is known that some of the infrastructure in the Niger Delta is old or weak for other reasons and that the infrastructure has been replaced more slowly than is desirable due to the lack of financing in the JV, primarily because NNPC is not given sufficient resources by the state. The at times limited access

to areas in the delta due to the security situation can weaken the monitoring and maintenance work and thus increase the risk of oil spills caused by operational failure. Recurring sabotage and repairs can also help to weaken the infrastructure, weaken the monitoring (for example because 'pigs'²² cannot be used) and as a result increase the risk of later operational failure.

4.3 CONSEQUENCES OF OIL SPILLS

The consequences of oil spills vary depending on factors such as where the oil spill takes place, the size of the oil spill, what natural values are affected, whether the spread of oil is prevented, whether the cleaning-up and rehabilitation work starts quickly, and whether the work is done efficiently and to a high standard.

Many oil spills affect relatively small areas. Some major oil spills and oil spills where the oil is spread by streams, rivers or tides can affect much larger areas. The delta is a relatively flat area, and oil spills will often be spread over a large area rather than aggregate in lower land. The Council on Ethics has not found any figures showing how much of the delta has been or is affected by oil spills, either in total or in relation to the NAOC JV. The Council assumes that large areas of the delta are affected, even though most of the large Niger Delta is not affected or only affected to a slight extent.

Oil spills have serious consequences for the areas that are affected during the period when the oil pollution exists. Vegetation is destroyed, water is polluted, and fish and game withdraw from the area or die. Oil spills can also go deep into the ground and down to the ground water even if this is not visible on the surface. Local communities whose livelihoods are based on these natural resources and who have few or no alternatives can experience very serious consequences due to damage to agricultural land, their drinking-water supply, forests, fish and other aquatic resources. This affects the food security, incomes and health of the local population.

Oil which is spilled will gradually decompose over time. This takes place when it is exposed to sunlight (photolysis) and biological decomposition by microorganisms which break down hydrocarbons. The extent of biological decomposition depends on such things as access to nutrients and oxygen, the temperature, and the microorganisms that are present. Since the crude oil in the delta is relatively 'light', some parts (such as volatile organic compounds) will to a certain extent evaporate and leave behind the 'heavier' and more solid components of the crude oil.

The duration of the consequences of an oil spill varies from days and weeks for small spills that have been handled efficiently, to months and years for large spills that have not been handled well, or recurring oil spills. Remedial measures to reduce the extent of the damage include firstly removing oil that can be collected and then rehabilitating affected areas, often by encouraging (adding oxygen and nutrients) growth in microorganisms that decompose oil (remediation by enhanced natural attenuation, RENA).

In the case of oil spills caused by operational failures, Nigerian law states that compensation is to be paid. In some cases, short-term alternatives are also given to the local population in the form of drinking water and food as part of the remedial measures. Quick and sufficient cleaning up and rehabilitation, combined with rapid and fair compensation,

reduce the oil spill's consequences for both the local population and the ecosystem.

Insufficient remediation has been a problem and a source of conflict for many years. At times, the company cannot enter the affected area quickly due to the security situation. The local opposition to NAOC has at times led to oil spills not being cleaned up and rehabilitated as quickly as is desirable. In several cases, local contractors and groups that Eni has hired to carry out the cleaning up and rehabilitation seem to have done work that is not good enough, or to have left the area before the work was finished. Both Eni and, ultimately, the authorities, must in principle approve the cleaning-up and rehabilitation work when the limit value for the permitted content of hydrocarbons in the soil has been reached. There is reason to believe that at times neither the oil company's nor the authorities' follow-up is good enough, among other things because of vagueness about the division of roles between departments and different interpretations of the regulations.²³

There is very little publicly available documentation of the effects of oil spills on specific areas in the Niger Delta. A lot of resources must have been utilised on studies and assessments in connection with the building or upgrading of infrastructure and probably also before the authorities have approved the cleaning up and rehabilitation of many oil spills. This information seems on the whole to be only available to the authorities and companies, with the exception of some impact analyses in connection with the creation of more modern infrastructure. Eni does not seem to have considered cumulative consequences – either the cumulative consequences of recurring oil spills, the consequences of oil spills and other effects of oil production or the consequences of oil production and other effects on the natural environment or local population.

There is very little information available from the monitoring of the consequences of oil spills for the local population and the ecosystem. In many, perhaps most, cases, there seems to be no information on parameters other than hydrocarbons in the soil. But even this limited information is only published to a slight extent. In such a rich and productive area as the Niger Delta, it is natural to expect a number of biological and socioeconomic conditions to be monitored, verified and published. Without documentation of the extent of consequences, the authorities and oil companies, which are to respectively regulate and implement efficient measures, will not really know what measures are necessary and effective to minimise the extent of the damage. The lack of publicly available and credible documentation has also led to a lot of more or less justified accusations against the company and authorities and an at times very high level of conflict.

4.4 NATIONAL LEGISLATION

Nigeria has several laws that are relevant to the environmental conditions while oil is being produced. The perhaps most important instrument is the Environmental Guidelines and Standards for the Petroleum Industry in Nigeria (EGASPIN).²⁴ In principle, the standards defined in EGASPIN and other parts of the regulations are high. For example, Nigeria's Petroleum Act 1969 states that oil and gas production must be in accordance with that which is generally accepted practice on oil fields, as defined in US standards.

The limits when it comes to standards seem primarily to lie in the authorities' and the company's follow-up of the regulations. The environmental and other authorities have

limited resources. Vagueness about roles and responsibilities also weakens the follow-up (for example between the DPR and NOSDRA), and the situation is problematic when the authorities that follow up the most important instrument on the environmental side (EGASPIN) are the petroleum authorities (DPR) which are to regulate the state's own oil company, and oil is by far the most important source of revenue for the state. These challenges due to the form of governance are also illustrated by the fact that environmentally harmful and resource-wasting flaring of associated gas has taken place on a large scale for over 25 years after being prohibited in Nigeria.²⁵ During the ongoing revision of the petroleum-sector legislation (Petroleum Industry Bill), it has been proposed to split the state players into more institutions in order to separate and focus their respective roles, reduce in-built conflicts and improve effectiveness.

5 Information from the company

The Council on Ethics and the company exchanged several letters and held many meetings in 2010, 2011 and 2012. The company has also commented on the draft recommendation. The company has given the Council on Ethics access to extensive documentation and made key personnel in Eni worldwide and NAOC in Nigeria available to the Council on Ethics.

Eni states that the same standards as in other countries form the basis of its operations in Nigeria. The company underlines the unusually complex conditions and unique challenges in the Niger Delta and Nigeria, conditions which are very difficult to understand without having spent time in Nigeria and the delta. Conditions in the Niger Delta are very challenging for all onshore oil production, not only for NAOC. The operational frameworks in the delta are also very different from operations in other parts of West Africa which also take place in river deltas with similar natural conditions but much fewer oil spills. The company has implemented extraordinary measures due to the difficult operating conditions in the Niger Delta.

Eni acknowledges that there are many oil spills and that these have negative effects on the ecosystem and the poverty-stricken local population. The company points out that today's oil-spill situation is very undesirable for all parties for economic, operational, environmental and social reasons. For the company and JV, oil spills mean a loss of oil and revenues, extra costs, the shutdown of production, and reputational harm. Eni emphasises that oil thefts and sabotage are a huge problem and the reason for most of the oil spills. Eni believes this is outside its control, and that NAOC has a good monitoring system.

Eni states that there are, on the whole, enough resources available for operations and for the cleaning up and rehabilitation of oil spills, and this work is done as quickly as possible. Eni states that it invests a large amount in preventive maintenance and monitoring pipelines to prevent oil spills (such as replacing old or damaged pipelines and shutting down production if there is any indication of an oil spill). The company also tests out new methods for dealing with the unusual conditions in the delta (such as various ways of monitoring infrastructure and laying pipelines deeper). There are also restrictions on

NAOC as an operator since NAOC cannot make unilateral decisions in the JV when it comes to preventing oil spills (with the exception of declaring an emergency).

Eni acknowledges that today's JV Agreement and the way in which it is practised restricts the operator's freedom of action, and that persistent underfunding is a challenge when it comes to large investments. Despite major challenges, the company sees opportunities for positive change, among other things linked to the new political leadership in Nigeria and the amnesty.

6 The Council on Ethics' assessment

The Council on Ethics has assessed selected aspects of the NAOC JV's oil production where Eni is the operator, based on the Ethical Guidelines' criterion of serious damage to the environment, with the aim of recommending exclusion or observation. The Council has focused on the extent of the oil spills and the damage caused by these, the company's control over and responsibility for the environmental damage, whether the company has implemented sufficient measures to prevent and rectify damage, as well as the future risk of serious environmental damage.

6.1 THE EXTENT AND DURATION OF THE OIL SPILLS

The Council on Ethics' studies have shown that the onshore oil production in the Niger Delta has for many years led to frequent and, in total, extensive oil spills. The reported frequency and volume of oil spills, which the Council considers to be minimum figures, are far higher than those which are normal worldwide and those which Eni experiences in other operations in relation to oil spills caused by both sabotage and operational failure. The Council finds that oil spills to which access is delayed or lacking, oil spills that are not discovered, oil spills due to extensive thefts of oil and oil spills caused by the transport and refining of illegally tapped oil are factors which contribute to the actual oil-spill volume in the delta being much larger than that which is reported.

Many ecologically sensitive and very valuable areas in the Niger Delta have been damaged by large, recurring, or insufficiently cleaned-up and rehabilitated oil spills. There is little doubt that the delta is one of the most oil-influenced large ecosystems in the world. In many areas, the damage to agricultural areas, forest areas, wetlands, fresh water and mangroves is severe and long-lasting. Many people also live in areas where there is extensive oil pollution and their livelihoods and health are very negatively affected. These are often poor people who are especially vulnerable because they have few or no other alternative ways of obtaining food, clean water and work. The Council therefore considers the consequences of oil spills to be very serious, even though many of the small oil spills probably have few or no long-term consequences. The Council on Ethics finds it very unfortunate that there are so few studies and little monitoring of the actual consequences of the extensive oil spills in the Niger Delta. This weakens the basis for effectively remedying the damage caused.

6.2 RESPONSIBILITY AND CONTROL

An important element in the Council on Ethics' assessment is the extent to which Eni can be held responsible for oil spills that the company in many cases believes is outside its control. It is relevant to consider several factors, from the JV's decision-making processes to the implementation and follow-up of various measures in a complex operational context. The Council finds that there are a number of situations in which Eni as the operator can and should implement extra measures to reduce the risk of damage and the extent of the damage.

In the JV, decisions regarding standards, guidelines, investment and operations budgets, schedules, etc., are reached through consensus. In principle, all the JV partners have a right of veto. By their agreement, the partners are co-responsible for the decisions that are made. The Council on Ethics registers that the company does not often use its veto right and that Eni agrees to activities which will very likely lead to oil spills.

The operator is responsible for implementing measures to prevent oil spills, including monitoring and safeguarding physical infrastructure. It is likely that the lack of financing for major investments which has existed for a number of years has negatively affected several important, long-term measures, while measures to maintain the operations and flow of revenue have been prioritised. Extensive upgrades, for example by replacing old or weak pipelines, are expensive, both directly in the form of costs and indirectly in the form of the loss of revenue due to a production stoppage. Such investments seem to be difficult to prioritise in the JV, primarily due to the Nigerian state's persistent underfunding and secondly because the JV partners are not very willing to pay the NNPC's contributions in advance. Over time, the standard of the infrastructure has fallen for natural reasons (such as corrosion) and because of the external influence of unauthorised third parties (such as oil thefts). Parts of the current physical infrastructure of the JV operations are probably not up to the standard they should be or the standard that Eni wants them to be. In many places, it will also be impossible to use important technology such as "pigs" for maintenance and monitoring purposes. The Council believes these are factors that increase the risk of oil spills. There is thus an exceptionally great need for the operator to implement effective measures.

Thefts of crude oil and sabotage are undoubtedly important causes of oil spills and serious damage. Inadequate monitoring, insufficient measures implemented by the operator, and a lack of follow-up by the authorities to deal with illegal activities are important reasons for the thefts continuing on a strikingly large and growing scale. Various measures over the past decade to reduce thefts have on the whole not reduced the number of thefts or the volume of oil spills. The authorities in the petroleum sector, including NNPC, also face major challenges in relation to bureaucracy, corruption and inefficiency in a number of important areas.²⁶ The sector is in various ways a system governed just as much by the interests of individuals and groups as by consideration of the best interests of the Niger Delta and Nigeria.²⁷ The weak form of governance is an important factor in the extensive oil spills and the billion-dollar industry based on the theft of oil. The Council places emphasis on the operator having a responsibility to implement special measures to monitor infrastructure and to respond sufficiently to the risks relating to the actual operating conditions.

The operator may declare an emergency and shut down the production or transportation through pipelines without the approval of its JV partners if there is a danger to human life or a risk of serious damage to the operations or of severe pollution. The Council on Ethics finds very few examples of the operator making use of an emergency to prevent an oil spill, even when the risk is great. This contributes to the huge amount of oil spills and environmental damage.

The operator's access to parts of the delta is at times restricted out of consideration for the safety of the operator's own staff and contractors. This weakens the maintenance and monitoring of the infrastructure, and comes in addition to the challenges which lie in operating in a huge area and in a river delta with, in some locations, a poorly developed infrastructure. The risk of oil spills increases and the Council believes this also means that the company should implement extra and more effective measures to deal with risks (such as better monitoring and the shutdown of the production operations/infrastructure if there is a high risk of an oil spill).

Following an oil spill, the operator must make sure that the clean-up starts immediately and that the best available methods and procedures are utilised.²⁸ Rapid start-up and competent cleaning-up and rehabilitation work are important for reducing the extent of the damage. The relatively recent UNEP study from Ogoniland (where SPDC, not NAOC, is the operator) documents that it is not unusual for cleaning up and rehabilitation not to be carried out in accordance with Nigeria's own standards, despite the fact that the authorities visit areas with oil spills and also approve the cleaning-up and rehabilitation work. The Council on Ethics has not seen documentation of the response time, quality and extent of the risk assessments and sampling (such as of the soil, water and biological materials) in order to consider the quality of the cleaning-up and rehabilitation work in the NAOC JV's area. The Council registers that, in the case that is well documented (Ogoniland), defects have been found in the way that the authorities deal with the cleaning-up and rehabilitation work and finds that this is a risk element the operator should deal with.

The Council believes that, in accordance with the United Nations Guiding Principles on Business and Human Rights, which do not directly apply to the environmental area but apply to breaches of human rights as a result of environmental damage, the company must be required to implement appropriate action to prevent breaches of human rights.

Regarding this, article 19 of the Guiding Principles states the following, among other things:

‘Appropriate action will vary according to:

(i) Whether the business enterprise causes or contributes to an adverse impact, or whether it is involved solely because the impact is directly linked to its operations, products or services by a business relationship;

(ii) The extent of its leverage in addressing the adverse impact.’

The official commentary on the principle also states: ‘There are situations in which the enterprise lacks the leverage to prevent or mitigate adverse impacts and is unable to increase its leverage. Here, the enterprise should consider ending the relationship, taking into account credible assessments of potential adverse human rights impacts of doing so.’²⁹

Eni must conduct similar assessments regarding its situation in the Niger Delta.

When it comes to responsibility and control, the Council of Ethics finds that Eni is to a large extent responsible, and can and should exercise significant control in relation to all the elements referred to above, especially in the form of prevention where the risk is great but also in the form of more effective measures when damage has occurred. The company is not the only party responsible and does not have full control, but its' very good insight into the operating conditions and the risks indicate, in the Council's view, that the company should do more, especially to prevent serious damage in advance. In a situation where the authorities do not sufficiently enforce the national legislation, the company must be expected to implement extraordinary measures to ensure that its activities do not contravene national laws or international standards.

6.3 FUTURE RISK

The Niger Delta is an unusually complex area for an oil company to operate in, and several decades of oil production without a good form of governance by the authorities and oil companies have resulted in unusual mechanisms which are both very destructive and difficult to change. When it comes to oil spills, there have on the whole been few positive trends and the reported number of oil spills has increased while the annual oil-spill volume is at around the same level as before. Without drastic changes in important factors, the Council on Ethics believes that the major risk of serious environmental damage in the future will not be significantly reduced in the short or medium term. However, as described below, there is great uncertainty regarding some of these factors.

The company's utilisation of its freedom to act in a complex situation is a key element, including Eni's willingness and ability to actually use the tools the company has in the JV (such as voting in the JV, declaring an emergency and shutting down production/infrastructure), when experience shows that operations will lead to an unacceptably high level of oil spills caused by either operational failures or sabotage. The company's willingness to use these tools seems at present to be outweighed by the company's fear of risking its position in the JV and in the worst case losing rights in what for many years to come will probably be one of the world's most important areas for conventional oil production.

The JV's form of governance, the insufficient financing of important investments and, not least, Eni's role in the JV as the operator in this context are also important aspects. Any changes to the JV Agreement that reduce NNPC's power, or in any other way improve Eni's and the JV's ability and willingness to make important investments and implement other measures to prevent oil spills, may reduce the future risk and damage. Nigeria is discussing reforms in the petroleum sector, and an extensive new law (Petroleum Industry Bill) has been proposed. The new legislation's effect on the JV and on the operator's opportunity to exercise greater influence is unclear.

A third important factor is the ability and willingness of the Nigerian authorities and Eni to monitor and control unauthorised third parties, especially the oil-theft industry, but also sabotage actions. Oil thefts require, among other things, drastic measures by the authorities, better monitoring by the operator, and that the operator shuts down production or transport when there are major problems or a high risk involved.

The new government elected in 2011, with a president from the Niger Delta (Goodluck Jonathan), is signalling various moves to change the situation in the Niger Delta. Thus, various players, not least the oil companies, are optimistic about political changes that may extend the freedom of action of Eni and the other companies.

6.4 OVERALL ASSESSMENT

The Council on Ethics sees that oil spills are very undesirable for Eni, the JV, and the government. Spilt oil is lost oil, lost revenues, and increased costs. There is no reason to doubt that the company does a lot to reduce the extent of the oil spills, irrespective of whether the risk is of an operational nature or relates to unauthorised third parties. Nevertheless, oil spills are very large in extent and result in a situation which is environmentally and socioeconomically unacceptable.

Eni has a clear responsibility for the unacceptable damage situation, but the company is not solely responsible for this situation. The company can be said to be co-responsible for unanimous votes in the JV, and for implementing and following these up as the operator. The company has considerable control over key conditions in the matter and is responsible for implementing measures if there is a great risk of an oil spill. The link between the operations and oil spills and the likelihood of a large number of oil spills under the present conditions mean that the company should implement extraordinary and effective measures to a much greater extent than has been the case up to now.

However, the Council on Ethics believes that there is currently an exceptional amount of uncertainty about future developments. Among other things, changes may occur in the JV's form of governance and framework and Nigeria has a new government that is clearly indicating it wants to change the unacceptable conditions in the Niger Delta. As an operator, Eni has good qualifications for driving change.

On this basis, the Council does not recommend excluding Eni but recommends putting the company under observation. This observation must especially be of how Eni utilises its changing freedom of action in the complex situation in the Niger Delta. Specifically what freedom of action the company will have depends, among other things, on political developments. The starting point is that the extent of oil spills from NAOC's operations is too large at present and that the subsequent damage is unacceptable. The way in which Eni carries out its role as an operator, its right to vote in the joint venture and its overall investment in Nigeria will be key elements in this observation.

7 Recommendation

The Council on Ethics finds that Eni Sp.A is responsible for serious environmental damage in the Niger Delta but that there is exceptional uncertainty linked to future developments. The Council on Ethics therefore recommends that Eni be put under observation for a period of up to four years.

Ola Mestad
Chair
(signature)

Dag Olav Hessen
(signature)

Ylva Lindberg
(signature)

Bente Rathe
(signature)

Notes

- 1 The company's ISIN is "IT0003132476" and the company's ticker is "ENIIM".
- 2 http://www.regjeringen.no/en/sub/styrer-rad-utvalg/ethics_council/ethical-guidelines.html?id=425277.
- 3 NB: some of the onshore operations also have some activity in offshore coastal areas.
- 4 Key documentation is referred to in footnotes. Websites that are referred to were available on 20 March 2013.
- 5 Sabotage: sabotage comprises various acts by unauthorised third parties, such as the illegal tapping of oil from pipelines and other infrastructure on a large or small scale using various methods and technologies (the theft of crude oil, often called 'bunkering') and direct vandalism (such as blowing up pipelines).
- 6 Operational failure: oil spills due to operational failure are caused by failures in equipment (such as corrosion, faults in valves or gaskets) or human error by the operator.
- 7 Nigerian Federal Ministry of Environment, Nigeria Conservation Foundation, World Wide Fund for Nature & The World Conservation Union (2006). *Niger Delta Natural Resource Damage Assessment and Restoration Project - Phase 1 - Scoping Report*. Available at: http://www.google.no/url?sa=t&rct=j&q=&esrc=s&frm=1&source=web&cd=1&cad=rja&sqi=2&ved=0CB4QFjAA&url=http%3A%2F%2Fcmsdata.iucn.org%2Fdownloads%2Fniger_delta_natural_resource_damage_assessment_and_restoration_project_recommendation.doc&ei=uQedUM28LqaN4gSo8YDgBw&usq=AFOjCNGAsqQCmU5qiwXPbLlgYnfrBzd2HQ&sig2=IsNUzjac5_2tFCzn8bM5Wg.
- 8 Refer for example to Transparency International (2012). *Corruption perception index*. Transparency International, Berlin. Nigeria is ranked as country no. 139 out of 174 countries/territories. Available at: http://cpi.transparency.org/cpi2012/in_detail/.
- 9 Refer for example to Transparency International & Revenue Watch Institute (2011). *Promoting revenue transparency 2011 - report on oil and gas companies*. Transparency International, Berlin. State-owned company Nigerian National Petroleum Corporation (NNPC) is ranked last of all the companies considered. Available at: http://www.transparency.org/whatwedo/pub/promoting_revenue_transparency_2011_report_on_oil_and_gas_companies.
- 10 United Nations Development Programme (2006). *Niger Delta Human Development Report*. United Nations Development Programme (UNDP), Abuja.
- 11 Energy Information Administration (2012). *Country Analysis Briefs. Nigeria*. Energy Information Administration (EIA), U.S. Department of Energy, Washington, D.C. Available at: <http://www.eia.gov/countries/cab.cfm?fips=NI>.
- 12 UNDP (2006).
- 13 Ariweriokuma, S. (2009). *The political economy of oil and gas in Africa. The case of Nigeria*. Routledge, New York.
- 14 There are probably fewer than 2,000 wells in production today.
- 15 Refer for example to BP (2011). *BP Statistical Review of World Energy June 2011*. BP, London. Available at: http://www.bp.com/assets/bp_internet/globalbp/globalbp_uk_english/reports_and_publications/statistical_energy_review_2011/STAGING/local_assets/pdf/statistical_review_of_world_energy_full_report_2011.pdf.
- 16 Refer for example to Ariweriokuma, S. (2009).
- 17 The oil-spill volume is usually calculated at the site of the oil spill by a so-called joint investigation team (JIT), also referred to as a joint investigation visit (JIV). The JIT consists of representatives of the authorities, operator and affected local communities. Possible sources of error in such calculations include: problems in calculating the volume of a liquid that has spread over a land area and/or water, and where some of the oil may have been carried away by rain, rivers or tides; relatively quick evaporation of some of the relatively 'light' and volatile crude oil in the Niger Delta; the burning of oil in a fire; delay in the arrival of the JIT at the site (for example, for logistical reasons or because the local community refuses to allow the JIT access); the JIT is prevented from getting to the site of the oil spill (for example, due to reasons of security) so that no estimate of the volume is prepared; or the oil spill is not discovered or reported.

- 18 Refer for example to World Bank (1995). Defining an environmental development strategy for the Niger Delta. World Bank, Washington, D.C.; United National Environment Programme (2011). Environmental assessment of Ogoniland. United National Environment Programme (UNEP), Nairobi. Available at: <http://www.unep.org/disastersandconflicts/CountryOperations/Nigeria/EnvironmentalAssessmentofOgonilandreport/tabid/54419/Default.aspx>.
- 19 The amnesty has reduced the number of sabotage actions drastically and has led to increased oil production. The effect of the amnesty may be short-lived, among other things because there is no long-term solution to the underlying political and social problems. It can be questioned whether alternative work can be obtained for all those who have given up their militant activities. New fractions of militant groups also seem to pop up once the previous groups have surrendered their weapons (Refer for example to RiskIntelligence (2010). Nigeria – Review of 2010 and Outlook for 2011. RiskIntelligence, Vedbaek). There are also indications that once the level of militant activity falls, oil thefts increase, possibly because people change their ‘job’ from militant activity to oil thefts.
- 20 Shell (2012). *Shell in Nigeria; The operating environment*. Fact sheet, Shell companies in Nigeria. Available at: <http://s00.static-shell.com/content/dam/shell/static/nga/downloads/pdfs/briefing-notes/operating-environment2012.pdf>.
- 21 Refer, for example, to statements by Nigeria’s finance minister, who refers to 400,000 barrels a day: <http://www.ft.com/cms/s/0/61fb070e-bf90-11e1-a476-00144feabdc0.html#axzz2Bdgehf99>.
- 22 Pigs (‘pipeline inspection gauges’) are a name for various tools that are placed inside pipelines and move through the pipe with the aim of, for example, cleaning its interior or measuring thickness or corrosion, mapping cracks, etc. Such technology cannot normally be used if the pipeline is deformed or has tapping equipment for stealing oil installed on it as this can stop the pig.
- 23 Refer for example to UNEP (2011).
- 24 Department of Petroleum Resources (2002). *Environmental Guidelines and Standards for the Petroleum Industry in Nigeria (EGASPIN)*. Department of Petroleum Resources (DPR), Lagos.
- 25 To reduce flaring and take care of a valuable resource, the Nigerian authorities announced the *Associated Gas Reinjection Decree* in 1979, which demanded that companies were to stop flaring in 1984. Nigeria and Russia are the countries in the world that flare off most gas.
- 26 Refer for example to Gboyega, A., Søreide, T., Minh Le, T. & Shukla, G.P. (2011). *Political economy of the Petroleum Sector in Nigeria*. Policy Research Working Paper. World Bank, Washington, D.C. Available at: http://www-wds.worldbank.org/servlet/WDSContentServer/WDSP/IB/2011/08/24/000158349_20110824134316/Rendered/PDF/WPS5779.pdf.
- 27 Refer for example to Thurber, M.C., Emelife, I.M. & Heller, P.R.P. (2010). *NNPC and Nigeria’s oil patronage ecosystem*. Working Paper #95. Program on Energy and Sustainable Development, Stanford University, Palo Alto. Available at: http://iis-db.stanford.edu/pubs/22995/WP_95_Thurber_Emelife_Heller_NNPC_16_September_2010.pdf.
- 28 Cf. Nigeria’s federal environmental legislation: ‘Environment Protection Agency Act’ (1998).
- 29 Cf. the UN’s ‘Protect, Respect and Remedy’ Framework for Business and Human Rights. Available at: <http://198.170.85.29/Ruggie-protect-respect-remedy-framework.pdf>, pp. 18-19.

To the Ministry of Finance

20 March 2013

UNOFFICIAL ENGLISH TRANSLATION

Recommendation on the observation of Royal Dutch Shell plc.

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1 Summary

The Council on Ethics recommends that the Anglo-Dutch energy and petrochemical company Royal Dutch Shell plc. (Shell) be placed under observation for a period of up to four years due to severe environmental damage caused by oil production in the Niger Delta in Nigeria. As of 31 December 2012, the Government Pension Fund Global (GPF) owned shares in Shell with a market value of NOK 28,829 million, equivalent to 2.34 per cent of the shares in the company.

Shell has produced oil in Nigeria since 1958, when commercial production began in the country. Its wholly-owned subsidiary Shell Petroleum Development Company of Nigeria Ltd. (SPDC) is the operator for the largest oil-production operation in Nigeria (the SPDC joint venture). The SPDC joint venture (SPDC JV) consists of the state-owned oil company Nigerian National Petroleum Corporation (NNPC) as the majority shareholder (55 per cent) and SPDC, Total Exploration & Production Nigeria Ltd. (a subsidiary of Total SA) and Nigerian Agip Oil Company Ltd. (a subsidiary of Eni Sp.A), with a 30, 10 and 5 per cent interest in the joint venture respectively.

Oil production in the Niger Delta has among other things been criticised for oil-spill pollution and air pollution from the flaring of associated gas, as well as for breaches of human rights. The Council on Ethics has assessed oil spills from onshore oil production and their consequences. The Council's assessments have included the SPDC JV and others. The Council has assessed the extent of oil spills and environmental damage; whether oil spills and environmental damage have major consequences for human life and health; whether oil spills and damage are a result of breaches of national legislation or various standards; the company's responsibility; whether the company has implemented adequate measures to prevent and if relevant rectify damage; and whether the company's practice is likely to continue.

The Council on Ethics' assessments have shown that SPDC JV's oil production has for a long time led to frequent and, in total, extensive oil spills. The frequency and volume of the reported oil spills are minimum figures but are far higher than those which are normal in an international perspective and those which Shell experiences in other operations. This applies to oil spills resulting from both operational failure and sabotage. Sabotage includes both destructive action and the theft of crude oil, often referred to as 'bunkering'. Oil theft has developed into a billion-dollar industry in the Niger Delta and results in frequent, but to a large extent unquantified, oil spills. The scope of, and technology for, oil thefts vary from the most primitive and polluting small-scale methods to professional and well-equipped operations that tap large volumes of oil from pipelines or wellheads and transport the crude oil to tankers for 'export'. These at times well-organised crimes take place relatively openly.

Oil spills resulting from operational failures are due, for example, to corrosion, equipment failure or human error by the operator. It is a known fact that parts of the infrastructure in the Niger Delta are old or weak and that the replacement of infrastructure is taking longer than is desirable due to the lack of financing in the joint venture, primarily because the State has not given NNPC sufficient resources.

From 2002-2011, SPDC reported around 1,700 oil spills of more than 100kg. On average, the company reported one oil spill around every second day. The number of oil spills caused by sabotage was relatively stable during the period. The number of oil spills caused by operational failure fell slightly, but the figure for 2011 was the second-highest during the period. Around 70 per cent of the oil spills during the period were caused by sabotage. The preliminary oil-spill figures for 2012 show that the total number of oil spills has risen slightly compared to 2011. The number of oil spills caused by operational failure has fallen, while the number of oil spills caused by sabotage has increased.

The reported oil-spill volume varies substantially from year to year and is dominated by a few large oil spills, while most oil spills are small in volume. The annual oil-spill volume was around four times larger in the period spanning 2007-2011 (55,480 barrels/year on average) as in the period spanning 2002-2006 (13,724 barrels/year). The volume of oil spills caused by both sabotage and operational failure rose sharply from the first to the second period. The volume caused by sabotage rose most measured by the number of barrels. The reported oil spills per produced unit of oil equivalent (boe) also rose sharply from 2002-2006 to 2007-2011. Sabotage caused around 74 per cent of the oil-spill volume in the period spanning from 2002 to 2011. After an oil spill, efforts to collect the oil and restore the damaged area commence. For the 2010-2011 period, Shell reported that around 70 per cent of the spill volume had been collected. Preliminary figures for oil spills in 2012 show that the total oil-spill volume has risen significantly compared to 2011. The volume of oil spills caused by operational failure has fallen while the volume of oil spills caused by sabotage has increased.

The situation in Ogoniland, a small part of the Niger Delta, is special in that the scope and consequences of oil spills are in many areas huge. Oil spills are mainly caused by thefts from pipelines operated by Shell. Crude oil is transported away from the oil pipeline and “refined” locally. This refining leads to major oil spills and these are not reported in the company’s figures. It will take several decades to clean up and rehabilitate many areas, if this is at all practically possible. Only a small part of the extensive oil spills in Ogoniland are quantified so these comprise a very small part of the numbers of oil spills referred to above.

Oil spills in the Niger Delta affect in part ecologically sensitive and valuable areas and in part densely populated areas. While minor oil spills may have limited or short-term consequences, major oil spills that are not properly cleaned up and rehabilitated often cause extensive and long-term damage to land areas, rain forests, wetlands, fresh water, mangroves and coastal zones. This also causes serious harm to the local people’s livelihoods.

SPDC’s control over – and responsibility for – the operations is regulated by the Joint Venture Agreement (JVA) and the way in which it is practised. In the joint venture, decisions on standards, guidelines, investment and operations budgets, plans and so forth are reached by consensus. Each participant has in principle a right of veto. All the participants are responsible for the decisions and their implementation. The right of veto has been practised by NNPC but does not seem to have been used by the other companies, either individually or jointly. The oil industry is Nigeria’s most important source of income, and

investments in joint ventures compete with other expenses in the national budget. In practice, this has for a number of years reduced the investments in oil infrastructure. This contributes to the operator being left with the responsibility for the day-to-day operations without the means to ensure the proper operation of the infrastructure.

The Council on Ethics and Shell have had an extensive dialogue from 2010 to 2013. The company has allowed access to a lot of information and made its views known. Shell states that it bases its operations in Nigeria on the same standards as in other countries but underlines the unusually complex situation in which SPDC operates. Shell believes its oil-spill figures are based on a good methodology and provide a correct picture. The company acknowledges the extensive oil spills and their negative effects on the ecosystem and poverty-stricken local population. Shell stresses that this is a highly undesirable situation for all parties concerned. The company believes that oil spills and pollution are primarily caused by unauthorised third parties through oil thefts and sabotage and that this lies outside its control. Shell emphasises that there are sufficient resources available for the clean-up and rehabilitation of oil spills and that this work has been carried out in so far as possible under the circumstances. The backlog of older oil-spill rehabilitation work is in the process of being cleared.

Shell acknowledges that the current JVA and the way in which it is executed greatly restrict the freedom to act; persistent underfunding makes major investments difficult. Despite the enormous challenges involved in producing oil in the Niger Delta, Shell sees opportunities for positive change while recognising that changes in the extremely complex operating conditions will take time.

The Council on Ethics has considered recommending exclusion or observation. The Council finds that the frequency and volume of oil spills, both those caused by operational failure and those caused by sabotage, are extremely high for the SPDC JV, despite the fact that the reported figures are minimum figures in relation to the actual oil spills that can be linked to SPDC's oil production and infrastructure (operational failure or sabotage). Many ecologically sensitive and very valuable areas have been damaged by large, repeated or inadequately cleaned up and rehabilitated oil spills. The Niger Delta is one of the most oil-influenced large ecosystems in the world, and the damage is large and long-lasting in many areas. The local people's livelihoods are also very negatively affected by oil spills. The local people are often poor and have few alternatives other than to utilise the local environment's natural resources, (fresh water, fish and agricultural land or finding food, drinking water and work) that have been damaged or destroyed by oil spills. The Council on Ethics believes that this makes the consequences of oil spills very severe in many areas.

There is a clear link between SPDC's operations and the serious damage to the environment. The company has a responsibility for the SPDC JV's unanimous decisions and the implementation and follow-up of these as the operator. The operator also has a special responsibility to propose and implement measures to prevent or reduce damage. The Council on Ethics thus believes that the company has a responsibility for the serious damage to the environment and the local people's livelihoods.

In a situation where the authorities do not sufficiently enforce the national laws, the company must be expected to implement extraordinary measures to ensure that its

activities do not breach legislation, norms or standards. Shell tries to base its operations in the Delta on international standards and invests considerable resources in this. As an operator, the company has nevertheless not managed to secure and monitor the infrastructure to a sufficient extent, or to prevent damage to the environment and the local people's livelihoods. The Council on Ethics finds that national legislation, international standards and Shell's own standards have regularly been breached.

As regards the future risk of damage to the environment and to the local people's livelihoods, the Council on Ethics finds that it is unlikely that major changes will take place in the short or medium term unless one or more of the following factors change significantly: A) Shell's willingness and ability to use the tools it has in the joint venture (such as voting on budgets, on plans and on operations which have proven to lead to extensive oil spills, and more frequently shutting down production/infrastructure when the situation in the field indicates that this is necessary). B) The method of management within the joint venture and the financing of important investments in the joint venture operations. C) The ability and willingness of the Nigerian authorities and Shell to monitor and reduce oil thefts and sabotage.

Despite the serious circumstances, the Council on Ethics does not recommend excluding the company because it believes there is an exceptional uncertainty about future developments. Shell expresses a willingness to change and, as an operator, has good qualifications for creating change. The long process of revising the legislation (Petroleum Industry Bill) is also expected to be completed soon and this may change the form of management and other conditions within the joint venture. In addition, the new government in Nigeria is indicating that it will take measures to change the unusually problematic situation in the Niger Delta and weaknesses in the authorities' regulation of the petroleum sector. This has the potential to change factors referred to above. The Council on Ethics thus recommends that the company be put under observation for a period of up to four years. The Council will monitor the situation in the Niger Delta and regularly assess developments in key conditions, with the emphasis on the company's actions and the utilisation of its freedom to act in a complex situation. During the observation, the Council will place particular emphasis on whether the extent of the oil spill from SPDC's operations and the unacceptable harmful effects have been significantly reduced. The way in which the joint venture is managed, and especially Shell's role as the joint venture operator, is another main issue, together with the authorities' handling of the oil-spill issue and especially Shell's actions in relation to this. The Council will also monitor the major clean-up of oil spills in Ogoniland and Shell's role in this.

2 Introduction

In March 2010, the Council on Ethics decided to assess the GPF's investment in Anglo-Dutch energy and petrochemical company Royal Dutch Shell plc. (Shell)¹ against the guidelines for the observation and exclusion of companies from the GPF's investment universe (the Ethical Guidelines).² The Council on Ethics has monitored the situation related to pollution from oil production in the Niger Delta for several years and started a more thorough assessment of onshore oil production in 2010. This assessment included Shell and its wholly owned subsidiary Shell Petroleum Development Company of Nigeria Ltd. (SPDC), which is the operator of the largest oil-production operation in Nigeria (the SPDC JV).

2.1 WHAT THE COUNCIL HAS ASSESSED

The Council on Ethics has considered whether there is an unacceptable risk that Shell is responsible for or contributes to serious damage to the environment according to § 2, third subsection, letter c of the Ethical Guidelines. There has been extensive local, national and international criticism of several circumstances of the company's operations in the Niger Delta. This has also led to investors withdrawing from the company.³ This criticism relates to such things as frequent oil spills with major consequences for the environment and local community; the destruction of habitats caused by the building of physical infrastructure or greater access to areas that are quite untouched or vulnerable due to the creation of, for example, roads, pipelines and channels; various types of pollution from exploration and production activities; the flaring of associated gas which leads to local and global pollution; and complicity in various breaches of human rights. To start off with, the Council assessed the diverse environmental damage in the Niger Delta based on the Ethical Guidelines. The Council then decided to concentrate its detailed studies on local environmental damage from oil spills due to onshore oil production.⁴ The Council on Ethics considered that the frequency and extent of oil spills were the most serious risk with regard to the Ethical Guidelines. In some areas, other consequences of oil production (such as the building of infrastructure, greater access to untouched areas and cumulative consequences) may nonetheless be more serious than limited oil spills.

The Council on Ethics assesses what is serious environmental damage in each individual company report and based on an overall assessment of specific operations and activities. Among other things, the Council places emphasis on whether:

- the damage is significant,
- the damage results in irreversible or long-term consequences,
- the damage results in significant negative consequences for people's life and health
- the damage is a result of national laws or international norms being breached
- the company has failed to act in order to prevent the damage
- the company has implemented sufficient measures to rectify the extent of the damage,
- it is likely that the company's practice will continue.

2.2 SOURCES

The Council has obtained information and documentation⁵ from the company, researchers, authorities, voluntary organisations and the media that is mainly in the public domain. The company has given the Council access to a lot of documentation. The quality of the available information varies greatly but has been considered sufficient or good for key parts of the recommendation. However, there is significant uncertainty linked to the extent of the oil spills, especially the volume. The assessments are primarily based on the material which the company has made available and other publicly available information from various reports and sources. Discussions with company employees and others have been useful in interpreting the material. The assessments in the recommendation concentrate on the frequency and volume of oil spills caused by sabotage⁶ and operational failure,⁷ factors which lead to oil spills, the cleaning up of oil spills and the management structures for the oil production operation (SPDC JV), including the responsibilities and controls within the joint venture operation.

The Council on Ethics has obtained and assessed information and documentation through a step-by-step assessment process. Following introductory studies, the Council on Ethics has had extensive contact with the company in 2010, 2011, 2012 and 2013. During the Council on Ethics' contact with Shell, the company was very open and replied in writing to several rounds of extensive questions from the Council.

Representatives of the Council on Ethics visited a number of locations in the Niger Delta in February 2011. They have had meetings with Shell in Oslo, London, Lagos, Port Harcourt and in the field in the Niger Delta. The Council has also had meetings and other contact with various interest groups and experts.

3 Background

3.1 SHELL

Shell is a group of energy and petrochemical companies with more than 90,000 employees in more than 80 countries. It is one of the world's biggest international oil companies and the largest international oil company in Nigeria measured by production volume. The company is listed on the London, Amsterdam and New York Stock Exchanges. As of 31 December 2012, the GPFG owned shares in Shell with a market value of NOK 28,829 million, equal to 2.34 per cent of the shares in the company. In addition, the GPFG owned an interest-bearing instrument in Shell worth NOK 989 million.

Shell has been involved in oil production in Nigeria since 1958 when the first commercial production of crude oil started in the country. Shell Petroleum Development Company of Nigeria Ltd. is the operator for the largest oil-production operation in Nigeria.

3.2 THE NIGER DELTA

3.2.1 NATURAL CONDITIONS

The Niger Delta covers a large area in the south of Nigeria (refer to figure 1). The exact size of the delta depends on the political, ecological or hydrological definition used. The authorities' Niger Delta Development Commission (NNDC) has defined the Niger Delta as an area of around 112,000 km² with a population of over 30 million.

The Niger Delta is exceptionally rich in natural resources and contains many important and sensitive ecosystems and unique biodiversity values in various types of forests (such as mangroves, swamp forests and rain forests), wetlands, fresh water and a productive coastal zone. The delta also has important spawning and nursery areas for fish populations in both Nigeria and along other parts of the coast of West Africa. Productive agricultural areas and rich fishing areas have led to the delta having one of the densest populations in Africa in many places. The areas with the densest populations have lost a lot of their natural value. The delta is supplied with water and food from the large Niger Basin, the ninth-largest area of precipitation in the world and the third-largest in Africa.



Figure 1: Location of Nigeria and the Niger Delta.

The Niger Delta is considered to be one of the ten most important wetland and coastal marine ecosystems in the world⁸ and has among other things a mangrove forest that is the third-largest in the world and the largest in Africa.

The Niger Delta also contains exceptionally large petroleum resources. The delta has been and will probably continue to be a globally very important area for oil and gas production.

3.2.2 SOCIOECONOMIC CONDITIONS AND CONFLICTS

Nigeria and the Niger Delta have a turbulent history that has at times been full of conflict. Since the end of the 1990s, the country has taken important steps towards democracy. Nigeria is now a developing democracy but has major challenges relating to both its form of governance and economic development (such as corruption, the abuse of power and differences in the material standards of living of various groups).⁹ The petroleum sector faces particularly large challenges related to corruption and other problems concerning its form of governance,¹⁰ something that is also acknowledged by Nigeria's top politicians.

In 1980, 28 per cent of Nigeria's population were categorised as poor. More than 20 years later, 71 per cent were considered to be poor. According to many development indicators, the Niger Delta is below average in Nigeria.¹¹ Much of the population lacks access to fundamental services such as clean water, electricity and medical assistance. More than 70 per cent of the population of the Niger Delta lives in more or less a subsistence economy in which the local nature comprises the basis for their existence in the form of agricultural areas, fishing resources, fresh water, forests, etc.

Nigeria is extremely dependent on the capital-intensive petroleum sector. Petroleum accounts for around 95 per cent of the country's export revenues.¹² In 2010, Nigeria was ranked as no. 182 of the world's 190 countries measured by GDP per person (USD 2,400).

It is a common opinion among the local population that they live in extreme poverty while enormous revenues from the delta do not benefit them. Paradoxically, the poverty in the Niger Delta has increased during the period when huge volumes of oil and gas have been produced.¹³ The Niger Delta is characterised by exceptional distrust between various groups and players. The local population feel to a large extent let down by the authorities and oil companies and often have a deep-rooted distrust of these. Distrust and conflicts also exist between various population groups in the delta.

There is a lot of power at federal level and revenues from both the petroleum sector and taxes and duties are to a large extent passed on to the states and local level through the federal level. The forms of governance at federal level, state level and local level, in which traditional government structures are still important, are all of importance to problems linked to the oil industry.

3.2.3 OIL PRODUCTION

Commercial crude-oil production has taken place for more than 50 years since Shell British Petroleum (now Royal Dutch Shell) found oil at Oloibiri in 1956 and started production in 1958. The oil company started production on land and has since moved out into the swampland and shallow areas on the continental shelf and later also to deeper sea areas outside the continental shelf. A number of international oil companies have taken part in these developments and operate in the Niger Delta.

International oil companies are directly involved in exploration and production activities through three main arrangements, of which the oldest and from a production viewpoint clearly biggest is joint-venture agreements with the state-owned oil company Nigerian National Petroleum Corporation (NNPC). NNPC is the majority partner in each joint venture. However, the operator is always an international oil company. Each joint venture has an Operating Committee (OPCOM) which decides on the frameworks for the joint venture's operations, such as its budget, work schedules, standards, etc. NNPC usually has six representatives while the operator usually has four. Any other partners usually have one representative each. OPCOM decisions must be unanimous.¹⁴ Gradually, two other types of agreement have also been developed and these do not require the state to contribute direct financing in cash as a joint venture does: Production Sharing Contracts (PSCs) and Service Contracts (SCs). The international oil companies have stronger rights to the oil resources in a joint venture than in a PSC or SC. In Nigeria, a joint venture

covers many oil fields and in part very large areas, while in other parts of the world a joint venture often only covers one oil field.

Over the past 50 years, the oil and gas industry has developed into by far the most important sector for the state's revenues and the country's export revenues. More than 25 billion barrels of oil have been produced in the Niger Delta. The crude oil is of high quality for refinement purposes and is in demand. The oil industry currently has a large physical presence in the delta, with thousands of kilometres of pipeline, several thousand wells and a large number of flow stations and other physical infrastructure. The land directly used by these installations is limited when measured as part of the delta, probably less than one per cent, but the area that is directly and indirectly affected is many times greater than this.

Onshore oil and gas production in the Niger Delta often consists of a large number of production wells¹⁵ that, through an extensive network of pipelines, are linked to flow stations that collect oil from a number of wells and separate water and gas from the crude oil. From the flow stations, the crude oil is transported in fewer and larger pipelines to an export terminal (see figure 2). A small volume of oil is refined in Nigeria.

In 2010, Nigeria was ranked number 12 of the world's oil producers measured in production, number 5 measured in exports and number 10 measured in proven reserves. The corresponding figures for natural gas are 26, 11 and 9.¹⁶ Nigeria imports refined petroleum products, partly due to its limited refining capacity but not least due to the low utilisation of its refining capacity. Nigeria has a chronic shortage of fuel, which makes it lucrative to both import fuel and sell locally refined fuel from illegally tapped oil in the black market.

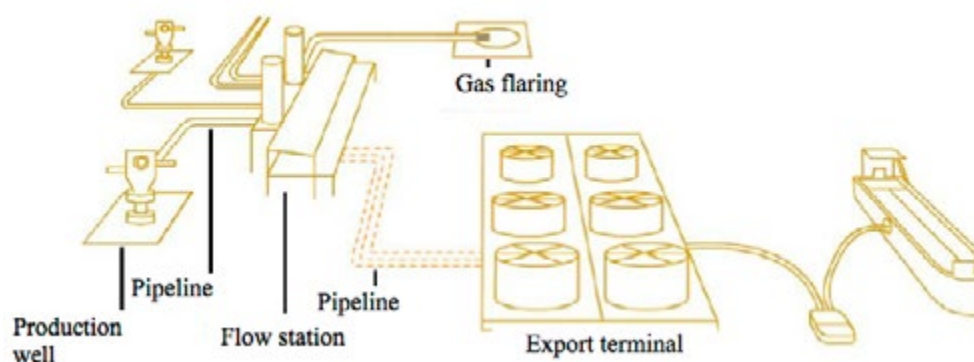


Figure 2: Simplified sketch of typical onshore oil production in the Niger Delta.

The Niger Delta is an unusually challenging and complicated place in which to produce oil. The natural conditions mean that access to parts of the river delta and wetlands is difficult. Even more important are complicated and sophisticated mechanisms to make individuals or groups wealthier, corruption, political and economic power struggles and ethnic and historical conflicts. Extensive organised crime in the form of oil thefts for billions of dollars, often taking place openly and apparently without consequences, is strikingly common. The delta is characterised by massive distrust between many of the players, a great deal of frustration and at times direct aggression towards the state and

petroleum industry which makes the safety situation in the delta difficult (such as attacks on oil installations, sabotage and kidnapping). Many local people feel that the state and oil industry have taken most of the enormous oil-production revenues and in many cases weakened their already vulnerable and marginal livelihoods.

The petroleum-sector legislation in Nigeria has been under revision for a long time and been discussed in the national assembly several times. After several long-lasting postponements, there is still a great deal of uncertainty about the content of the new legislation (Petroleum Industry Bill), but many people expect changes to primarily affect offshore operations in deep waters. It is unclear when new legislation will be in place.

3.3 THE SPDC JOINT VENTURE

The SPDC JV has four partners (refer to figure 3). NNPC is the majority partner, while the other two international oil companies (subsidiaries of Total and Eni) have smaller stakes than Shell. SPDC is the largest private oil and gas company in Nigeria. The SPDC JV is the largest oil-producing company in the Niger Delta and holds licences which cover a huge area of in total around 30,000 km² (refer to figure 4). The area lies in nine states (Abia, Akwa Ibom, Bayelsa, Cross River, Delta, Edo, Imo, Ondo and Rivers) and contains around 70 producing oil fields, a network of around 9,000 km of pipeline, 1,000 producing wells and 87 flow stations where oil and gas from wells are collected before separation and transfer to export terminals or gas-fired power stations. The huge area means that SPDC is in contact with more than 1,000 local communities in the delta.

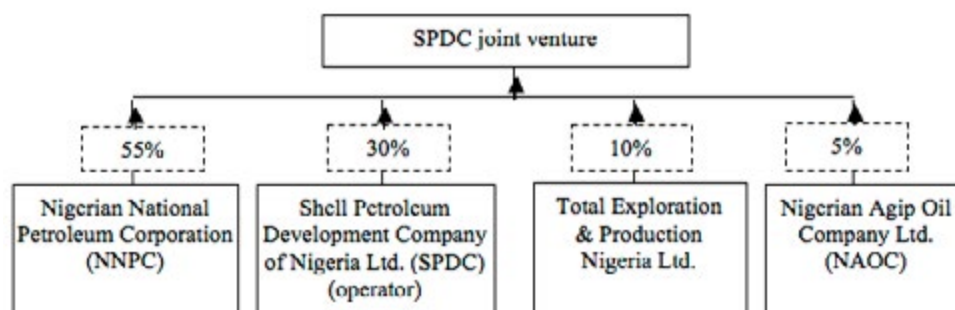


Figure 3: Economic interests in the joint venture for which SPDC (Shell) is the operator.

For much of the past 50 years, Shell has been the largest producer among the international oil companies. For the past few years, Mobil has produced the most since SPDC has reduced its production due to unrest and sabotage. Mobil operates offshore and has to a large extent avoided such problems. The SPDC JV still has large, high-quality oil and gas resources that are relatively easy to access.

The relationship between the partners in the joint venture is governed by a Joint Operating Agreement (JOA) entered into in 1991. The joint venture's operations and investments are financed by cash contributions from the partners in proportion to their economic interest in the joint venture. The joint venture is not a registered company with limited liability such that can raise loans and flexibly finance its operations and investments.

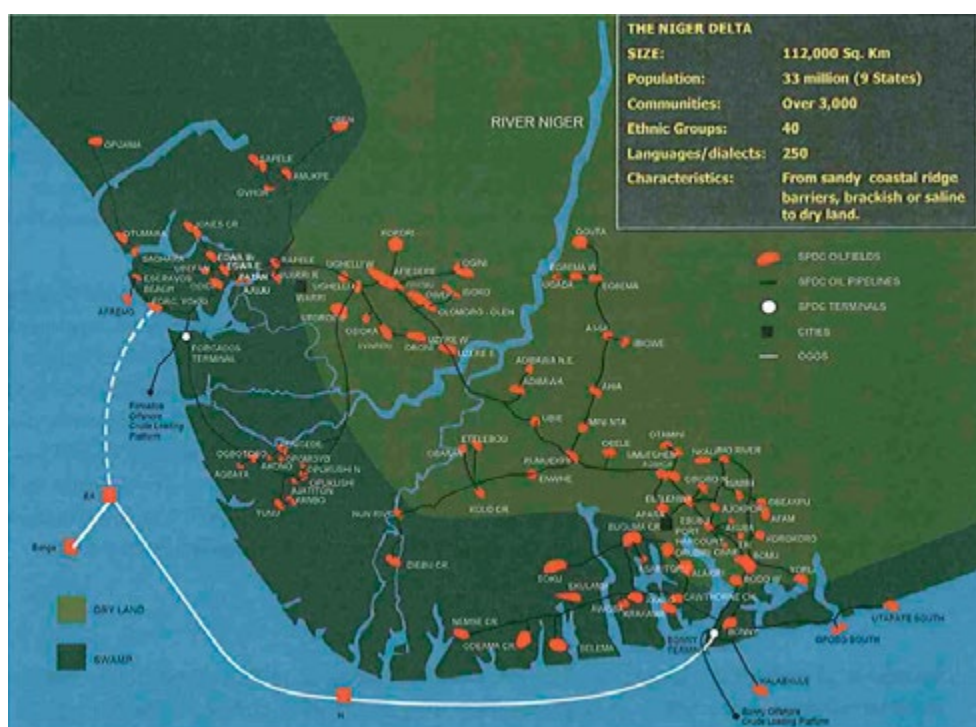


Figure 4: Overview showing the SPDC JV's oil fields and the main pipelines in the Niger Delta, Nigeria (source: Shell).

The federal authorities in Nigeria do not allocate enough resources to ensure that NNPC contributes its share of the financing in order to safeguard the optimal operation of the joint venture. In practice, capital-intensive investments in the petroleum sector compete with other social measures for limited resources in the annual state budget. There have been too little annual contributions and too much unpredictability and underfinancing in Nigerian joint ventures for a number of years, this does not just apply to the SPDC JV.¹⁷

In exceptional cases, the joint venture has made large investments (such as in a production plant) without NNPC's contribution. The other partners have in such case paid NNPC's share in advance under separate agreements (modified carry agreements). The oil companies want to minimise the use of this model in so far as possible because it in practice deviates from the JOA without other parts of this agreement having been reassessed, and because it is economically risky.

The joint venture's most important decision-making forum is its Operating Committee (OPCOM), which among other things approves and revises budgets and work schedules and determines the joint venture's guidelines, standards, procedures and investigations, etc. Various sub-committees provide advice. The OPCOM checks that decisions are carried out. The composition of the OPCOM is shown in table 1.

OPCOM decisions are made based on consensus. Frequent contact between the joint venture's partners seems to ensure that proposals which are submitted to the OPCOM are agreed to by all the partners. A partner can in principle unilaterally block a proposal with which the partner disagrees. In practice, NNPC seems to be the one that blocks proposals

regarding, for example, major investments that cost more than the state can contribute, or measures that sharply reduce the flow of income (such as shutting down production for lengthy periods). Shell has stated that there are always sufficient resources in the operating budget to pay for cleaning up, rehabilitation and compensation for oil spills. Questions linked to oil spills are regularly discussed by the OPCOM and various sub-committees.

Table 1: The number of representatives of, and key tasks for, the members of the SPDC JV's OPCOM.

Joint venture partner	Number of representatives	Key tasks
Nigerian National Petroleum Corporation (NNPC)	6	Appoints the chair. Provides financing equal to its 55 per cent stake.
Shell Petroleum Development Company of Nigeria Ltd. (SPDC)	4	Responsible for the day-to-day operation of the joint venture as the operator. Provides financing equal to its 30 per cent stake.
Total Exploration and Production Nigeria Ltd.	1	Provides financing equal to its 10 per cent stake.
Nigerian Agip Oil Company Ltd. (NAOC)	1	Provides financing equal to its 5 per cent stake.

The operator is responsible for the day-to-day running of joint venture operations within the budget, schedules, standards, etc. that the OPCOM has agreed on. The operator cannot make unilateral decisions without the OPCOM's agreement. This reduces the operator's freedom of action. In an emergency, the operator may implement measures it believes are necessary to safeguard life and property and prevent pollution without the permission of the OPCOM.

Along the pipelines, it is primarily the local population that have contracts with the operator to monitor irregularities and maintain a corridor along the pipelines (a right-of-way), among other things to prevent high vegetation from growing in the pipe trenches. The operator also has an infrastructure-monitoring system to discover such things as the illegal tapping of oil or damage which leads to oil spills. The Nigerian authorities are responsible for safety at strategically important installations (such as production plants, export terminals and power stations).

The JVA is different from normal joint venture agreements in the industry in several areas. For instance, it is not normal in other countries for the state-owned oil company to make decisions alone, even where the state-owned company has the majority interest. In practice, NNPC makes some decisions alone by not providing sufficient financing to ensure that certain investments are carried out. Normally, a joint venture partner loses rights if it does not fulfil its duties according to the agreement (such as in the form of financial contributions), and may for example lose its right to vote. In the most extreme situations, a partner may lose its stake in the joint venture in return for financial compensation. In Nigeria, NNPC's failure to provide contributions and make payments does not seem to have significant consequences for NNPC's role in a joint venture.

4 The main issues and the Council on Ethics' findings

4.1 THE EXTENT OF THE OIL SPILLS

The Niger Delta has been subject to many thousands of oil spills over the past few decades, especially from onshore production. There are no exact figures for oil spills and estimates from various sources vary widely. The figures for and volumes of oil spills are disputed and subject to a great deal of uncertainty. Civil-society groups claim the companies' and state's reports are incomplete, present far-too-low figures and lack independent verification. The Nigerian authorities do not publish complete statistics and figures issued by the authorities also do not always seem to be consistent. The Council on Ethics has reviewed the statistics showing the frequency and volume of the SPDC JV's oil spills. These figures have on the whole been published in various reports from Shell or on the company's website.¹⁸ The main trends during the 2002-2011 period are explained in further detail below. Preliminary figures for 2012 were available during the Council's final discussions on this case and are referred to briefly.

The Council on Ethics has used Shell's data as a minimum estimate.¹⁹ Various studies point out that the reported figures are minimum estimates, and some claim that the actual oil spills are many times larger than the reported figures.²⁰ The Council on Ethics has no good indications of the extent of unreported or incorrectly reported oil spills but assumes that the reporting is on the whole incomplete for various reasons. A recent extensive study in Ogoniland²¹ revealed many more oil spills than those registered in the official database of the National Oil Spill Detection and Response Agency (NOSDRA) and by SPDC. Conditions in Ogoniland are not necessarily representative of the Niger Delta, but parts of the delta other than Ogoniland will also have many oil spills linked to the theft, transport and any local 'refining' of oil that is not reported.

4.1.1 NUMBER OF OIL SPILLS

During the 2002-2011 period, SPDC reported around 1,700 oil spills of more than 100kg, which equals an annual average of 170 oil spills. There was no clear trend in the figures for the total number of oil spills each year during the period (refer to figure 5). The averages for 2002-2006 and 2007-2011 were 167 and 172 oil spills per annum respectively. This means that the company on average had one oil spill of more than 100kg around every second day. The number of oil spills caused by sabotage was relatively stable during the period, apart from a sharp increase in 2007 when the security situation worsened (refer to figure 6). The number of oil spills caused by operational failure fell slightly during the period, although the 2011 figure was the second-highest for the period. Around 70 per cent of the reported oil spills during the period spanning 2002-2011 were caused by sabotage. Preliminary oil-spill figures for 2012 show that the total number of oil spills rose slightly compared to 2011. The number of oil spills caused by operational failure fell while the number of oil spills caused by sabotage increased.

4.1.2 VOLUME OF OIL SPILLS

The total volume of oil spills varies widely from year to year and is dominated by a few large oil spills, while most oil spills are small in volume. The major contribution from a few large oil spills leads to there being no clear trend in the volume of oil spills over time, either for the total oil-spill volume or the volume of oil spills divided into those caused by sabotage and those caused by operational failure (refer to figures 7 and 8).²²

The average annual reported oil-spill volume rose sharply from the 2002-2006 period (13,724 barrels/year) to the 2007-2011 period (55,480 barrels/year). The average for the entire period is 34,602 barrels/year. The volume of oil spills caused by both sabotage and operational failure increased from the first to the second half of the period. The volume caused by sabotage rose the most measured in number of barrels, while the volume caused by operational failure rose the most in terms of percentage. In the 2007-2011 period, oil spills caused by operational failure comprised 27 per cent of the total reported volume, compared to 22 per cent in the 2002-2006 period. Sabotage caused around 74 per cent of the oil-spill volume during the 2002-2011 period. One large oil spill caused by operational failure in 2008 comprised a large percentage of the oil spills caused by operational failure in the 2007-2011 period. According to Shell, around 68 per cent of the oil-spill volume was collected in 2010²³ while 72 per cent was collected in 2011.²⁴

Preliminary oil-spill figures for 2012 show that the total oil-spill volume has risen significantly since 2011. The volume of oil spills caused by operational failure has fallen while the volume of oil spills caused by sabotage has increased.

The oil spill per produced oil equivalent (boe) also varied a lot during the 2002-2011 period. This variation has roughly been the same as the variation in the oil-spill volume (refer to figures 9 and 10). The oil spill per boe increased sharply from the 2002-2006 period to the 2007-2011 period, from 34 to 222 barrels per million boe. The corresponding figures for Shell outside Nigeria are 27 and 19 barrels per million boe respectively.²⁵

A simple comparison of the oil-spill volumes of SPDC and Shell in the rest of the world shows that while the average annual oil-spill volume when Shell is an operator outside Nigeria has fallen sharply from the 2002-2006 period (around 26,000 barrels/year) to the 2007-2011 period (around 18,000 barrels/year),²⁶ the SPDC's oil-spill volume has quadrupled (from 13,724 barrels/year to 55,480 barrels/year). Outside Nigeria, very few oil spills are caused by sabotage.

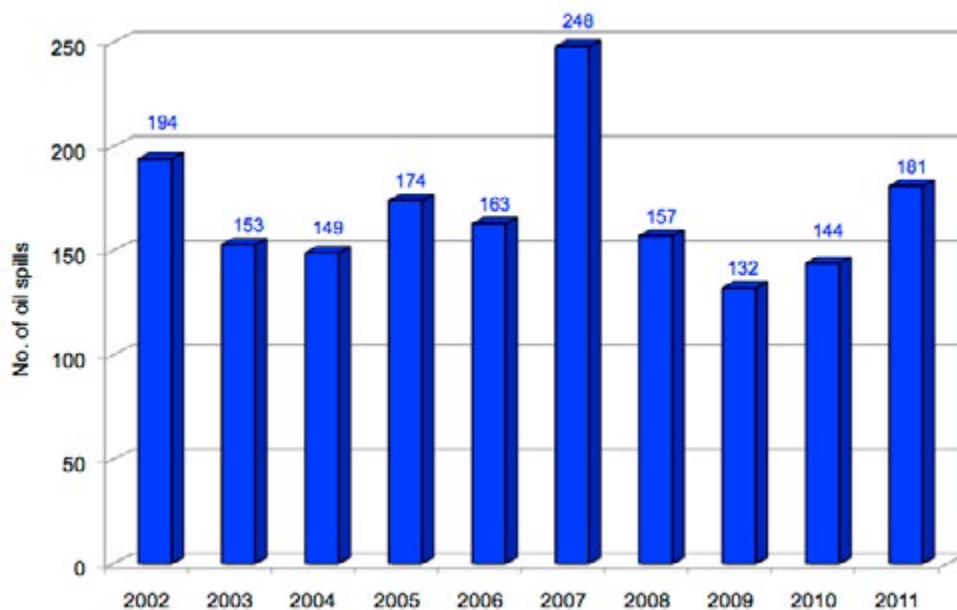


Figure 5: The SPDC JV's total no. of oil spills (sabotage and operational failure) in the Niger Delta during the 2002-2011 period (source: Shell's website, refer to footnote 18).

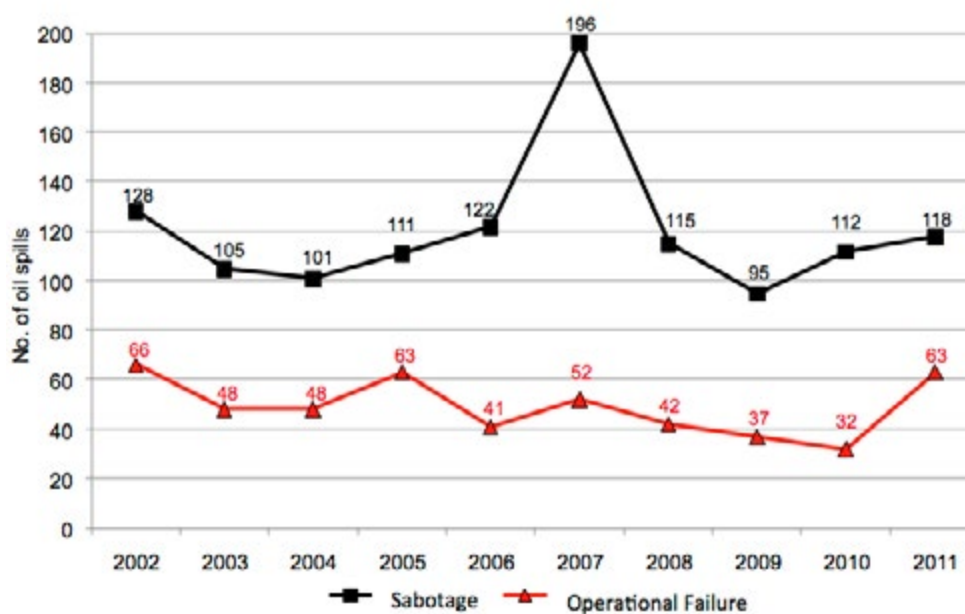


Figure 6: The SPDC JV's number of oil spills divided into those caused by sabotage and those caused by operational failure in the Niger Delta during the 2002-2011 period (source: Shell's website, refer to footnote 18).

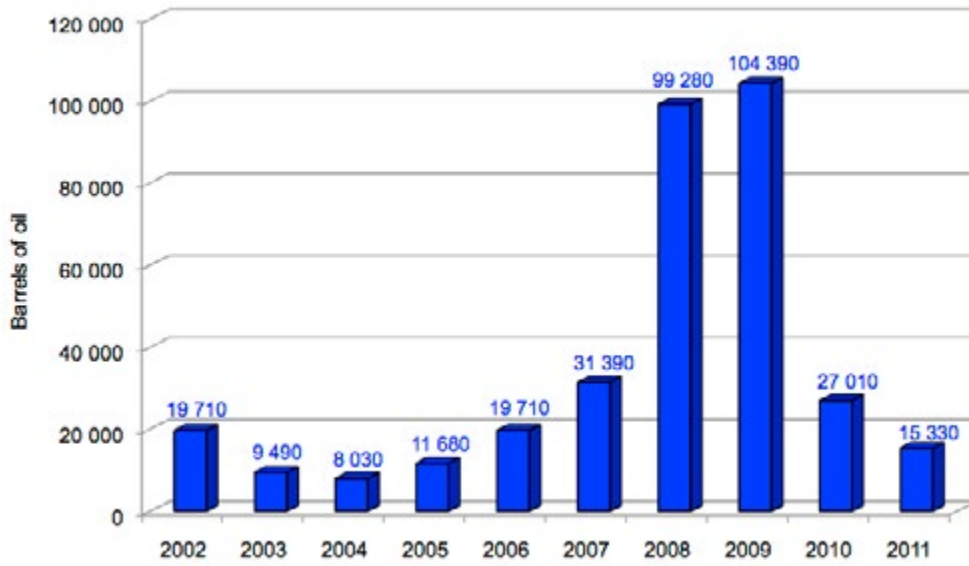


Figure 7: The SPDC JV's total oil-spill volume (sabotage and operational failure) in the Niger Delta during the 2002-2011 period (source: Shell's website, refer to footnote 18).²⁷

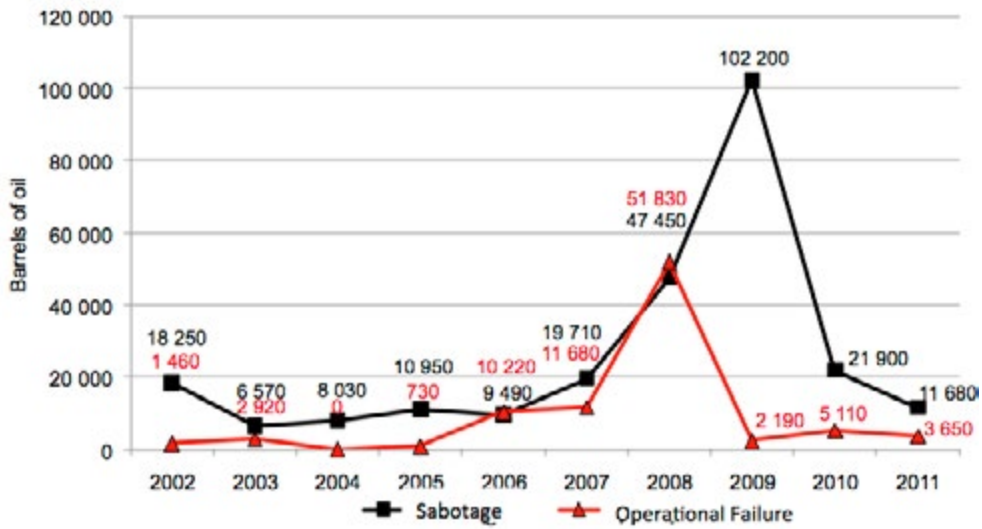


Figure 8: The SPDC JV's oil-spill volume, divided into oil spills caused by sabotage and those caused by operational failure, in the Niger Delta in the 2002-2011 period (source: Shell's website, refer to footnote 18).²⁸

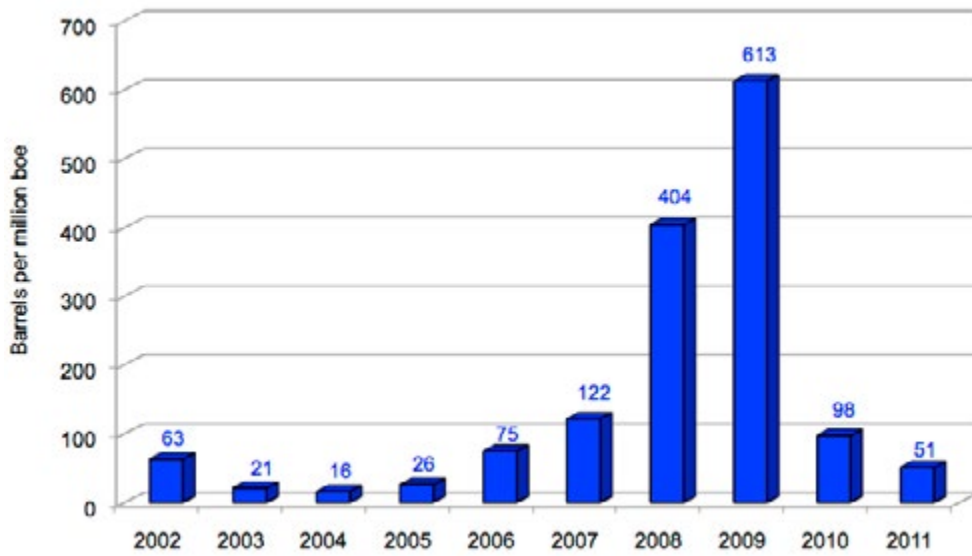


Figure 9: The SPDC JV's total oil-spill volume (barrels) per produced million barrels of oil equivalent (boe) in the Niger Delta during the 2002-2011 period. (The Council on Ethics' calculations are based on figures received from Shell. NB: the offshore oil-spill from the Bonga field (SNEPCo) is not included, cf footnote 28).

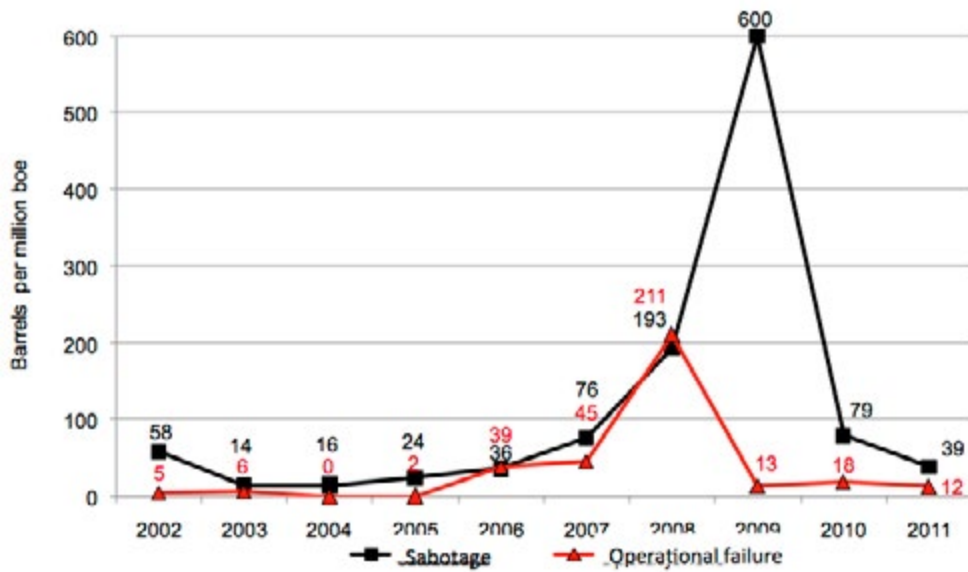


Figure 10: The SPDC JV's oil spill (barrels) per produced million barrels of oil equivalent (boe), divided into oil spills caused by sabotage and those caused by operational failure, in the 2002-2011 period (the Council on Ethics' calculations are based on figures received from Shell. Note: the offshore oil-spill from the Bonga field (SNEPCo) is not included, cf footnote 29).

4.2 CAUSES OF OIL SPILLS

The causes of oil spills in the Niger Delta are normally classified as either sabotage or operational failure. The cause of an oil spill is normally determined by a so-called joint investigation team (JIT). Such a JIT is established after an oil spill and consists of representatives of the authorities, operator and local communities that are affected, each of which chooses its own representatives. The JIT tries to achieve consensus on the cause. In the case of disagreement, the authorities will report their conclusions. Shell believes the cause of oil spills is in most cases easy to determine. The operator and authorities seem to agree on the cause in almost all cases.

The classification of cause is at times disputed. According to Nigerian law, compensation is to be paid for damage when the cause is operational failure, but not if it is sabotage. While the local community is interested in classifying the cause as operational failure so that it will receive compensation, the oil companies are interested in classifying oil spills as sabotage in order to avoid paying compensation. Civil-society groups often claim that companies and authorities under-report operational-failure causes and often erroneously classify causes as sabotage. At a local level, frustration about the lack of benefits from the oil production, many destructive oil spills, etc., may also lead to compensation for oil spills being seen as one of the few mechanisms that can be used to obtain revenues from the oil production, irrespective of the cause of the oil spill.

The information that the Council on Ethics has received from the company indicates it is often easy to prove the direct cause of an oil spill. Therefore, significant wrong categorisation seems to be rather unlikely. The Council assumes that the reported ratio of sabotage causes to operational-failure causes is reasonably correct.

4.2.1 SABOTAGE

Sabotage may contain an element of protest against the authorities or an oil company and be an attempt to draw attention to political or other views and demands. During the 2005-2007 period, the number of very destructive sabotage actions, such as the use of explosives to blow up pipelines and other infrastructure, increased. The frequency of such actions declined after the authorities introduced an amnesty for militant groups that carried out such operations in 2009.²⁹

The theft of crude oil, sometimes referred to as 'bunkering', has developed into a billion-dollar industry in the Niger Delta, and results in frequent oil spills that are to a large extent not reported. SPDC estimates that more than 150,000 barrels of oil disappear each day from the joint venture operations.³⁰ With an oil price of USD 100 per barrel, this represents a value of USD 5.5 billion annually. The figure is probably much higher, since this refers only to what the company can calculate based on measurements in limited parts of the pipeline network. Others believe the thefts are much greater and increasing sharply.³¹ The scope of, and technology used for, thefts vary from small-scale, primitive and polluting methods to make a hole in pipelines and transport small volumes of oil in open containers for 'local refining', to professional and well-equipped operations that tap large volumes of oil from pipelines or wellheads and transport the crude oil to tankers for 'export'. These at times well-organised crimes take place relatively openly, indicating

that they are directly or indirectly, through protection or acceptance, linked to persons or groups with enough influence to prevent the extensive and prolonged thefts from being stopped. It is striking that these take place in this way and to this extent.

At times, sabotage may also be a purely speculative act by groups seeking either compensation for damage from oil spills that they themselves or their accomplices have caused, or revenues through local contracts for cleaning up and rehabilitating oil spills.

4.2.2 OPERATIONAL FAILURE

Oil spills caused by operational failure are *inter alia* due to corrosion, equipment failure or human error on the part of the operator. It is known that some of the infrastructure in the Niger Delta is old or weak for other reasons and that the infrastructure has been replaced more slowly than is desirable due to the lack of financing in the joint venture, primarily because NNPC is not given sufficient resources by the state. The documentation indicates a higher frequency of oil spills caused by operational failure in the delta than in other locations in which Shell operates.³² The at times limited access to areas in the delta due to the security situation can weaken the monitoring and maintenance work and thus increase the risk of oil spills caused by operational failure. Recurring sabotage and repairs can also help to weaken the infrastructure, weaken the monitoring (for example because ‘pigs’³³ cannot be used) and as a result increase the risk of later operational failure.

4.3 CONSEQUENCES OF OIL SPILLS

The consequences of oil spills vary depending on factors such as where the oil spill takes place, the size of the oil spill, what natural values are affected, whether the spread of oil is prevented, whether the cleaning-up and rehabilitation work starts quickly and whether the work is done efficiently and to a high standard.

Many oil spills affect relatively small areas. Some major oil spills and oil spills where the oil is spread by streams, rivers or tides can affect much larger areas. The delta is a relatively flat area and oil spills will often be spread over a large area rather than aggregating in lower land. The Council on Ethics has not found any figures showing how much of the delta has been or is affected by oil spills, either in total or in relation to the SPDC JV. The Council assumes that large areas of the delta are affected, even though most of the large Niger Delta is not affected or only affected to a slight extent.

Oil spills have serious consequences for the areas that are affected during the period when the oil pollution exists. Vegetation is destroyed, water is polluted and fish and game withdraw from the area or die. Oil spills can also go deep into the ground and down to the ground water even if this is not visible on the surface. Local communities whose livelihoods are based on these natural resources and who have few or no alternatives can experience very serious consequences due to damage to agricultural land, their drinking-water supply, forests, fish and other aquatic resources. This affects the food security, incomes and health of the local population.

Oil which is spilled will gradually decompose over time. This takes place when it is exposed to sunlight (photolysis) and biological decomposition by microorganisms which break down hydrocarbons. The extent of biological decomposition depends on such

things as access to nutrients and oxygen, the temperature and the microorganisms that are present. Since the crude oil in the delta is relatively 'light', some parts (such as volatile organic compounds) will to a certain extent evaporate and leave behind the 'heavier' and more solid components of the crude oil.

The duration of the consequences of an oil spill varies from days and weeks for small spills that have been handled efficiently, to months and years for large spills that have not been handled well, or recurring oil spills. Remedial measures to reduce the extent of the damage include firstly removing oil that can be collected and then rehabilitating affected areas, often by encouraging (adding oxygen and nutrients) growth in microorganisms that decompose oil (remediation by enhanced natural attenuation, RENA).

In the case of oil spills caused by operational failures, Nigerian law states that compensation is to be paid. In some cases, short-term alternatives are also given to the local population in the form of drinking water and food as part of the remedial measures. Quick and sufficient cleaning up and rehabilitation, combined with rapid and fair compensation, reduce the oil spill's consequences for both the local population and ecosystem.

Insufficient remediation has been a problem and a source of conflict for many years. At times, the company cannot enter the affected area quickly due to the security situation. The local opposition to Shell has sometimes led to oil spills not being cleaned up and rehabilitated as quickly as is desirable, in some sites for several years. In recent years, Shell has increased its efforts to clear the backlog of cleaning-up and rehabilitation work. The company planned to clear the backlog in 2011-2012 if it was given safe access to the locations in question. The backlog has been reduced but not cleared. In several cases, local contractors and groups that Shell has hired to carry out the cleaning up and rehabilitation seem to have done work that is not good enough or to have left the area before the work was finished. Both Shell and in the end the authorities are in principle to approve the cleaning-up and rehabilitation work when the limit value for the permitted content of hydrocarbons in the soil has been reached. At times, neither Shell's nor the authorities' follow-up is good enough.³⁴

There is very little publicly available documentation of the effects of oil spills on specific areas in the Niger Delta. A lot of resources must have been used on studies and assessments in connection with the building or upgrading of infrastructure and probably also before the authorities have approved the cleaning up and rehabilitation of many oil spills. This information seems on the whole to be only available to the authorities and companies, with the exception of some impact analyses in connection with the creation of more modern infrastructure. SPDC does not seem to have considered cumulative consequences – either the cumulative consequences of recurring oil spills, the consequences of oil spills and other effects of oil production or the consequences of oil production and other effects on the natural environment or local population.

There is very little information available from the monitoring of the consequences of oil spills for the local population and the ecosystem. In many, perhaps most, cases, there seems to be no information on parameters other than hydrocarbons in the soil. But even this limited information is only published to a slight extent. In such a rich and productive area as the Niger Delta, it is natural to expect a number of biological and socioeconomic

conditions to be monitored, verified and published. Without documentation of the extent of consequences, the authorities and oil companies, which are to respectively regulate and implement efficient measures, will not really know what measures are necessary and effective to minimise the extent of the damage. The lack of publicly available and credible documentation has also led to a lot of more or less justified accusations against the company and authorities and at times a very high level of conflict and many legal processes against the company.

4.4 OGORILAND

Ogoniland is a relatively small– but for Shell extremely challenging – part of the Niger Delta (1,000 km²). In 2011, the UN's environmental programme³⁵ published an extensive study of oil pollution in Ogoniland.³⁶ Ogoniland is part of the SPDC JV's area but SPDC has not been able to produce oil there since 1993 due to a very high level of conflict between the Ogoni people and Shell. Since 1993, Shell has transported oil through Ogoniland in pipes from producing oil fields outside Ogoniland. These pipelines are the source of very extensive oil spills. An NNPC pipeline also goes through Ogoniland carrying refined petroleum products. SPDC still owns a lot of infrastructure in Ogoniland (such as wells and pipelines).

UNEP has conducted an extensive mapping of oil spills and pollution, including an analysis of more than 4,000 samples of drinking water, ground water, surface water, precipitation, fish, sediments, soil and air. UNEP's study documents the widespread and at times totally destructive pollution of various ecosystems and local population's livelihoods, even in areas where oil spills occurred many years ago. In some places, it will in the best case take several decades to clean up and rehabilitate the oil spill. The costs of this have not been calculated but they will be huge. UNEP recommends that the oil companies and authorities initially set aside a total of USD 1 billion to start this work.

One important cause of the pollution in Ogoniland is the many oil thefts and local 'refining' before products (such as diesel) are sold on the black market. The illegal tapping, transport and refinement of crude oil often take place using very simple, dangerous and polluting technology, and often close to rivers and wetlands. Pollution that reaches rivers and streams spreads rapidly to larger areas, and the heavy rains and flat landscape also contribute to this. The pollution has spread deeper than many people believed it would, often more than 5m down into the ground, and has also reached ground-water reservoirs. The vegetation, including mangroves, is completely destroyed in several places and fishing areas are empty of fish due to pollution. There is severe pollution in the soil and water in several areas even though this is not visible on the surface. There are still large oil spills from way back in the 1970s that have not been cleaned up and rehabilitated in Ogoniland.³⁷ According to Shell, oil spills in Ogoniland made up around 5-6 per cent of SPDC's volumes of oil spill caused by both sabotage and operational failure in the 2006-2010 period.

UNEP criticises SPDC and the authorities on various levels for not doing enough to stop the thefts and local refining of oil. UNEP also points out that the local community has contributed to the unnecessarily large size of the damage by delaying or preventing SPDC's access to the oil spill to clean it up, often by making unreasonable demands on

SPDC that result in long negotiations before any agreement can be reached and the cleaning-up work can start.

UNEP also makes some institutional and systemic problems clear. The overlapping roles and responsibilities of the Department of Petroleum Resources (DPR) and National Oil Spill Detection and Response Agency (NOSDRA) and different interpretations of the environmental regulations result in inconsistent and insufficient follow-up of oil operations and pollution. UNEP also points out the lack of independence in the verification of oil spills and that the authorities do not have sufficient resources to do a good enough job. UNEP criticises SPDC for not complying with its own standards and procedures and for not carrying out cleaning-up and rehabilitation work in accordance with either the regulations or its own standards. This has also helped to spread the oil spills to larger areas and ground waters in several locations.

UNEP's study recommends the largest oil-spill clean-up in history – something that will take 25-30 years and cost several billion US dollars, although the exact figure is unknown. UNEP underlines that some of this work is only expedient if polluting thefts and refining activities are stopped. Shell does not envisage returning to Ogoniland as an operator due to the history of conflicts between the Ogoni people and Shell. Shell will help to pay for the cleaning-up and rehabilitation work.

The Council on Ethics considers Ogoniland to be an important area that must be given high priority in the cleaning-up and rehabilitation work. At the same time, it is important to underline that the catastrophic consequences of oil spills in Ogoniland are not representative of large parts of the Niger Delta.

4.5 NATIONAL LEGISLATION

Nigeria has several laws that are relevant to the environmental conditions while oil is being produced. The perhaps most important instrument is the Environmental Guidelines and Standards for the Petroleum Industry in Nigeria (EGASPIN).³⁸ In principle, the standards defined in EGASPIN and other parts of the regulations are high. For example, Nigeria's Petroleum Act 1969 states that oil and gas production must be in accordance with that which is generally accepted practice on oil fields, as defined in US standards.

The limits when it comes to standards seem primarily to lie in the authorities' and the company's follow-up of the regulations. The environmental and other authorities have limited resources. Vagueness about roles and responsibilities also weakens the follow-up (for example between the DPR and NOSDRA), and the situation is problematic when the authorities that follow up the most important instrument on the environmental side (EGASPIN) are the petroleum authorities (DPR) which are to regulate the state's own oil company, and oil is by far the most important source of revenue for the state. These challenges due to the form of governance are also illustrated by the fact that environmentally harmful and resource-wasting flaring of associated gas has taken place on a large scale for over 25 years after being prohibited in Nigeria.³⁹ During the ongoing revision of the petroleum-sector legislation (Petroleum Industry Bill), it has been proposed to split the state players into more institutions in order to separate and focus their respective roles, reduce in-built conflicts and improve effectiveness.

5 Information provided by the company

The Council on Ethics has had a lot of contact with the company in 2010, 2011, 2012 and 2013, including several exchanges of letters, meetings and field visits in the Niger Delta. The company has also commented on the draft recommendation. The company has given the Council on Ethics access to extensive documentation and made key personnel in Shell worldwide and SPDC in Nigeria available to the Council on Ethics.

Shell states that the same standards as in other countries form the basis of its operations in Nigeria. The company underlines the unusually complex conditions and unique challenges in the Niger Delta and Nigeria, conditions which are very difficult to understand without having spent time in Nigeria and the delta. Conditions in the Niger Delta are very challenging for all onshore oil production, not only for SPDC. The operational frameworks in the delta are also very different from operations in other parts of West Africa which also take place in river deltas with similar natural conditions but much fewer oil spills. The company has implemented extraordinary measures due to the difficult operating conditions in the Niger Delta.

Shell acknowledges that there are many oil spills and that these have negative effects on the ecosystem and poverty-stricken local population. The company points out that today's oil-spill situation is very undesirable for all parties for economic, operational, environmental and social reasons. For the company and joint venture, oil spills mean a loss of oil and revenues, extra costs, the shutdown of production, and reputational harm. Shell emphasises that oil thefts and sabotage are a huge and growing problem. These cause most of the oil spills. Shell believes this is outside its control and that SPDC has a good monitoring system. The company does not have a mandate to itself enforce the law and stop thefts from the infrastructure for which it is the operator. The company believes the Council must also consider the role of the Nigerian state here.

Shell states that there are enough resources available for the cleaning up and rehabilitation of oil spills and that this work is carried out in so far as possible under the circumstances. The backlog of rehabilitation of older oil spills is in the process of being cleared.

The number of oil spills caused by operational failure has fallen and the company has implemented a number of measures to reduce the risk of oil spills, such as making it more difficult to tap oil from wellheads in Ogoniland and replacing some of the older pipeline network in the delta.

Shell acknowledges that today's JVA and the way in which it is practised strongly restricts the operator's freedom of action and that persistent underfunding is a challenge when it comes to large investments. SPDC points out that it cannot make unilateral decisions within the joint venture regarding the prevention of oil spills (apart from declaring an emergency).

Despite major challenges, the company sees opportunities for positive change, among other things linked to the new political leadership in Nigeria and the amnesty for armed groups. At the same time, Shell admits it will take a long time to change the complex and in part destructive systems that have developed over a long period and are now deeply rooted, and that there will probably be setbacks along the way. Shell will not consider

pulling out of Nigeria, on the contrary it envisages operating there for several decades to come.

In its comments on a draft of the recommendation, the company writes that it disagrees with several of the assessments and conclusions, for example that the volume of oil spill from SPDC's facilities is a minimum estimate. The company believes its methods for calculating oil spills are good and verified by independent third parties. Shell also underlines that the conditions which the Council proposes are to be observed are the same conditions that the company is concerned about or monitors closely. The company wants any observation to clearly distinguish between conditions which lie outside the joint venture's or the company's control and those conditions that the company can control. Shell does not agree that it can and should exercise significant control over conditions which comprise the unusually difficult operating situation.

6 The Council on Ethics' assessment

The Council on Ethics has assessed selected aspects of the SPDC JV's oil production where Shell is the operator, based on the Ethical Guidelines' criterion of serious damage to the environment, with the aim of recommending exclusion or observation. The Council has focused on the extent of and damage caused by the oil spills, the company's control over and responsibility for the environmental damage, whether the company has implemented sufficient measures to prevent and rectify damage, and the future risk of serious environmental damage.

6.1 THE EXTENT AND DURATION OF THE OIL SPILLS

The Council on Ethics' studies have shown that the onshore oil production in the Niger Delta has for many years led to frequent and, in total, extensive oil spills. The reported frequency and volume of oil spills, which the Council considers to be minimum figures, are far higher than those which are normal worldwide and those which Shell experiences in other operations – in relation to oil spills caused by both sabotage and operational failure. Shell believes the reported volume figures have been arrived at on the basis of a good and recognised methodology. Shell does not believe that it can or should report oil spills that stem from the massive thefts, transport or local refining of oil taken from SPDC's infrastructure, where oil spills occur in the area outside the pipeline corridors (right-of-way). The Council finds that oil spills to which access is delayed or lacking, oil spills that are not discovered, oil spills due to extensive thefts of oil and oil spills caused by the transport and refining of illegally tapped oil are factors which contribute to the actual oil-spill volume in the delta being much larger than that which is reported.

Many ecologically sensitive and very valuable areas in the Niger Delta have been damaged by large, recurring or insufficiently cleaned-up and rehabilitated oil spills. There is little doubt that the delta is one of the most oil-influenced large ecosystems in the world. In many areas, the damage to agricultural areas, forest areas, wetlands, fresh water and mangroves is huge and long-lasting. Many people also live in areas where there is

extensive oil pollution and their livelihoods and health are very negatively affected. These are often poor people who are especially vulnerable because they have few or no other alternative ways of obtaining food, clean water and work. The Council therefore considers the consequences of oil spills to be very serious, even though many of the small oil spills probably have few or no long-term consequences. The Council on Ethics finds it very unfortunate that there are so few studies and little monitoring of the actual consequences of the extensive oil spills in the Niger Delta. This weakens the basis for effectively remedying the damage caused. Ogoniland is in an extremely difficult situation and the conditions in several locations there are catastrophic and may be impossible to rehabilitate during the next generation despite possible massive investments.

6.2 RESPONSIBILITY AND CONTROL

An important element in the Council on Ethics' assessment is the extent to which Shell can be held responsible for oil spills that the company in many cases believes is outside its control. It is relevant to consider several factors, from the joint venture's decision-making processes to the implementation and follow-up of various measures in a complex operational context. The Council finds that there are a number of situations in which Shell as the operator can and should implement extra measures to reduce the risk of damage and the extent of the damage.

In the joint venture, decisions regarding standards, guidelines, investment and operations budgets, schedules, etc., are reached through consensus. In principle, all the joint venture partners have a right of veto. By their agreement, the partners are co-responsible for the decisions that are made. The Council on Ethics registers that the company does not often use its veto right and that Shell agrees to activities which will very likely lead to oil spills.

The operator is responsible for implementing measures to prevent oil spills, including monitoring and safeguarding physical infrastructure. It is likely that the lack of financing for major investments which has existed for a number of years has negatively affected several important, long-term measures, while measures to maintain the operations and flow of revenue have been prioritised. Extensive upgrades, for example by replacing old or weak pipelines, are expensive, both directly in the form of costs and indirectly in the form of the loss of revenue due to a production stoppage. Such investments seem to be difficult to prioritise in the joint venture, primarily due to the Nigerian state's persistent underfunding and secondly because the joint venture partners are not very willing to pay the NNPC's contributions in advance. Over time, the standard of the extensive infrastructure has fallen for natural reasons (such as corrosion) and because of the external influence of unauthorised third parties (such as oil thefts). Critics of Shell claim, based on studies, that the pipelines in the delta are often old, weak and not up to standard. Shell has previously publicly admitted a backlog in its maintenance and replacement of a large network of old pipelines. The company now says this backlog has been reduced. Parts of the current physical infrastructure of the joint venture operations are probably still not up to the standard they should be or the standard that Shell wants them to be. In many places, it will also be impossible to use important technology such as 'pigs' for maintenance and

monitoring purposes. The Council believes these are factors that increase the risk of oil spills. There is thus an exceptionally great need for the operator to implement effective measures.

Thefts of crude oil and sabotage are undoubtedly important causes of oil spills and serious damage. Inadequate monitoring, insufficient measures implemented by the operator and a lack of follow-up by the authorities to deal with illegal activities are important reasons for the thefts continuing on a strikingly large and growing scale. Various measures over the past decade to reduce thefts have on the whole not reduced the number of thefts or the volume of oil spills. The authorities in the petroleum sector, including NNPC, also face major challenges in relation to bureaucracy, corruption and inefficiency in a number of important areas.⁴⁰ The sector is in various ways a system governed just as much by the interests of individuals and groups as by consideration of the best interests of the Niger Delta and Nigeria.⁴¹ The weak form of governance is an important factor in the extensive oil spills and the billion-dollar industry based on the theft of oil. The Council places emphasis on the operator having a responsibility to implement special measures to monitor infrastructure and to respond sufficiently to the risks relating to the actual operating conditions.

The operator may declare an emergency and shut down the production or transportation through pipelines without the approval of its joint venture partners if there is a danger to human life or a risk of serious damage to the operations or of severe pollution. An emergency has been declared a few times (for example in the case of long-lasting major thefts and a destructive oil spill at Soku), but the Council on Ethics finds very few examples of the operator making use of an emergency to prevent an oil spill even when the risk is great. This contributes to the huge amount of oil spills and environmental damage.

The operator's access to parts of the delta is at times restricted out of consideration for the safety of the operator's own staff and contractors. This weakens the maintenance and monitoring of the infrastructure and comes in addition to the challenges which lie in operating in a huge area and in a river delta with, in some locations, a poorly developed infrastructure. The risk of oil spills increases and the Council believes this also means that the company should implement extra and more effective measures to deal with risks (such as better monitoring and the shutdown of the production operations/infrastructure if there is a high risk of an oil spill).

Following an oil spill, the operator must make sure that the cleaning-up work starts immediately and that the best available methods and procedures are utilised.⁴² Rapid start-up and competent cleaning-up and rehabilitation work are important for reducing the extent of the damage. The relatively recent UNEP study from Ogoniland documents that it is not unusual for cleaning-up and rehabilitation work not to be carried out in accordance with Nigeria's and SPDC's own standards. The Council on Ethics has not seen documentation of the response time and quality of the cleaning-up and rehabilitation work in other parts of the SPDC JV area, but emphasises that, in the case that is well documented (Ogoniland), huge defects have been found in the cleaning-up work and that the system and its weaknesses are to a large extent the same in other parts of the joint venture operations.

The Council believes that, in accordance with the United Nations Guiding Principles on Business and Human Rights, which do not directly apply to the environmental area but apply to breaches of human rights as a result of environmental damage, the company must be required to implement appropriate action to prevent breaches of human rights.

Regarding this, article 19 of the Guiding Principles states the following, among other things:

‘Appropriate action will vary according to:

- (i) Whether the business enterprise causes or contributes to an adverse impact, or whether it is involved solely because the impact is directly linked to its operations, products or services by a business relationship;
- (ii) The extent of its leverage in addressing the adverse impact.’

The official commentary on the principle also states: ‘There are situations in which the enterprise lacks the leverage to prevent or mitigate adverse impacts and is unable to increase its leverage. Here, the enterprise should consider ending the relationship, taking into account credible assessments of potential adverse human rights impacts of doing so.’⁴³ Shell must conduct similar assessments regarding its situation in the Niger Delta.

When it comes to responsibility and control, the Council of Ethics finds that Shell is to a large extent responsible and can and should exercise significant control in relation to all the elements referred to above, especially in the form of prevention where the risk is great but also in the form of more effective measures when damage has occurred. The company is not the only party responsible and does not have full control, but its very good insight into the operating conditions and risks indicate, in the Council’s view, that the company should do more, especially to prevent serious damage in advance. In a situation where the authorities do not sufficiently enforce the national legislation, the company must be expected to implement extraordinary measures to ensure that its activities do not contravene national laws or international standards.

6.3 FUTURE RISK

The Niger Delta is an unusually complex area for an oil company to operate in and several decades of oil production without a good form of governance by the authorities and oil companies have resulted in unusual mechanisms which are both very destructive and difficult to change. When it comes to oil spills, there have on the whole been few positive trends and the reported oil-spill volume per produced unit has increased, although with a significant reduction from 2009 to 2010 and 2011. Without drastic changes in important factors, the Council on Ethics believes that the major risk of serious environmental damage in the future will not be significantly reduced in the short or medium term. However, as described below, there is great uncertainty regarding some of these factors.

Shell expresses a willingness to change and has, as an operator, good qualifications for driving change. The company’s utilisation of its freedom to act in a complex situation is a key factor, including Shell’s willingness and ability to actually make use of the tools it has in the joint venture (such as voting in the joint venture, declaring an emergency and shutting down production/infrastructure) when experience shows that operations will lead to

an unacceptably high level of oil spills caused by either operational failures or sabotage. The company's willingness to use these tools seems at present to be outweighed by the company's fear of risking its position in the joint venture and in the worst case losing rights in what for many years to come will probably be one of the world's most important areas for conventional oil production.

The joint venture's form of governance, the insufficient financing of important investments and – not least – Shell's role as the operator are also important aspects in this context. Any changes to the JVA that reduce NNPC's power or in any other way improve Shell's and the joint venture's ability and willingness to make important investments and implement other measures to prevent oil spills may reduce the future risk and damage. Nigeria is discussing reforms in the petroleum sector and an extensive new law (Petroleum Industry Bill) has been proposed. The new legislation's effect on the joint venture and on the operator's opportunity to exercise greater influence is unclear.

A third important factor is the ability and willingness of the Nigerian authorities and Shell to monitor and control unauthorised third parties, especially the oil-theft industry but also sabotage actions. Oil thefts require among other things drastic measures by the authorities, better monitoring by the operator and that the operator shuts down production or transport when there are major problems or a high risk involved.

The new government elected in 2011, with a president from the Niger Delta (Goodluck Jonathan), is signalling various moves to change the situation in the Niger Delta. Thus, various players, not least the oil companies, are optimistic about political changes that may extend the freedom of action of Shell and the other companies.

6.4 OVERALL ASSESSMENT

The Council on Ethics sees that oil spills are very undesirable for Shell, the joint venture and the government. Spilt oil is lost oil, lost revenues and increased costs. There is no reason to doubt that the company does a lot to reduce the extent of the oil spills, irrespective of whether the risk is of an operational nature or relates to unauthorised third parties. Nevertheless, oil spills are very large in extent and result in a situation which is environmentally and socioeconomically unacceptable.

Shell has a clear responsibility for the unacceptable damage situation, but the company is not solely responsible for this situation. The company can be said to be co-responsible for unanimous votes in the joint venture and for implementing and following these up as the operator. The company has considerable control over key conditions in the matter and is responsible for implementing measures if there is a great risk of an oil spill. The link between the operations and oil spills and the likelihood of a large number of oil spills under the present conditions mean that the company should implement extraordinary and effective measures to a much greater extent than has been the case up to now.

However, the Council on Ethics believes that there is an exceptional amount of uncertainty about future developments. Among other things, changes may occur in the joint venture's form of governance and framework and Nigeria has a new government that is clearly indicating it wants to change the unacceptable conditions in the Niger Delta. Shell expresses a willingness to change and, as an operator, has good qualifications for driving change.

On this basis, the Council does not recommend excluding Shell but recommends putting the company under observation. This observation must especially monitor how Shell utilises its changing freedom of action in the complex situation in the Niger Delta. Specifically what freedom of action the company will have depends, among other things, on political developments. The starting point is that the extent of oil spills from SPDC's operations is too large at present and that the subsequent damage is unacceptable. The way in which Shell carries out its role as an operator, its right to vote in the joint venture and its overall investment in Nigeria will be key elements in this observation. The Council will also monitor the major efforts to clean up oil spills in Ogoniland and Shell's role there.

7 Recommendation

The Council on Ethics finds that Royal Dutch Shell plc. is responsible for serious environmental damage in the Niger Delta but that there is exceptional uncertainty linked to future developments. The Council on Ethics therefore recommends that Shell be put under observation for a period of up to four years.

Ola Mestad
Chair
(signature)

Dag Olav Hessen
(signature)

Ylva Lindberg
(signature)

Bente Rathe
(signature)

Notes

- 1 The company's ISINs are GB00B03MLX29, GB00B03MM408 and US7802592060, and the company's ticker is RDSALN.
- 2 http://www.regjeringen.no/en/sub/styrer-rad-utvalg/ethics_council/ethical-guidelines.html?id=425277.
- 3 For example, the Swedish seventh AP fund (AP7) has withdrawn from Royal Dutch Shell plc. due to the environmental damage and breaches of human rights in the Niger Delta (AP7 (2011). Årsredovisning 2010, AP7, Stockholm. p. 40. Available at: http://www.ap7.se/PageFiles/92/AP7_%c3%85R_2010.pdf).
- 4 Some of the onshore operations also have some activity in offshore coastal areas.
- 5 Key documentation is referred to in footnotes. Websites that are referred to were available on 20 March 2013.
- 6 Sabotage: sabotage comprises various acts by unauthorised third parties, such as the illegal tapping of oil from pipelines and other infrastructure on a large or small scale using various methods and technologies (the theft of crude oil, often called 'bunkering') and direct vandalism (such as blowing up pipelines).
- 7 Operational failure: oil spills due to operational failure are caused by failures in equipment (such as corrosion, faults in valves or gaskets) or human error by the operator.
- 8 Nigerian Federal Ministry of Environment, Nigeria Conservation Foundation, World Wide Fund for Nature & The World Conservation Union (2006). Niger Delta Natural Resource Damage Assessment and Restoration Project - Phase 1 – Scoping Report. Available at: http://www.google.no/url?sa=t&rct=j&q=&esrc=s&frm=1&source=web&cd=1&cad=rja&sqi=2&ved=0CB4QFjAA&url=http%3A%2F%2Fcmsdata.iucn.org%2Fdownloads%2FNiger_delta_natural_resource_damage_assessment_and_restoration_project_recommendation.doc&ei=uQedUM28LqaN4gSo8YDgBw&usg=AFQjCNGAsqQCmU5qiwXPbLlgYnfrBzd2HQ&sig2=IsNUzjac5_2tFCzn8bM5Wg.
- 9 Refer for example to Transparency International (2012). Corruption perception index. Transparency International, Berlin. Nigeria is ranked as country no. 139 out of 174 countries/territories. Available at: http://cpi.transparency.org/cpi2012/in_detail/.
- 10 Refer for example to Transparency International & Revenue Watch Institute (2011). Promoting revenue transparency 2011 – report on oil and gas companies. Transparency International, Berlin. State-owned company Nigerian

- National Petroleum Corporation (NNPC) is ranked last of all the companies considered. Available at: http://www.transparency.org/whatwedo/pub/promoting_revenue_transparency_2011_report_on_oil_and_gas_companies.
- 11 United Nations Development Programme (2006). Niger Delta Human Development Report. United Nations Development Programme (UNDP), Abuja.
 - 12 Energy Information Administration (2012). Country Analysis Briefs. Nigeria. Energy Information Administration (EIA), U.S. Department of Energy, Washington, D.C. Available at: <http://www.eia.gov/countries/cab.cfm?fips=NI>.
 - 13 UNDP (2006).
 - 14 Ariweriokuma, S. (2009). The political economy of oil and gas in Africa. The case of Nigeria. Routledge, New York.
 - 15 There are probably fewer than 2,000 wells in production today.
 - 16 Refer for example to BP (2011). BP Statistical Review of World Energy June 2011. BP, London. Available at: http://www.bp.com/assets/bp_internet/globalbp/globalbp_uk_english/reports_and_publications/statistical_energy_review_2011/STAGING/local_assets/pdf/statistical_review_of_world_energy_full_report_2011.pdf
 - 17 Refer for example to: Ariweriokuma, S. (2009).
 - 18 Refer for example to: http://www.shell.com/home/content/environment_society/performance/environmental_data/.
 - 19 The oil-spill volume is usually calculated at the site of the oil spill by a so-called joint investigation team (JIT), also referred to as a joint investigation visit (JIV). The JIT consists of representatives of the authorities, operator and affected local communities. Possible sources of error in such calculations include: problems in calculating the volume of a liquid that has spread over a land area and/or water, and where some of the oil may have been carried away by rain, rivers or tides; relatively quick evaporation of some of the relatively "light" and volatile crude oil in the Niger Delta; the burning of oil in a fire; delay in the arrival of the JIT at the site (for example, for logistical reasons or because the local community refuses to allow the JIT access); the JIT is prevented from getting to the site of the oil spill (for example, due to reasons of security) so that no estimate of the volume is prepared; or the oil spill is not discovered or reported.
 - 20 Refer for example to: World Bank (1995). *Defining an environmental development strategy for the Niger Delta*. World Bank, Washington, D.C.
 - 21 United National Environment Programme (2011). *Environmental assessment of Ogoniland*. United National Environment Programme (UNEP), Nairobi. Available at: <http://www.unep.org/disastersandconflicts/CountryOperations/Nigeria/EnvironmentalAssessmentofOgonilandreport/tabid/54419/Default.aspx>.
 - 22 SPDC (Shell) has stated the volume figures in tonnes. The volume has been converted into barrels by the Council on Ethics (1 tonne = 7.3 barrels).
 - 23 Figures taken from correspondence between the Council on Ethics and Shell in 2012.
 - 24 Shell (2012). *Shell in Nigeria. Environmental performance – oil spills*. Fact sheet, Shell companies in Nigeria. (<http://s00.static-shell.com/content/dam/shell/static/nga/downloads/pdfs/briefing-notes/environmental-performance2012.pdf>).
 - 25 Absolute values for these figures are not directly comparable but the trends can be compared. Note that the number of oil spills outside Nigeria only relates to operations where Shell is the operator, while the production figures for Shell outside Nigeria apply to Shell's share of the production irrespective of whether Shell is the operator or only a partner in a JV or suchlike.
 - 26 NB: the figure 18,000 barrels/year for the 2007-2011 period also includes a large oil spill caused by operational failure on the Bonga field offshore Nigeria in 2011 (35,040 barrels), where Shell Nigeria Exploration and Production Company Ltd. (SNEPCO) is the operator, not SPDC. If the Bonga oil spill is removed from the figures, the annual average oil spill during the 2007-2011 period falls to around 11,000 barrels/year.
 - 27 In 2011, Shell reported a larger total oil-spill volume for Nigeria (50,370 barrels) than that shown in figure 7 (15,330 barrels). This was due to a large oil spill on the Bonga field offshore (35,040 barrels) where Shell Nigeria Exploration and Production Company Ltd. (SNEPCo), not SPDC, is the operator.
 - 28 In 2011, Shell reported a higher volume of oil spill caused by operational failure in Nigeria (38,690 barrels) than that shown in figure 8 (3,650 barrels). This was due to a large oil spill on the Bonga field offshore (35,040 barrels), cf footnote 27.
 - 29 The amnesty has reduced the number of sabotage actions drastically and has led to increased oil production. The effect of the amnesty may be short-lived, among other things because there is no long-term solution to the underlying political and social problems. It can be questioned whether alternative work can be obtained for all those who have given up their militant activities. New fractions of militant groups also seem to pop up once the previous groups have surrendered their weapons (refer for example to: RiskIntelligence (2010). *Nigeria – Review of 2010 and Outlook for 2011*. RiskIntelligence, Vedbaek). There are also indications that once the level of militant activity falls, oil thefts increase, possibly because people change their 'job' from militant activity to oil thefts.
 - 30 Shell (2012). *Shell in Nigeria; The operating environment*. Fact sheet, Shell companies in Nigeria. Available at: <http://s00.static-shell.com/content/dam/shell/static/nga/downloads/pdfs/briefing-notes/operating-environment2012.pdf>.

- 31 Refer for example to statements by Nigeria's finance minister, who refers to 400,000 barrels a day: <http://www.ft.com/cms/s/0/61fb070e-bf90-11e1-a476-00144feabdc0.html#axzz2Bdgeh99>.
- 32 Refer for example to Steiner, R. (2010). *Double standard. Shell practices in Nigeria compared with international standards to prevent and control pipeline oil spills and the Deepwater Horizon oil spill*. Friends of the Earth Netherlands, Amsterdam. Available at: <http://www.foei.org/en/resources/publications/pdfs/2010/double-standard-shell-practices-in-nigeria-compared-with-international-standards/view>.
- 33 Pigs ('pipeline inspection gauges') are a name for various tools that are placed inside pipelines and move through the pipe with the aim of, for example, cleaning its interior or measuring thickness or corrosion, mapping cracks, etc. Such technology cannot normally be used if the pipeline is deformed or has tapping equipment for stealing oil installed on it as this can stop the pig.
- 34 Refer for example to UNEP (2011).
- 35 UNEP *Disasters and Conflict Programme*
- 36 UNEP (2011).
- 37 UNEP (2011).
- 38 Department of Petroleum Resources (2002). *Environmental Guidelines and Standards for the Petroleum Industry in Nigeria (EGASPIN)*. Department of Petroleum Resources (DPR), Lagos.
- 39 To reduce flaring and take care of a valuable resource, the Nigerian authorities announced the *Associated Gas Reinjection Decree* in 1979, which demanded that companies were to stop flaring in 1984. Nigeria and Russia are the countries in the world that flare off most gas.
- 40 Refer for example to Gboyega, A., Søreide, T., Minh Le, T. & Shukla, G.P. (2011). *Political economy of the Petroleum Sector in Nigeria*. Policy Research Working Paper. World Bank, Washington, D.C. Available at: http://www-wds.worldbank.org/servlet/WDSContentServer/WDS/IB/2011/08/24/000158349_20110824134316/Rendered/PDF/WPS5779.pdf.
- 41 Refer for example to Thurber, M.C., Emelife, I.M. & Heller, P.R.P. (2010). *NNPC and Nigeria's oil patronage ecosystem*. Working Paper #95. Program on Energy and Sustainable Development, Stanford University, Palo Alto. Available at: http://iis-db.stanford.edu/pubs/22995/WP_95_Thurber_Emelife_Heller_NNPC_16_September_2010.pdf.
- 42 Cf. Nigeria's federal environmental legislation: 'Environment Protection Agency Act'(1998).
- 43 Cf. The UN's "Protect, Respect and Remedy" Framework for Business and Human Rights. Available at: <http://198.170.85.29/Ruggie-protect-respect-remedy-framework.pdf>, s. 18-19.

To the Ministry of Finance

18 April, 2013

UNOFFICIAL ENGLISH TRANSLATION

Recommendation on the exclusion of Zuari Agro Chemicals Ltd. from the Government Pension Fund Global's investment universe

1 Summary

The Council on Ethics recommends excluding the Indian company Zuari Agro Chemicals Ltd.¹ (Zuari) from the Government Pension Fund Global due to an unacceptable risk that the company through its production of hybrid seed contributes to the worst forms of child labour.

In the autumn of 2011 and 2012 the Council on Ethics surveyed the prevalence of child labour in the production of hybrid cottonseed for the company. On average 20 per cent and up to 30 per cent of the workforce used in the seed production for the company was found to be children. The Council on Ethics has based its assessment on the understanding that the company does not itself own the farms where the seed is cultivated and does not have a direct contractual relationship with the people who work there either; rather the seed is cultivated on commission from and under the supervision of the company.

The Council on Ethics has attached importance to the systematic use of children in production for the company. This is regarded as the worst forms of child labour because of the young age of the children and the health hazards they are exposed to in this work, partly as a result of the use of pesticides. The Council on Ethics has also attached importance to the fact that the risk of child labour is well known in this industry, that the company probably has a close working relationship with the farmers who use child labour, and that the company has not taken concrete steps to reduce the extent of child labour.

2 Introduction

In 2011, the Council on Ethics decided to assess the Fund's investment in the then Zuari Industries Ltd. against the Guidelines for the observation and exclusion of companies from the Government Pension Fund Global's investment universe (the GPF Global Ethical Guidelines). The background was the question of whether there was extensive use of child labour in the seed production for the company.

The seed production takes place at the company Zuari Seeds Ltd., which is now a wholly owned subsidiary of Zuari Agro Chemicals Ltd.² At the end of 2012, the GPF Global owned shares in Zuari Agro Chemicals Ltd. valued at NOK 14.5 million, corresponding to 1.5 per cent of the company's shares.

Both Zuari Seeds Ltd. and Zuari Agro Chemicals Ltd. are referred to as ‘Zuari’ below.

The Council on Ethics has previously undertaken extensive surveys on the use of child labour in hybrid seed production for multinational companies in India. The case at hand pertains to an Indian company that was not in the GPFG portfolio when the previous studies were conducted.

2.1 WHAT THE COUNCIL ON ETHICS HAS CONSIDERED

The Council on Ethics has considered the GPFG’s investment in Zuari in the light of section 2, 3 (a) of the ethical guidelines for the Fund:

‘The Ministry of Finance may, on the advice of the Council of Ethics, exclude companies from the investment universe of the Fund if there is an unacceptable risk that the company contributes to or is responsible for: [...] the worst forms of child labour and other child exploitation; [...]’³

The Council on Ethics bases its assessment of whether child labour can be categorised as ‘the worst forms of child labour’ under the guidelines on the wording of the UN Convention on the Rights of the Child, which in Article 32 obliges states to protect children from work that is hazardous or likely to interfere with the child’s education or development.⁴

The Council on Ethics also bases its assessments on the wording of the ILO Convention 182, which defines the worst forms of child labour, *inter alia*, as work that is likely to harm the health or safety of children. The same convention also stipulates that exposing children to any form of slavery or practices similar to slavery, including debt bondage and serfdom, is to be regarded as the worst forms of child labour.⁵

Even if it is states, as opposed to companies, that are obligated by international human rights conventions, companies can nevertheless be said to contribute to human rights violations. The Council does not take a position on the extent to which the state is responsible for any human rights violations; it is sufficient to establish that the company in question is acting in a manner that links it to serious or systematic violations of internationally recognised human rights.⁶ This applies regardless of whether the state where the violations are taking place has ratified the conventions against which the circumstances are assessed.

The Council on Ethics considers that the following elements can form the basis for the assessment of whether there is an unacceptable risk of a company contributing to human rights violations: There must be a concrete link between the company’s operations and the violations in question, and the violations must also either be ongoing or there must be an unacceptable risk that they will occur in the future. The Council has also placed much emphasis on whether the company’s operations have led to extensive and lasting negative impacts for the people affected, to what extent particularly vulnerable groups have been affected, and what the company has done to improve the conditions.

Commercial hybrid seed production in India is organised such that seed companies enter into agreements with local farmers for the cultivation of seed. The company

provides upfront inputs such as the seed for planting and pesticides, and visits the farms regularly for quality control and to give advice. The seed companies do not themselves use children as workers in the sense that they employ children; rather the company's link to the use of child labour is through the use of local farmers whom the children work for.

In this case, the Council on Ethics has assessed whether the use of child labour in hybrid seed production for Zuari implies that the company contributes to the worst forms of child labour.

2.2 SOURCES

The Council on Ethics has used a consultant to survey the extent of child labour in the production for the company.⁷ Surveys were carried out in autumn 2011 and 2012 at a total of 30 and 80 farms, respectively, in the states Gujarat, Maharashtra, Andhra Pradesh and Karnataka. The assessment is also based on the company's letters to the Council on Ethics. In addition, information has been obtained from the company's annual report and website as well as other sources.

3 Background

3.1 CHILD LABOUR IN THE INDIAN SEED INDUSTRY IN GENERAL

Despite the increased attention given to the problem in recent years, there is still widespread use of child labour in the Indian seed industry. A survey conducted in 2009–2010 estimated that some 380,000 children, of whom roughly 170,000 were under the age of 14, worked in the cultivation of hybrid cottonseed in India.⁸ A similar survey conducted in 2010 estimated that some 150,000 children, of whom 60,000 were under 14 years of age, worked on the cultivation of hybrid vegetable seed in India.⁹

The cultivation of hybrid seed is extremely labour-intensive when plants have to be pollinated manually, as is the case for hybrid cotton seed. Working conditions are generally poor with long working days, physically demanding work and continuous exposure to pesticides. In some cases, children work in slavery-like conditions in debt bondage.

The Council on Ethics first began working on this issue in 2005. Since then there have been developments in several areas that have affected both the extent of child labour and various aspects linked to production in general. The Indian government, primarily the National Commission for Protection of Children's Rights (NCPR), has implemented a number of measures to reduce the use of child labour. In 2006, UNICEF initiated a programme to reduce the prevalence of child labour in this industry.¹⁰ The large, multinational companies involved in the industry have come under pressure from civil society and investors regarding child labour. Not least, NBIM¹¹ has raised this issue with several of the major companies, which have introduced extensive programmes to prevent child labour in their production.¹²

Since 2007, the area under hybrid cottonseed cultivation in India has increased by over 60 per cent, from about 24,000 to 40,000 hectares. The area under cultivation for the companies that the GPF is invested in constitutes roughly one-third of this. Much of this expansion has been in remote areas where this kind of production has not been done in

the past and where there is a plentiful supply of cheap labour and little attention is given to the issue of child labour. In the states Gujarat and Tamil Nadu, the entire expansion has been in less developed areas.

3.2 ABOUT ZUARI AGRO CHEMICALS LTD.

Zuari Agro Chemicals Ltd. produces inputs for agricultural production, primarily artificial fertilisers and pesticides, but also hybrid cotton seed and vegetable seed.¹³ The company operates in India where the seed production is carried out by its wholly owned subsidiary Zuari Seeds Ltd.

In 2011 production of hybrid cottonseed for the company took place in Gujarat, Andhra Pradesh and Maharashtra and encompassed a total of about 350 hectares.¹⁴ In 2012, this had risen to some 800 hectares. This constitutes roughly 2 per cent of the total production in India. It is estimated that around 4,000 farms were involved in cottonseed production for the company in 2012.¹⁵

The company also produces hybrid vegetable seed, mainly chilli pepper, tomato and okra, primarily in Karnataka. The Council on Ethics does not have accurate data on the scope of this production, but it is estimated to encompass approximately 250 farms.

3.3 RELATED CASES

Several rounds of studies were carried out on commission for the Council on Ethics during the period 2006–2008 to chart the prevalence of child labour in the Indian seed industry. The studies looked into production for several different companies and in different areas. A common feature was that in areas where measures to reduce the use of child labour had not been implemented, children often made up around 30 per cent of the workforce, in some places even more.

In 2006 the Council submitted a recommendation to the Ministry of Finance to exclude the company Monsanto Co. from the GPFG.¹⁶ The background for this was the extensive use of child labour in the production of hybrid cottonseed for the company. In this case, the Council on Ethics attached importance to the extent of the use of child labour, the young age of the children, the health risks the children were exposed to as a result of the use of pesticides, and the fact that some of the children were sent to work far away from their homes.

Since NBIM was engaged in active ownership dialogue with Monsanto and several other companies to try to influence them to adopt better measures to prevent child labour in seed production, the Council on Ethics in 2008 recommended that the Ministry of Finance maintain its investment in Monsanto, on the grounds that active exercise of ownership would probably reduce the prevalence of child labour. An important factor in this decision was the fact that NBIM was the only major institutional investor that had initiated this type of agenda with the companies, and that the GPFG's investment in the companies was a prerequisite for NBIM to be able to continue to exert this influence.

Studies that the Council had undertaken in 2011 demonstrated a significant decrease in the incidence of child labour in those companies where concrete measures to this end had been implemented. In the areas that have achieved the best results, children typically

constituted between 2 and 4 per cent of the workforce in production for these companies. While the problem has not been completely eliminated, the prevalence of child labour had gone from being consistent and systematic to more sporadic.

The extent of the GPFG's investments in small Indian companies has increased in recent years. The Indian company to which this recommendation pertains, Zuari, has not been included in NBIM's active ownership dialogue and the company has not participated in the industry initiative that NBIM helped to initiate.

4 The Council on Ethics' surveys 2011-2012

On assignment for the Council on Ethics, surveys were conducted in autumn 2011 and 2012 on the prevalence of child labour in the production of hybrid cotton- and vegetable seed for Zuari. This was part of a larger survey of the use of child labour in hybrid seed production for a number of companies in India.

The purpose of the surveys was to chart the extent of child labour and practices linked to the use of pesticides on farms producing hybrid seed for companies in the GPFG in the states Gujarat, Andhra Pradesh, Maharashtra and Karnataka.

4.1 METHODOLOGY

The surveys were conducted through unannounced visits to the farms. The age of the workers was determined through conversations with workers and observations. In this study, anyone above the age of 15 years was categorised as an adult and everyone under the age of 15 years was categorised as a child. Cases where it could not be determined whether the worker was above or less than 15 years were categorised as "unsure".

As with previous surveys of this type, children were frequently observed leaving the field when strangers approached. Where these were observed and could be counted, they were counted and categorised as children in the study.

2011

Studies were conducted at 30 randomly selected farms that produce for Zuari, 20 in Gujarat and 10 in Maharashtra, in the period from August to December 2011. The 30 farms in the sample accounted for about 2.5 per cent of the area under hybrid cottonseed cultivation for the company in the 2011 season.

2012

The working conditions were surveyed at 80 farms in 16 villages in Gujarat, Andhra Pradesh and Karnataka. Of these, 60 produced cottonseed (30 each in Gujarat and Andhra Pradesh) and 20 produced vegetable seed. The cottonseed producers in the sample accounted for about 5 per cent of the area under hybrid cottonseed cultivation for the company in the 2012 season.

4.2 THE FINDINGS OF THE SURVEYS

Prevalence of child labour, 2011

The total workforce on the farms visited in the study amounted to 164 people. 43 of these may have been children under the age of 15 years: 31 people were determined with certainty to be under 15; in 12 cases the individual's age was not determined with certainty.

15 per cent of the children were under the age of 10 years old, and 90 per cent of the children were under the age of 14.

The proportion of children who were working (only including certain observations) accounted for between 15 and 20 per cent of the workforce at each farm. Including the uncertain observations, the proportion of children in the workforce was almost 30 per cent.

Prevalence of child labour, 2012

The total workforce on the farms visited in the study amounted to 1017 people, 227 of whom may have been children under the age of 15 years. 164 people were determined with certainty to be under 15. In 63 cases the individual's age was not determined with certainty. Almost 20 per cent of the children were under the age of 10 years.

Children constituted some 10–20 per cent of the workforce at each farm (only including certain observations). Including the uncertain observations, the proportion of children in the workforce was 15–25 per cent.

The use of child labour varied according to what was being produced: the proportion of children in the production of tomato seed was around 15 per cent, whereas the proportion of children involved in the production of cotton seed and chilli pepper seed was approximately 25 per cent.

Other findings from the Council on Ethics' research

The studies conducted in 2011 indicate that roughly half of the children working on the farms were contract workers; the others had family ties to the farms. There were equal numbers of boys and girls. The studies conducted in 2012 found that almost 80 per cent of the children were contract workers. Two-thirds of the children were girls. In Gujarat and Andhra Pradesh, 40 per cent of the children were migrant workers, i.e. children sent from other regions and sometimes even other states to work.¹⁷

Both studies estimated that around 60 per cent of the children never went to school. The other children go to school sporadically outside the farming season, to varying degrees.

As for the use of pesticides, the workers at more than 90 per cent of the visited farms did not have access to suitable personal protection equipment and were not given any training in the safe use of the chemicals. Only two farms were observed to have implemented some basic measures to protect the person who carried out the spraying. It is common for children and adults to be in the field during or immediately after spraying.

5 Information from the company

In June 2011, the Council on Ethics sent a letter to the company asking whether child labour was used in the production of hybrid seed for the company and whether the company had issued any guidelines and implemented measures to prevent this. The company did not respond to the Council's initial request.

A first draft of this recommendation was sent to Zuari in June 2012, in which the company was invited to make any comments it might have.¹⁸ Zuari Global Ltd. responded to this letter in July 2012. The company stressed that no minors were employed by the company and that the company had never employed minors nor encouraged such practice.

The company pointed out that it stipulated strict requirements that the suppliers that produce seed for the company must not use child labour, at the same time as it admitted that any use of child labour that might nevertheless occur may be due to the financial circumstances in this industry. The company further stated that it has repeatedly stressed to the farmers the importance of schooling for children.

The company also pointed out that it does not have any direct control over the individual farmers, that it is the state that has the formal responsibility for ensuring that the law is observed, and that the company's Code of Conduct specifies that it does not accept child labour in its own operations or those of its suppliers, contract producers and other business associates.¹⁹

A renewed draft of this recommendation, with the results from the 2012 surveys, was sent to the company in March 2013. Again, the company was invited to submit any remarks.²⁰ The company maintains that it has not employed children in its production, that the company does not accept the use of child labour in the seed production and the company also informs that it conducts inspections at regular intervals to assure that child labour is not used:

‘Contrary to the assertions in your report, neither Company, nor ZSL [Zuari Seeds Ltd.] have employed or encouraged to employ children, as labour, in any form, in its operations. In fact ZSL neither has a concrete link nor a close working relationship with local growers at all. The growing operations are conducted by entering into agreements with Organisers, who in turn identify the local growers. It is pertinent to note that one of the pre-requisites, expressly reflected in each agreement is the “No use of Child Labour in the seed production activities”. The company displays zero tolerance for to the non-compliance to this clause in the agreement. In fact, the representatives of ZSL inspect the farms at regular intervals to ascertain the conformity with the Agreement.’²¹

6 The Council's assessment

Introductory observations

The ethical guidelines for the GPFG state that the Council on Ethics can recommend the exclusion of companies from the Fund's investment universe if there is an unacceptable risk that the company contributes to or is itself responsible for systematic violations of human rights, for example through the use of the worst forms of child labour.

In this case, the Council on Ethics has considered whether the company can be said to contribute to child labour, and if so, whether the child labour in question must be regarded as "the worst forms of child labour". The Council has also considered whether the use of child labour can be considered to be systematic, and whether it is likely that these violations will continue.

Assessment of the extent and nature of the child labour

The Council on Ethics' surveys indicate that children are estimated to make up around 20 per cent of the workforce involved in production for the company. It is difficult to determine the exact scope of the child labour, and it also varies between different types of seed and different geographical areas, but there are probably somewhere between 3000 and 4000 children working in the production for the company in total.²²

The demonstrated proportion of child labour in production for Zuari corresponds to that found in the Council on Ethics' previous surveys of other companies that do not have effective measures to reduce the use of child labour. This indicates that the surveys that form the basis for this recommendation provide a realistic picture of the conditions in the production of hybrid seed for Zuari.

The Council on Ethics also finds that the proven cases of child labour must be considered to qualify as 'the worst forms of child labour'. This is supported by several factors.

The young age of the children is one important factor. In the Council on Ethics' surveys, it was estimated that almost 20 per cent of the children were under the age of 10 years, and 90 per cent of the children were under 14. The majority of the children had no family connection to the production site where the children are involved in seasonal work, and many were working away from their families and care providers.

Another significant factor that makes this case fall under the category 'the worst forms of child labour' is the obvious health risks that the children are exposed to because of the almost constant exposure to pesticides. Children work without any form of protection in areas during or immediately after spraying. There is widespread, frequent use of pesticides, with crops often being sprayed several times a week. Farms consistently use pesticides that are harmful both on contact with the skin and when inhaled and that can cause serious and permanent health problems with long-term exposure.

The children also have to work very long hours (up to 14 hours a day) and perform demanding physical labour, often in extreme heat. Because the season for the cultivation of hybrid seed is long (at least eight months a year), these children usually receive no or only very limited schooling.

In addition to the fact that the violations specified above are regarded as serious, the

Council on Ethics also finds that they must be regarded as systematic and widespread, since children constitute up to 30 per cent of the workforce on the farms included in the studies and on average around 20 per cent.

Link between the company's operations and the violations

In formal terms, the child labour does not occur at Zuari. The link between the company and child labour is established through the agreements that the company enters into with local farmers. The company enters into agreements with local growers, in some cases through an intermediary, for the production of seed. The company provides inputs such as the seed for planting and pesticides. The company's representatives inspect the farms at regular intervals to provide advice and guidance and to check the quality and are therefore familiar with the conditions under which production occurs. The Council on Ethics therefore finds that there is an unequivocal link between the company's operations and the use of child labour in production for the company, and that the company buys seed in full knowledge that extensive use of child labour is common in seed cultivation.

Assessment of the information from the company

The company claims not to control operations on the individual farms. At the same time, the company states that it in fact does conduct regular inspections to ensure that the production is conducted as specified in the contracts, including that child labour is not to be used.

The Council does not know exactly how these inspections are conducted (e.g. how often they are performed and if they are unannounced) or how effective they are, but can only observe that despite of the company's routines for inspections, extensive child labour is used in the production for the company.

The companies that have succeeded in reducing the use of child labour have implemented concrete programmes to achieve such improvements. The main initiatives have been the introduction of financial incentives where use of child labour is penalised and farmers are rewarded for not using child labour. Parallel to this, monitoring systems have been introduced with unannounced inspections.

The fact that a company has a policy or code of conduct is not sufficient in itself to achieve reductions in the use of child labour. Nor is it sufficient that the company has established control mechanisms if these are not suited to detect instances of child labour. As long as the company does not introduce more appropriate measures to mitigate the problem, it is likely that child labour will be used in production for Zuari in the future too.

Assessment of future risk

There does not seem to have been any significant reduction in the use of child labour in production for the company from 2011 to 2012. The results are not directly comparable, since the working conditions have been studied in connection with the cultivation of different types of seeds. To the extent that there can be said to have been a slight decrease in the scope of child labour (compared with the figures from the production of cottonseed), it is probably due to other factors, such as a poor harvest, rather than measures

implemented by the company. The Council on Ethics therefore finds no grounds to believe that there is a downward trend in the use of child labour in production for the company.

In the light of these factors, the Council on Ethics finds there is an unacceptable risk that the company contributes to systematic use of the worst forms of child labour and that this will continue in the future.

7 Recommendation

The Council on Ethics recommends that the company Zuari Agro Chemicals Ltd. be excluded from the investment universe of the Government Pension Fund Global due to an unacceptable risk that the company contributes to serious, systematic human rights violations.

Ola Mestad
Chair

(sign.)

Dag Olav Hessen

(sign.)

Ylva Lindberg

(sign.)

Marianne Olsson

(sign.)

Bente Rathe

(sign.)

Notes

- 1 Zuari Agro Chemicals Ltd. ISIN: INE840M01016.
- 2 In 2011 Zuari Seeds Ltd. was a wholly owned subsidiary of Zuari Industries Ltd. Following a restructure in 2012 Zuari Seeds Ltd. is now a wholly owned subsidiary of Zuari Agro Chemicals Ltd.
- 3 Guidelines for the observation and exclusion of companies from the Government Pension Fund Global's investment universe: http://www.regjeringen.no/en/sub/styret-rad-utvalg/ethics_council/ethical-guidelines.html?id=425277.
- 4 UN Convention on the Rights of the Child, Article 32: 'States Parties recognize the right of the child to be protected from economic exploitation and from performing any work that is likely to be hazardous or to interfere with the child's education, or to be harmful to the child's health or physical, mental, spiritual, moral or social development.' <http://www.ohchr.org/EN/ProfessionalInterest/Pages/CRC.aspx>.
- 5 ILO Convention no. 182: 'For the purposes of this Convention, the term 'the worst forms of child labour' comprises: (a) all forms of slavery or practices similar to slavery, such as the sale and trafficking of children, debt bondage and serfdom and forced or compulsory labour, including forced or compulsory recruitment of children for use in armed conflict; [...] (d) work which, by its nature or the circumstances in which it is carried out, is likely to harm the health, safety or morals of children.' <http://www.ilo.org/public/english/standards/reln/ilc/ilc87/com-chic.htm>.
- 6 See section 3.2 of the Council on Ethics' recommendation on the exclusion of Wal-Mart Stores Inc., dated 15 November 2005, and section 5.1 of the recommendation on the exclusion of Monsanto Co., dated 20 November 2006 (www.etikkradet.no).
- 7 Research was carried out by Dr Davuluri Venkateswarlu, Glocal Research and Consultancy Services, Hyderabad, India.
- 8 Dr. Venkateswarlu (2010) 'Seeds of Child Labour – Signs of Hope. Child and Adult Labour in Cottonseed Production in India', ICN et al.: <http://www.indianet.nl/pdf/signsofhope.pdf>.
- 9 Dr. Venkateswarlu (2010) 'Growing up in the Danger Fields: Child and Adult Labour in Cottonseed Production in India', ICN, ILRF. et. al.: <http://www.indianet.nl/pdf/dangerfields.pdf>.
- 10 UNICEF: 'It is estimated that hundreds of thousands of children, mainly girls, work in India's cotton industry alone. The vast majority of these child workers do not attend school. In many cases, children are employed because they are paid much less than adults – about \$1 per day – and work longer hours. Moreover, they can't easily complain. Cotton production is painstaking work that requires long hours of cleaning, seeding and hauling water to fields, then standing and individually cross-pollinating each flower by hand before finally plucking every bloom.'

Often, child workers suffer respiratory and other health problems caused by exposure to pesticides, extreme heat and physical stress. Some are also beaten or sexually abused by employers. Since 2006, UNICEF and the IKEA Social Initiative have partnered to tackle child labour in India by building public awareness about existing laws that forbid it. The country's child labour law prohibits the hiring of children younger than 14, but enforcement has been difficult since few children understand their rights.' http://www.unicef.org/education/india_55444.html.

- 11 Norges Bank Investment Management (NBIM) manages the Government Pension Fund Global.
- 12 NBIM: *Children's Rights – a concern for investors*, <http://www.nbim.no/no/media-og-publikasjoner/temaartikler/2009/investor-expectations-on-childrens-rights/>.
- 13 The company's website: <http://zuari.in/>.
- 14 350 hectares = 3.5 square kilometres.
- 15 The average size of the farms included in the study was 0.2 hectares.
- 16 The recommendation and correspondence concerning the Council on Ethics' recommendation on the exclusion of the company Monsanto Co., November 2006: <http://www.regjeringen.no/nb/sub/styrer-rad-utvalg/etikkradet/Tilradninger/tilradninger/menskerettigheter/tilradning-20-november-2006-om-utelukkel.html?id=526099>.
- 17 This kind of trafficking of children is often organised through a network of agents who pay an advance on the children's wages to the parents against a 10 per cent commission. This system is described in more detail in 'Wages of Adolescence: Annual Exodus of Tribal Adolescents from South Rajasthan to Bt Cotton Seed Plots of North Gujarat', Katiyar Sudhir (2006).
- 18 Letter from the Council on Ethics to Zuari Industries Ltd., dated 28 June 2012.
- 19 Letter from Zuari Global Ltd. (formerly Zuari Industries Ltd.) to the Council on Ethics, dated 4 July 2012.
- 20 Letter from the Council on Ethics to Zuari Agro Chemicals Ltd., March 1, 2013.
- 21 Letter from Zuari Agro Chemicals Ltd. to the Council on Ethics, March 19, 2013.
- 22 This estimate was reached by using the findings concerning the number of children working per unit of land used to produce the different types of seed in the different states and multiplying it by the production area for the different types of seed in the various states.

To the Ministry of Finance

25 April 2013

UNOFFICIAL ENGLISH TRANSLATION

Recommendation to revoke the exclusion of the companies Africa Israel Investments Ltd. and Danya Cebus Ltd. from the investment universe of the Government Pension Fund Global

1 Background

In November 2009, the Council on Ethics recommended the exclusion of the Israeli company Africa Israel Investments Ltd. (AFI) and its listed subsidiary Danya Cebus Ltd. from the GPFG.¹ The reason was the companies' involvement in the building of Israeli settlements in the West Bank.

The Ministry of Finance followed the recommendation of the Council on Ethics and decided to exclude the companies in August 2010.

2 Information from the company

The Council on Ethics routinely considers whether the basis for the exclusion of companies continues to be present.

At a meeting with AFI in April 2013, and in subsequent correspondence, the company has informed the Council on Ethics that neither AFI nor any of its subsidiaries are involved in the construction of settlements in the West Bank anymore, and that there are no plans for such activities in future:

'Africa Israel Investments Ltd. and its subsidiaries have no current construction projects concerning Israeli settlements in the West Bank, and at the present have no plans for such activities in the future.'²

3 The Council on Ethics' assessment

As per the GPFG's ethical guidelines, the Council on Ethics recommends the exclusion of companies from the Fund's investment universe due to actions that present an unacceptable risk of a company contributing to violations of the rights of individuals in situations of war or conflict.³ There is widespread agreement that Israel's construction of settlements in the West Bank is illegal, and the Council on Ethics has therefore recommended the exclusion of companies that build Israeli settlements in the West Bank. The Council on Ethics remains of the view that such activities can constitute a basis for the exclusion of companies from the GPFG.

The exclusion mechanism is not intended to punish companies for previous actions, but rather to prevent investment in companies that are responsible for or contribute to on-going or potential future breaches of standards.

The recommendation to exclude AFI and Danya Cebus followed on-going construction activities in the West Bank. The Council on Ethics also attached importance to the company's lack of response to the Council on Ethics' enquiry regarding potential future construction activities in the area.

As the company has now stated that these construction activities have ended and that there are no plans for such activities in the future, nor are there indications from other sources that the company is involved in such activities, the Council on Ethics considers that the basis for continued exclusion is no longer present.

4 Recommendation

The Council on Ethics for the Government Pension Fund Global recommends that the exclusion of the companies Africa Israel Investments Ltd. and Danya Cebus Ltd. be revoked.

Ola Mestad
Chair

(Sign.)

Dag Olav Hessen

(Sign.)

Ylva Lindberg

(Sign.)

Marianne Olsson

(Sign.)

Bente Rathe

(Sign.)

Notes

- 1 Recommendation on the exclusion of Africa Israel Investments Ltd. and Danya Cebus Ltd.: http://www.regjeringen.no/pages/13898012/Recommendation_Africa_Israel.pdf.
- 2 Meeting on 10 April 2013 in Yehud, Israel, and email from AFI to the Council on Ethics, 19 April 2013.
- 3 Guidelines for the observation and exclusion of companies from the Government Pension Fund Global's investment universe: http://www.regjeringen.no/en/sub/styret-rad-utvalg/ethics_council/ethical-guidelines.html?id=425277.

To the Ministry of Finance

1 November, 2013

UNOFFICIAL ENGLISH TRANSLATION

Recommendation to exclude the companies Africa Israel Investments Ltd. and Danya Cebus Ltd. from the investment universe of the Government Pension Fund Global

1 Summary

The Council on Ethics recommends the exclusion of the Israeli companies Africa Israel Investments Ltd. (AI) and Danya Cebus Ltd. (DC) from the Government Pension Fund Global (GPFG) due to an unacceptable risk of the companies, through their construction activity in East Jerusalem, contributing to serious violations of the rights of individuals in situations of war or conflict.

2 Introduction

In September 2013, the Council on Ethics decided to reconsider the Fund's investment in AI¹ and DC by reference to the Guidelines for the observation and exclusion of companies from the Government Pension Fund Global's investment universe (the ethical guidelines).² The reason for this was information that DC is constructing settlements in East Jerusalem. This construction activity must be regarded as illegal.

DC is a listed subsidiary of AI, which owns 82 per cent of DC.

The companies were excluded from the GPFG from August 2010 to August 2013 on the recommendation of the Council on Ethics. The reason for the exclusion was that the companies were engaged in the construction of settlements in the West Bank.

When the Council on Ethics was in contact with the company in the spring of 2013, AI made it clear that neither the company nor any of its subsidiaries were involved in or had plans to construct settlements in the West Bank. The Council on Ethics proceeded on this basis, and recommended in April of this year that the companies should no longer be excluded from the GPFG.³ Since then, the Council on Ethics has received information that DC is constructing settlements in East Jerusalem.

2.1 WHAT THE COUNCIL HAS CONSIDERED

The Council on Ethics has considered whether there is an unacceptable risk of AI or DC contributing to serious violations of the rights of individuals in situations of war or conflict in accordance with section 2(3)(b) of the ethical guidelines. The background is DC's construction of the 'C Jerusalem' project in the the Gilo neighbourhood in East Jerusalem.

2.2 SOURCES

The information about DC's construction of settlements in East Jerusalem became known to the Council on Ethics after the recommendation to revoke the exclusion of the companies was published.

AI has confirmed to the Council on Ethics that DC is the general contractor for the C Jerusalem project.

3 Background

3.1 PREVIOUS CASES

The Council on Ethics has twice previously made recommendations regarding the exclusion of companies engaged in the construction of settlements in the West Bank and East Jerusalem.⁴ The recommendation to exclude the company Shikun & Binui Ltd. in 2011 was made due to the company's construction of settlements in East Jerusalem. The assessment of the Council on Ethics regarding AI's construction activity in East Jerusalem is identical to the assessment on which the 2011 recommendation was based.

3.2 THE LEGALITY OF ISRAELI SETTLEMENTS IN EAST JERUSALEM

The purpose of the Fourth Geneva Convention is to protect civilians during war and occupation. The convention establishes the obligations and rights of an occupying power in an occupied territory. Israel acceded to the convention without reservations in 1951.

Article 49 of the convention states, '[...] The Occupying Power shall not deport or transfer parts of its own civilian population into the territory it occupies.'

In connection with Israel's launch of the plans to construct further settlements in East Jerusalem, to which this recommendation relates, the UN Secretary-General stated in 2011:

'The Secretary-General is deeply disappointed by the recent approval by the Government of Israel to build more than 900 housing units in East Jerusalem. He reiterates that settlement activity in the West Bank, including East Jerusalem, is contrary to international law, and he is concerned by provocative actions on the ground.'⁵

The International Court of Justice (ICJ) in The Hague⁶, the UN Security Council⁷ and the International Committee of the Red Cross (ICRC)⁸ have established that Israel's construction of settlements in the West Bank and East Jerusalem contravenes the Fourth Geneva Convention.

3.3 THE STATUS OF EAST JERUSALEM

Israel claims that East Jerusalem has a different status from the rest of the West Bank. In 1980, Israel annexed East Jerusalem by adopting the '*Basic Law: Jerusalem, Capital of Israel*'.⁹ In 1980, the UN Security Council adopted resolution 478, which established, among other things, that Israel's annexation of East Jerusalem was illegal and did not alter the occupied status of the territory.¹⁰

4 Information from the companies

The Council on Ethics has written to AI, asking whether it or its subsidiaries are involved in construction projects in East Jerusalem.¹¹

In an email from AI (10 September of this year), the company confirmed that DC is the general contractor for the C Jerusalem project in East Jerusalem. The company also pointed out that it regards East Jerusalem as part of Israel, and that its construction activity there cannot be equated to the construction of settlements in the rest of the West Bank.

The Council on Ethics sent a draft version of this recommendation to AI on 2 October, 2013, and invited the company to submit any remarks it may have. AI did not respond to this.

5 The Council's assessment

The Fund's investments in companies that can be said to contribute to violations of the Fourth Geneva Convention may fall within section 2(3)(b) of the GPF's ethical guidelines.

There is broad international consensus that Israel's construction of settlements in the West Bank and East Jerusalem is illegal, and there is no basis for the suggestion that settlements in East Jerusalem and in the rest of the West Bank should be assessed differently under international law. DC's construction of the C Jerusalem project must therefore be equated to the construction of Israeli settlements in the rest of the West Bank. The Council on Ethics maintains that companies that construct such settlements should be excluded from the GPF.

AI holds a controlling interest in DC. Thus, AI should be excluded as a consequence of DC's construction activity in East Jerusalem.

6 Recommendation

The Council on Ethics recommends the exclusion of the companies Africa Israel Investments Ltd. and Danya Cebus Ltd. from the investment universe of the Government Pension Fund Global due an unacceptable risk of the companies contributing to serious violations of the rights of individuals in situations of war or conflict.

Ola Mestad Chair (sign.)	Dag Olav Hessen (sign.)	Ylva Lindberg (sign.)	Marianne Olsson (sign.)	Bente Rathe (sign.)
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Notes

- 1 ISIN: IL0006110121.
- 2 http://www.regjeringen.no/en/sub/styrer-rad-utvalg/ethics_council/ethical-guidelines.html?id=425277.
- 3 Recommendation to revoke the exclusion of Africa Israel Investments Ltd. and Danya Cebus Ltd., 25 April 2013 (published 21 August 2013).
- 4 Council on Ethics: Recommendation 16 November 2009 on exclusion of the companies Africa Israel Investments Ltd. and Danya Cebus Ltd.: http://www.regjeringen.no/pages/13898012/Recommendation_Africa_Israel.pdf, and Council on Ethics: Recommendation 21 December 2011 on exclusion of the company Shikun & Binui Ltd.: http://www.regjeringen.no/pages/37921777/Tilr_Shikun_Binui_publ_eng.pdf.
- 5 Statement 6 August 2011 by the UN Secretary-General: <http://unispal.un.org/UNISPAL.NSF/5ba47a5c6cef541b802563e000493b8c/c4bb7721a06a99dc852578e6004a5728?OpenDocument>.
- 6 In its advisory opinion of 2004 concerning the legality of Israel's separation barrier with the West Bank, the ICJ also considered the legality of the settlements (paragraph 120): 'The Court concludes that the Israeli settlements in the Occupied Palestinian Territory (including East Jerusalem) have been established in breach of international law.' In this context, the ICJ found that Israel's establishment of new settlements in the West Bank and East Jerusalem is illegal. <http://www.icj-cij.org/docket/files/131/1671.pdf>.
- 7 Security Council resolution 465, which was unanimously adopted on 1 March 1980, established among other things that Israel's policy and practice of constructing settlements on occupied territory, including East Jerusalem, lack legal validity and 'constitute a flagrant violation' of the Fourth Geneva Convention. <http://unispal.un.org/UNISPAL.NSF/0/5AA254A1C8F8B1CB852560E50075D7D5>.
- 8 The ICRC has made statements on the legality of the Israeli settlements in the West Bank on several occasions. A statement from 2001 stated, among other things, that the ICRC had repeatedly pointed out that the Israeli settlements had been established in contravention of international humanitarian law. The ICRC emphasised that the State of Israel had introduced laws and administrative regulations in connection with the settlements that contravened the Fourth Geneva Convention in certain areas. http://www.icrc.org/Web/eng/siteeng0.nsf/htmlall/57JRGW?OpenDocument&View=defaultBody&style=custo_print.
- 9 Israel's Ministry of Foreign Affairs: 'Basic Law: Jerusalem, Capital of Israel 1) Jerusalem, complete and united, is the capital of Israel.[...]', http://www.mfa.gov.il/MFA/MFAArchive/1980_1989/Basic%20Law-%20Jerusalem-%20Capital%20of%20Israel.
- 10 'The Security Council [...] Affirms that the enactment of the "basic law" by Israel constitutes a violation of international law and does not affect the continued application of the Geneva Convention relative to the Protection of Civilian Persons in Time of War, of 12 August 1949, in the Palestinian and other Arab territories occupied since June 1967, including Jerusalem; [...] Determines that all legislative and administrative measures and actions taken by Israel, the occupying Power, which have altered or purport to alter the character and status of the Holy City of Jerusalem, and in particular the recent "basic law" on Jerusalem, are null and void and must be rescinded forthwith'; <http://unispal.un.org/UNISPAL.NSF/0/DDE590C6FF232007852560DF0065FDDB>.
- 11 Letter from the Council on Ethics to Africa Israel Investments Ltd, 4 September 2013.

To the Ministry of Finance

2 May 2013

UNOFFICIAL ENGLISH TRANSLATION

Recommendation on the exclusion of Alliant Techsystems Inc. from the investment universe of the Norwegian Government Pension Fund Global

1 Introduction

The Council on Ethics recommends that Alliant Techsystems Inc. (ATK) no longer be excluded from the Fund on the grounds that it manufactures cluster munitions.

As the company manufactures key components for nuclear weapons, the Council on Ethics nevertheless recommends that the company continue to be excluded from the Fund.

2 Background

The Fund's ethical guidelines state that the Fund's assets shall not be invested in companies which themselves or through entities they control produce weapons that violate fundamental humanitarian principles through their normal use.¹ Cluster munitions and nuclear weapons are among the weapons that fall into this category.

On 16 June 2005, the Council on Ethics recommended excluding the American company ATK from the Fund's investment universe because the company produced cluster munitions.² The Ministry of Finance decided to exclude the company in August 2005, and the company has since been excluded from the Fund.

The Council on Ethics routinely assesses whether the grounds for excluding companies remain in place.³ In this regard, the Council on Ethics has obtained the following information about the company's production of cluster munitions and nuclear weapons.

ATK's cluster munitions production

In 2005, exclusion of the company was recommended on the grounds of its production of the cluster munition CBU 87/B, which contained 202 sub-munitions of the type BLU-97. In addition, the company has until recently referred to its production of the sub-munition called BLU-108 on its own website.

The company no longer refers to these cluster munitions on its website and has stated that it no longer produces any kind of cluster munitions.⁴

ATK's production of key components for nuclear weapons

The company states on its own website that it is responsible for upgrading the rocket engines of the Minuteman III, an intercontinental ballistic missile.⁵ The company also states that it produces the rocket engines for the nuclear missile Trident II (D5), which is intended to be launched from submarines.⁶

3 Information provided by the company

The Council on Ethics has written to the company asking if it still produces cluster munitions and whether it produces key components of nuclear weapons.⁷ The company has not replied to the Council on Ethics' inquiry.

4 The Council on Ethics' assessment

The Council on Ethics considers it likely that the company has stopped producing cluster munitions. The basis for excluding the company on the grounds that it produces cluster munitions is therefore no longer existent.

The Council on Ethics has previously decided that the production and upgrade of missiles that have no function other than to carry nuclear weapons must be regarded as the production of key components of nuclear weapons and thus constitute grounds for exclusion from the Fund. ATK states on its own website that it carries out this activity. The Council on Ethics is therefore of the opinion that the company should continue to be excluded from the Fund.

5 Recommendation

The Council on Ethics recommends revoking the exclusion of Alliant Techsystems Inc. on the grounds that it produces cluster munitions.

The Council on Ethics nevertheless recommends that the company remain excluded from the Fund's investment universe due to its production of key components of nuclear weapons.

Ola Mestad
Chair

(sign.)

Dag Olav Hessen

(sign.)

Ylva Lindberg

(sign.)

Gro Nystuen

(sign.)

Bente Rathe

(sign.)

Notes

- 1 Guidelines for the observation and exclusion of companies from the Government Pension Fund Global's investment universe, section 2:
<http://www.regjeringen.no/nb/sub/styrer-rad-utvalg/etikkradet/etiske-retningslinjer.html?id=425277>.
- 2 Recommendation of the Council of Ethics, 16 June 2005: <http://www.regjeringen.no/pages/1661742/Tilrading%20klasevapen%2015%20juni%202005.pdf>.
- 3 Guidelines for the observation and exclusion of companies from the Government Pension Fund Global's investment universe, section 5, subsection 5:
<http://www.regjeringen.no/nb/sub/styrer-rad-utvalg/etikkradet/etiske-retningslinjer.html?id=425277>.
- 4 Letter from Alliant Techsystems Inc. to the Council on Ethics' consultant, GES Investment Services.
- 5 'Minuteman III is a silo-based intercontinental ballistic missile with three solid-propellant stages and a fourth-stage liquid-propulsion engine. It has been the prime nuclear deterrent for the United States for the last four decades, and plans are in place for it to continue in this role through 2020. The Minuteman III continues to undergo a major refurbishment under the U.S. Air Force's Prime Integration Contract led by Northrop Grumman Mission Systems. ATK is responsible for refurbishing all three solid-propellant stages of the missile.', <http://www.atk.com/products-services/minuteman-iii/>.
- 6 'ATK manufactures solid-propulsion boost motor systems for all three stages of the Trident II missile, also known as the Trident D5, under a contract from prime contractor Lockheed Martin Space Systems Co. ATK has a long history of producing solid-propulsion systems for submarine-launched missiles, beginning with the Polaris missile in the 1950s. The Trident II is a three-stage, solid-propellant, inertial-guided missile system that is the primary strategic weapons program in the U.S. Navy's Fleet Ballistic Missile system.', the company's annual report for 2012: http://www.atk.com/wp-content/uploads/2012/09/annualreport_ATK_20122.pdf<http://www.atk.com/products-services/trident-ii/>.
- 7 Letter from the Council on Ethics to ATK, 11 March 2013.

To the Ministry of Finance

13 June 2013

UNOFFICIAL ENGLISH TRANSLATION

Recommendation concerning the exclusion of Lockheed Martin Corp. from the investment universe of the Government Pension Fund Global

1 Introduction

The Council on Ethics recommends that Lockheed Martin Corporation (Lockheed Martin) no longer be excluded from the Fund on the grounds that it manufactures cluster munitions.

As the company manufactures key components for nuclear weapons, the Council on Ethics nevertheless recommends that the company continue to be excluded from the Government Pension Fund Global (GPFG).

2 Background

The Fund's ethical guidelines state that the Fund's assets shall not be invested in companies which themselves or through entities they control produce weapons that violate fundamental humanitarian principles through their normal use.¹ Cluster munitions and nuclear weapons are among the weapons that fall into this category.

On 16 June 2005, the Council on Ethics recommended the exclusion of the American company Lockheed Martin from the GPFG's investment universe because the company produced cluster munitions.² The Ministry of Finance decided to exclude the company in August 2005, and the company has since been excluded from the Fund.

The Council on Ethics routinely assesses whether the basis for excluding a company remain in place.³ In this regard, the Council on Ethics has gathered the following information about the company's production of cluster munitions and nuclear weapons.

Lockheed Martin's production of cluster munitions

In 2005, the exclusion of Lockheed Martin was recommended on the grounds of its production of various versions of the MLRS M-26S missile. This surface-to-surface missile is fired using the MLRS field artillery system. The M-26S carried M77 DPICM cluster munitions. The production of this weapons system was due to end in 2013.

The company has informed the Council on Ethics that the production of this weapons system has now ended, that the company will not conclude any new agreements for the

production of the system, and that the company will not produce any other types of cluster munitions.⁴

Lockheed Martin's production of key components for nuclear weapons

The state-owned British company AWE (Atomic Weapons Establishment) is responsible for the development, production and maintenance of the United Kingdom's nuclear warheads. AWE is owned by the UK Ministry of Defence, but the actual business is run by the joint-venture company AWE Management Ltd. (AWE ML), of which Lockheed Martin owns one-third.⁵ The other partners in AWE ML are the companies Serco Group Plc. and Jacobs Engineering Group Inc.,⁶ which have previously been excluded from the Fund due to their participation in AWE ML.^{7 8}

3 Information provided by the company

The Council on Ethics wrote to Lockheed Martin asking whether it still produces cluster munitions and whether it produces key components for use in nuclear weapons. As discussed above, the company responded to the enquiry with respect to the production of cluster munitions. The company has not responded to the Council on Ethics' question concerning the production of nuclear weapons. Information about Lockheed Martin's ownership of – and role in – AWE ML has come from the state-owned British company AWE.

4 The Council on Ethics' assessment

The Council on Ethics considers it clear that the company has stopped producing cluster munitions. The basis for excluding the company on the grounds that it produces cluster munitions is therefore no longer present.

AWE ML is engaged in the development, production, testing and maintenance of nuclear warheads, and its operations fall within the nuclear weapons criterion in the ethical guidelines for the GPF. In 2007 and 2012, the companies Serco Group Plc. and Jacobs Engineering Group Inc. were both excluded from the GPF due to their participation in AWE ML. Both companies hold the same ownership share in AWE ML as Lockheed Martin.

5 Recommendation

The Council on Ethics recommends revoking the exclusion of the Lockheed Martin Corporation on the grounds that it produces cluster munitions.

The Council on Ethics nevertheless recommends that the company remain excluded from the Fund's investment universe due to its production of key components of nuclear weapons.

Ola Mestad
Chair

(Signature)

Dag Olav Hessen

(Signature)

Ylva Lindberg

(Signature)

Marianne Olsson

(Signature)

Bente Rathe

(Signature)

Notes

- 1 Guidelines for the observation and exclusion of companies from the Government Pension Fund Global's investment universe, section 2: http://www.regjeringen.no/en/sub/styret-rad-utvalg/ethics_council/ethical-guidelines.html?id=425277.
- 2 Recommendation from the Advisory Council on Ethics for the Government Petroleum Fund, 16 June 2005: <http://www.regjeringen.no/en/dep/fin/Selected-topics/the-government-pension-fund/responsible-investments/Recommendations-and-Letters-from-the-Advisory-Council-on-Ethics/recommendation-on-exclusion-of-cluster-w.html?id=419583>.
- 3 Guidelines for the observation and exclusion of companies from the Government Pension Fund Global's investment universe, section 5, fifth paragraph: http://www.regjeringen.no/en/sub/styret-rad-utvalg/ethics_council/ethical-guidelines.html?id=425277.
- 4 Email from Lockheed Martin Corporation to the Council on Ethics, 6 May 2013.
- 5 AWE's website: 'Our work at AWE covers the entire life cycle of nuclear warheads; from initial concept, assessment and design, through to component manufacture and assembly, in-service support, and finally decommissioning and disposal.' http://www.awe.co.uk/aboutus/what_we_do_27815.html.
- 6 AWE's website: 'AWE is contracted to the Ministry of Defence (MOD) through a government-owned / contractor operated (GOCO) arrangement. While our sites and facilities remain in government ownership, their management, day-to-day operations and the maintenance of Britain's nuclear stockpile is contracted to a private company: AWE Management Limited (AWE ML). AWE ML is a consortium comprising three equal partners: Serco Group plc, the Lockheed Martin Corporation and Jacobs Engineering Group. Following competition, a contract was awarded to AWE ML covering an initial period of 10 years from April 2000. In 2003, the contract was extended to a 25-year term following a detailed evaluation of AWE ML's long-term partnering proposals. The contract is priced in five-yearly periods. The next contract period takes effect from 3 April 2013.' http://www.awe.co.uk/aboutus/the_company_eb1b2.html.
- 7 Recommendation of 15 November 2007 on the exclusion of the company Serco Group Plc.: <http://www.regjeringen.no/pages/2042005/Serco%20Group.%20Unofficial%20English%20translation.pdf>.
- 8 Recommendation of 31 August 2012 on the exclusion of the companies The Babcock & Wilcox Co. and Jacobs Engineering Group Inc.: http://www.regjeringen.no/upload/FIN/etik/2013/babcock_wilcox_jacobs_eng.pdf.

To the Ministry of Finance

13 September 2013

UNOFFICIAL ENGLISH TRANSLATION

Recommendation to exclude Sesa Sterlite from the investment universe of the Government Pension Fund Global

1 Introduction

On 15 May 2007, the Council on Ethics recommended the exclusion of Vedanta Resources Ltd., (Vedanta) and its listed subsidiaries Sterlite Industries Ltd. (Sterlite) and Madras Aluminium Company Ltd. (Malco) from the investment universe of the Government Pension Fund Global due to an unacceptable risk of contribution to current and future severe environmental damage and systematic human rights violations.

The Ministry of Finance decided to follow the recommendation of the Council on Ethics, and announced the exclusion of the companies on 6 November 2007.

Since the recommendation was made, Vedanta has bought shares in three listed companies: Sesa Goa Ltd. (iron ore and the production of pig iron), Hindustan Zinc (Zinc-India) and Cairn India (oil and gas). Malco was delisted in India in 2009. At that time, Vedanta owned 95 per cent of the shares in Malco.

In February 2012, Vedanta gave notice that the company was working on a restructuring involving, amongst other things, a merger between Sterlite Industries and Sesa Goa, Vedanta Aluminum (VAL) and Malco that would result in the formation of a new company, Sesa Sterlite. On 17 August 2013, it was announced that the merger had been completed.¹

In the new structure, Vedanta has a controlling ownership interest of 58.3 per cent in Sesa Sterlite. Malco, Sesa Goa and VAL are divisions of Sesa Sterlite. Cairn India and Zinc India are listed subsidiaries, in which Sesa Sterlite has ownership interests of 58.8 per cent and 64.9 per cent, respectively. Sesa Sterlite also has other subsidiaries, but these are not listed (see Figure 1).²

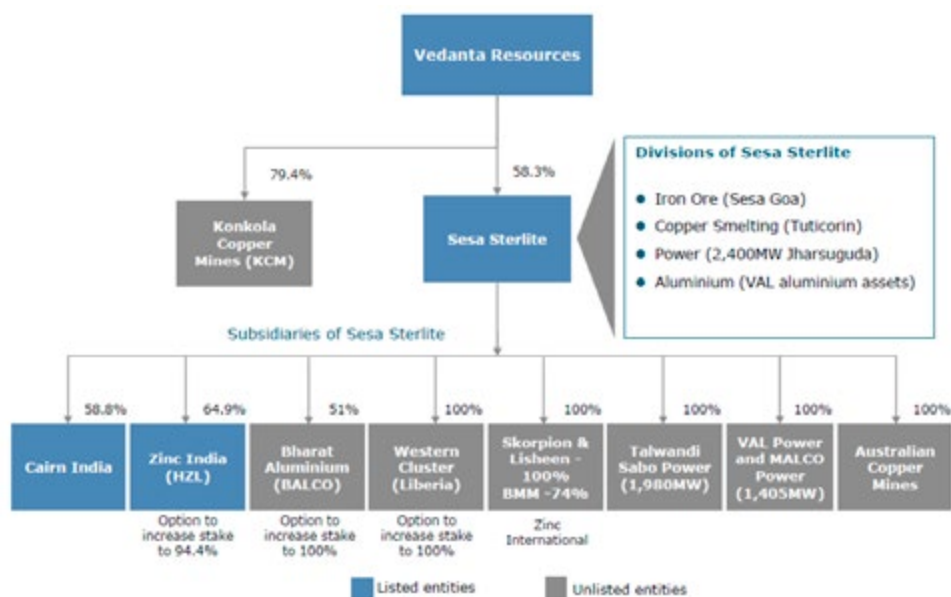


Figure 1: Organisational structure of Vedanta and its subsidiary Sesa Sterlite³

2 The Council on Ethics' assessment

The Council has regularly updated its assessment of Vedanta and, in the Council's view, the basis for the recommendation made in 2007 continues to apply. According to Vedanta, the merger of the subsidiaries will contribute to a more purposive and efficient organisational structure. It does not change the companies' operations. As a result of the restructuring, the previously excluded companies Sterlite Industries and Malco are now part of the new company Sesa Sterlite, in which Vedanta has a controlling ownership interest. Accordingly, both Vedanta and Sesa Sterlite should be excluded from the investment universe of the Government Pension Fund Global.

3 Recommendation

The Council on Ethics recommends the exclusion of the company Sesa Sterlite from the investment universe of the Government Pension Fund Global due to an unacceptable risk of the company being responsible for severe environmental damage and systematic human rights violations.

Ola Mestad
Chair

(Signature)

Dag Olav Hessen

(Signature)

Ylva Lindberg

(Signature)

Marianne Olsson

(Signature)

Bente Rathe

(Signature)

Notes

- 1 Bloomberg: All-share merger of Sesa Goa and Sterlite Industries becomes effective, <http://www.bloomberg.com/article/2013-08-17/adFljbyViF8.html>.
- 2 SEC filings: Form 6-K Sterlite Industries, 31 May 2012, and Form 20-F Sterlite Industries, 30 July 2013.
- 3 Sterlite Industries Corporate Presentation – Feb 2013, http://www.sterlite-industries.com/investor_relations/PDFs/Sterlite-Corporate-Presentation-Final.pdf.

To the Ministry of Finance

2 May 2011

UNOFFICIAL ENGLISH TRANSLATION

Recommendation on the exclusion of Daewoo International Corporation, Oil and Natural Gas Corporation Ltd., GAIL India Ltd., and Korea Gas Corporation from the investment universe of the Government Pension Fund Global

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1 Introduction

At its meeting of 16 June 2006, the Council on Ethics decided to assess whether investments in the Korean companies Daewoo International Corporation (Daewoo) and Korea Gas Corporation (KOGAS), as well as the Indian companies Oil and Natural Gas Corporation Ltd. (ONGC) and GAIL India Ltd. (GAIL), could be in conflict with the ethical guidelines for the Government Pension Fund Global (GPFG). The companies were already engaged in the extraction of oil and gas on the Shwe-field off the coast of Burma, and it was understood that they would also take part in the planned construction of a pipeline to transport the gas from the Shwe-field over land to India. At the time it was assumed that India would be the most probable purchaser of the gas. The Council operated under the understanding that the construction of the pipeline over land through Burma would lead to serious human rights violations.

The market value of the shares held by the Government Pension Fund Global in the respective companies as of 31 December 2010 amounted to the following: Daewoo NOK 7.7 million; KOGAS NOK 5.5 million; ONGC NOK 263 million; and GAIL NOK 500.2 million.

The point of departure for the current recommendation is that Daewoo, ONGC, GAIL and KOGAS purchased shares in the Hong Kong based joint venture company which is responsible for building and operating the pipeline which will carry the gas from the Schwe-field, off the Burmese coast, to China.¹ The company responsible for the pipeline is a joint venture. It is led and controlled by a Chinese state company, China National Petroleum Corporation (CNPC), while Daewoo, ONGC, GAIL and KOGAS are minority owners with shares ranging from 25.04 per cent to 4.1735 percent. The pipeline corridor traverses 800 kilometers on Burmese land, from the city of Kyauk Phyu on Burmas west coast to Yunnan Province in China.

Ever since November of 2005, when it issued its recommendation concerning the activities of the French company Total, the Council on Ethics has kept a close eye on companies operating in the country. Total was the operator of an international joint venture which was responsible for the construction of the so-called Yadana Gas Pipeline in 1995-98. Throughout the preparation of the corridor and the building of the pipeline, military forces carried out extensive and serious abuses against civilians in the form of forced relocation, forced labour, violence, torture and summary executions. The Council believes that the project discussed in this recommendation shares a number of similarities with the Yadana project as concerns the kind of project, the use of military forces and the risk of human rights violations.

In October 2007 the Ministry of Finance asked the Council on Ethics for a clarification of the Council's work concerning companies operating in Burma. In its response to the Ministry, the Council wrote that 'If companies in the Fund's portfolio were to enter into contract agreements regarding the construction of such pipelines, the Council may recommend the exclusion of these companies already from the time of entering into the agreements. Because such undertakings would most likely involve an unacceptable risk of contributing to human rights violations, it is not considered necessary to wait until the violations actually take place.'

The building of a gas pipeline has recently begun on Burma's west coast. It is to be placed parallel to, and in the same corridor as, an oil pipeline which CNPC is responsible for building. Both pipelines will cross areas populated by ethnic minorities as well as areas where extensive use of forced labour and other abuses against civilians have previously been reported. There are reports of an increased military presence along the pipeline's corridor as well as of land confiscation in areas where the construction of the pipeline started.

The companies are not aware of any human rights violations so far in the project. They highlight that they are concerned with preventing human rights violations, and that this is something they repeatedly have conveyed to CNPC and the Burmese government. They also inform that matters of human rights are often discussed in the joint venture.

Some of the companies maintain that, as minority shareholders, they have little influence over decisions concerning the planning and construction of the pipeline; these are controlled by CNPC. In the present case the Council finds that the degree of influence in the project is not decisive. The companies have entered into a joint venture with one single purpose: to build a pipeline through Burma. When choosing to participate in the project, the companies also accepted that the Burmese military would be in charge of securing the pipeline. In other words, it is the kind of project in question and the military's role in the project that pose a significant risk for human rights violations. The Council considers it improbable that the companies' commitment and their possible influence over the Burmese government will hinder Burmese military forces from carrying out abuses in connection with the construction of the pipeline.

The Council operates under the understanding that the construction of an almost 800 kilometre-long pipeline on Burmese land through areas of conflict involving diverse ethnic groups will lead to serious and systematic violations of human rights. The Council also takes for granted that the militarisation of the area along the corridor will increase as work on the pipeline progresses. It is well known that the scope of forced labour and other abuses against civilians increase when soldiers are stationed in an area. This seems to be a basic, structural characteristic of the regime and the way in which the military is employed in projects of this nature. Even though it is the Burmese authorities, rather than the companies, who carry out the abuses, there is a connection between the violations of human rights and the companies' activities insofar as the violations take place with the aim of facilitating the companies' activities. The Council's view is that this results in an unacceptable risk of the company contributing to future violations of human rights.

For this reason the Council recommends that Daewoo International Corporation, Oil and Natural Gas Corporation Ltd, GAIL India Ltd. and Korea Gas Corporation be excluded from the investment universe of the Government Pension Fund Global.

2 Sources

The Council has based this recommendation on reports and documents from United Nations organisations, voluntary organisations and information from the companies. The Council has also commissioned its own studies to map the status of the construction of the pipelines as well as to gather information on the militarisation along the pipeline's corridor and the related risk for human rights violations.

Sources are referred to in footnotes.

3 Concerning the pipeline and human rights violations

3.1 THE COMPANIES INVOLVED IN THE CONSTRUCTION OF THE PIPELINE

In 2000, Daewoo signed two production sharing contracts with the Myanmar Oil and Gas Enterprise (MOGE)² in order to explore, develop and market the gas from the blocks A-1 and A-3 on the Shwe gas field.³ Commercially exploitable finds were discovered four years later. Daewoo has since sold its share in the blocks to ONGC Videsh (a wholly-owned subsidiary of ONGC), GAIL and KOGAS to form a joint venture. Daewoo is the operator of the consortium.⁴

In 2008, Daewoo signed a Memorandum of Understanding (MoU) with the state owned China National Petroleum Corporation (CNPC) for the sales of natural gas produced from blocks A-1 and A-3. This required the transportation of the gas to China, and on 27 March 2009, the Chinese government signed an agreement with the Burmese government for the construction of two pipelines: a pipeline for the transport of gas from the Shwe-field on the west coast of Burma to China, and a parallel pipeline for the transport of crude oil.⁵

In February 2010, the Indian government approved the participation of ONGC and GAIL in the construction of the gas pipeline. According to information available on ONGC Videsh's website, the pipeline will be built, owned and operated by the joint-venture company. Through its subsidiary Southeast Asia Gas Pipeline Co., CNPC holds a 50.9 per cent ownership of the company. Daewoo International owns 25.04 per cent, while ONGC owns 8.347 per cent. GAIL and KOGAS own 4.1735 per cent each, and MOGE owns 7.365 per cent.⁶

3.2 THE RIGHTS AND OBLIGATIONS OF THE JOINT VENTURE AND MOGE'S ROLE

According to CNPC, a shareholder agreement and an agreement concerning the rights and obligations of the pipeline company were signed on 4 June 2010. The agreements defined CNPC as the controlling party of the joint venture, in charge of the design, construction, operation and maintenance of the pipeline.⁷

In its letter, ONGC informs the Council that the agreement requires the joint venture partners to pay reasonable compensation for the acquisition of private land, the relocation

of houses, as well as losses of – or damages to – crops. Furthermore, the joint venture shall endeavour to employ Burmese citizens and to pay for the education and training of qualified nationals and MOGE personnel in the field of petroleum science, engineering and management.⁸

There is little specific information available on which rights and obligations the pipeline company must fulfil with regard to security issues. In a press release posted on CNPC's homepage it appears that the agreement between the two parties 'stipulates that Myanmar government shall ensure the [pipeline] company's ownership and exclusionary right to the pipeline and guarantee the safety of the pipeline.'⁹

Due to the fact that both of the pipelines will run in parallel in the same pipeline corridor,¹⁰ it is likely that Burmese authorities will be responsible for the preparation of the pipeline corridor and the security for both pipelines. This is the same role that MOGE has had in similar pipeline projects before.¹¹ The contract between MOGE and the French company Total concerning the construction of the Yadana Pipeline stipulates that 'MOGE shall assist and expedite Contractor's execution of the Work Programme by providing cost, facilities, supplies and personnel including, but not limited to, supplying and making available..., security protection and right of way and easements as may be requested by Contractor and made available from the resources under MOGE's control.'¹²

In other contracts which MOGE has signed with CNPC, but which are not directly related to the pipeline, the very same clause is present.¹³ This may indicate a standard wording which MOGE employs in its contracts with international oil companies. It follows also from these contracts that MOGE's costs for performing said services will be refunded in US dollars. The Council therefore assumes that MOGE and the Burmese authorities will be responsible for matters of security throughout the preparation of the pipeline corridor and the construction of the gas pipeline.

3.3 THE CONSTRUCTION OF THE PIPELINE

According to a press release from CNPC, the construction of the Myanmar-China Oil and Gas pipeline project officially started on 3 June 2010.¹⁴

Both pipelines will start from the port of Kyauk Phyu in the Rakhine State, on the west coast of Burma, and will cross the Chinese border by the cities of Nam Khan Ruili in Yunnan province.¹⁵ The pipelines will traverse Burma along some 800 km.¹⁶ On the Chinese side, the gas pipeline will go through Kunming and end up in Nanning, the capital of the Guangxi Province (see figure 1).¹⁷ The pipelines are expected to be completed by 2013.

To the Council's knowledge, both pipelines are being built at the same time and construction has started at a number of points along the pipeline corridor. Work is well under way around the city of Kyauk Phyu in Rakhine State, where the gas is brought onshore. Much of the work, however, seems to be tied to the expansion of the port and the construction of the gas terminal as well as the construction of roads and other infrastructure. Work is also started along the corridor further east, around Yenanyuang Township in Magway Division and in the eastern part of Mandalay, where the pipeline will cross the Irrawaddy River. This work is expected to be completed by the end of May, before the

start of the rainy season.¹⁸ Assessments have also been carried out in the Shan State, in the northern end of the pipeline on the border with China, but construction has not yet started.¹⁹ The project seems to still be in an early phase, where preparation and construction has not started along much of the corridor.



Figure 1: Map over the pipeline corridor²⁰

3.4 HUMAN RIGHTS VIOLATIONS

The organisation Earthrights International has reported human rights violations in Rakhine state, which allegedly have been carried out in connection with the construction of infrastructure and landing of gas. These are mainly related to the confiscation of land, where local people have been forced to abandon their properties and farmland on short notice and without being offered compensation.²¹ So far there is limited information about violations at other locations along the pipeline corridor, probably because the clearing of the pipeline corridor appears not to have started yet.

Reports from among others the International Labour Organization (ILO) and The United Nations Special Rapporteur on Human Rights in Myanmar do not indicate that the human rights situation in Burma has improved, notwithstanding the election in November 2010. These reports document that it is mainly the military that perpetrates violations against the local population. The organisation Human Rights Watch describes the situation as follows:

‘Abuses by the Burmese military against civilians in violation of international humanitarian law include the widespread use of anti-personnel landmines, sexual violence against women and girls, extrajudicial killings, forced labour, torture, beatings, targeting of food production and means of civilian livelihood, and confiscation of land and property.’²²

The Council operates under the understanding that as long as Burma's military forces are responsible for security under the construction of the pipeline, the abuse of civilians will be probable. Based on previous experience, the construction of pipelines and other infrastructure projects leads to increased militarisation of the area, which again increases the risk of human rights violations.²³ In connection with the construction of the Yadana pipeline in 1995-1998, where Total was the operator, the increased militarisation of the area around the pipeline led to extensive abuses against civilians, including the systematic use of forced labour. Local people were required to build military camps, roads and infrastructure for the pipeline corridor, as well as clear land for the corridor itself. Other abuses on the part of the security forces against the civilian population included violence, torture, summary executions of what the military regarded as ethnic rebels, as well as punishment and violence in connection with forced labour, not least against women and children.²⁴

The gas pipeline to China will run for nearly 800 kilometres across central Burma and pass through 22 townships. So far at least 28 battalions²⁵ are reportedly stationed in areas along the pipeline corridor including regions such as the Rakhine and Shan states, where there is an on-going conflict between the regime and local ethnic groups.²⁶ Burmese military forces have been stationed in Shan-state for many years and seem now to increase their presence in the state, but it is not clear whether this is due to the pipeline. The pipeline will run through areas which are controlled by ethnic militia groups fighting Burmese forces. In 2009, the conflict led to 10,000-30,000 people fleeing to China.²⁷ According to Human Rights Watch, military forces carry out direct assaults on civilians in these areas. One of the conflict areas, home to the ethnic group Wa, lies in the area where the pipeline will cross the Chinese border. Due to the fear of increased tensions, polls were not conducted there in November.²⁸ There have also been reports that the army and the navy have increased their presence in the area around Kyauk Pyu in Rakhine state.²⁹

A detailed report submitted by the International Trade Union Confederation (ITUC) to the ILO in 2007, documented the extensive use of forced labour in a number of states, including the Rakhine and Shan states. The report states that the military forces local people to porter, construct and maintain military camps, provide services to the soldiers such as cooking and cleaning, as well as generate an income for the troops in agricultural or industrial projects owned by the military. Also the organisation Minority Rights International describes a similar picture:

‘Military and other government authorities are persistently reported as still engaged in 2006 and 2007 in patterns of gross violation of human rights, including forced labour, conscription, arbitrary detention, torture, rape, sexual slavery and extra-judicial killings, especially in central and southern Shan State as the SPDC's armed forces engage the Shan State Army-South.’³⁰

The US State Department's 2009 report on the human rights situation in Burma,³¹ and not least the reports from the UN Special Rapporteur to Burma, confirm that the military's unacceptable practice continues.³²

4 The companies' positions and communication with the Council on Ethics

4.1 THE COMPANIES' COMMUNICATION WITH THE COUNCIL

The Council has communicated with the companies since early 2007. On 17 January 2007 and in accordance with the ethical guidelines, Norges Bank sent a Draft Recommendation on exclusion to Daewoo, ONGC, GAIL and KOGAS on behalf of the Council on Ethics. The draft was based on information that these companies were involved in the planned overland pipeline for the transport of gas from the Shwe-field to India. At the time India was considered to be the most likely buyer of the gas. The companies were given the opportunity to comment on the Council's Draft Recommendation and provide any new information pertinent to the case.

In a letter of 30 January 2007, Daewoo clarified that no decision had been made so far with regard to the pipeline route, and that also other alternatives for the transportation of gas were being considered. This was confirmed in letters from GAIL and ONGC (both dated 8 February 2007) as well as KOGAS (e-mail dated 29 May 2007). Based on the information the companies provided, the Council chose to await developments.

Following information in the press that the joint venture companies on 20 June 2008 had signed a MOU with CNPC for the sale of gas, as well as information in Daewoo's own newsletter of 2nd quarter of 2008 stating that Daewoo also will be responsible for the construction of the pipeline, the Council wrote another letter to Daewoo. The Council requested that Daewoo clarify its role and responsibilities in the pipeline project.

In its response to the Council, dated 31 October 2008, Daewoo informed that the onshore pipeline to China, including construction, would be operated by CNPC. 'The members of the Shwe consortium, as gas producer and seller, have been considering participating in the onshore pipeline project as shareholders. However, the individual members of the Shwe consortium have not finally decided whether each will join in the pipeline project.'³³ Accordingly, the Council chose to await further developments.

In spring 2010 the Indian government approved ONGC and GAIL's participation in the pipeline project. On 1 July 2010, the Council requested information from these companies about their role and responsibilities in the pipeline project, and which measures the companies would implement to prevent serious human rights violations. A similar letter was sent to Daewoo and KOGAS 20 December 2010, after it became clear that these companies also participated in the pipeline project.

GAIL, ONGC and Daewoo confirmed that the companies were minority shareholders in the joint venture company that is responsible for the construction of the gas pipeline. KOGAS did not respond. A new draft recommendation was sent to the companies on 1 February 2011; ONGC and Daewoo responded with their comments. The companies' views are presented below.

4.2 THE COMPANIES' POSITION

Role and responsibilities in the pipeline project

Daewoo, GAIL and ONGC confirm that the companies are minority shareholders in the joint venture company that is responsible for constructing the Burma-China gas pipeline. CNPC is the majority shareholder. The companies claim not to have any direct role in the construction or management of the project, but as shareholders they each have one Director Position on the board of the joint venture.³⁴ ONGC adds that as a minority shareholder it has limited influence on the decision making process in the joint venture.

Daewoo informs that its role and responsibilities 'are to procure an investment necessary for the development of the Project, as a stakeholder.' The company is entitled to participate in decisions associated with the development of the project, which enables the company to monitor procedures and the implementation of the project in line with industry practice and international standards.⁵ Furthermore, Daewoo writes that the company contributes to the project through its experience and expertise acquired as operator of other projects.

Measures to prevent human rights violations

The companies' responses show that all are concerned with preventing human rights violations and that this is conveyed to the project management.

GAIL states that:

'The issue of human rights violations has been discussed at length among the shareholders including CNPC and MOGE. The shareholders have agreed to exercise necessary care and caution to prevent any violation in execution of the project. CNPC, who shall be executing the project, have conveyed that they are aware of the issues and have proper mechanism in place to handle the situation effectively and also with sensitivity.'³⁶

For its part Daewoo also states: 'The significance of avoiding any kind of human rights abuse has been repeatedly addressed by Daewoo to the management of the Project Company. Daewoo's own guidelines (such as Code of Corporate Conduct & Ethics and land/crop compensation manuals) were given to them as well.'³⁷

According to ONGC, the fact that a number of companies participate in the joint venture contributes to improved monitoring. The company points out that 'despite being a minority shareholder we do have an appointed director on the board of the Company and are therefore in an ideal position to keep a diligent watch over the Company's operations.' ONGC also informs that the Pipeline Company is required 'to pay reasonable compensation for the acquisition of private land, relocations of houses and/or losses of or damages to crops to any owner thereof affected by the grant to the Right-of-Way or the construction, expansion, operation or maintenance of the Onshore Transportation System or the Company's facilities and equipment within the union of Myanmar'³⁸ Daewoo informs that the company last year provided compensation for land without involvement of the military.³⁹

Both Daewoo and ONGC state that human rights violations have not been reported so

far: '... to the best of our knowledge and information available, we can report that there has been no instance or issue of human rights violations (in particular, that of land confiscation, use of forced labour and forced displacement of people) in the project.'⁴⁰ Daewoo adds:

'Some organizations might imply the human right violation in connection with the Pipeline, but we wish you would understand that there can be different interpretation on the facts in accordance with what the interpreting parties wish to achieve. As we previously pointed out, there was no known report of human rights issue regarding the Yetagun Project, which came after the Yadana project. This illustrates that the human rights issue can be avoided as long as the participating stakeholders are determined to it.'⁴¹

Daewoo also informs that Burmese authorities on several occasions have modified the pipeline route to avoid populated areas.

The companies' view on the Council's assessment

Daewoo is critical of the Council's reasoning that it may exclude companies in anticipation of future human rights violations, rather than base its assessment on the factual occurrence of events. The company emphasizes that human rights violations will not take place if the companies are willing to prevent abuses. Daewoo also would appreciate an assessment of whether the participation of foreign companies contributes positively to the prevention of human rights violations in the project.

5 The Council on Ethics' assessment

The Council has assessed whether the operation of the joint venture is in conflict with the Fund's Ethical Guidelines under the criteria for contributing to serious or systematic human rights violations. In its letter to the Ministry of Finance dated 11 October 2007, the Council states that 'If companies in the Fund's portfolio were to enter into contract agreements regarding the construction of such pipelines, the Council may recommend the exclusion of these companies already from the time of entering into the agreements. Because such undertakings would most likely involve an unacceptable risk of contributing to human rights violations, it is not considered necessary to wait until the violations actually take place'⁴²

The Council's point of departure is thus that the risk of serious or systematic human rights violations associated with infrastructure projects in Burma is imminent. Nevertheless, the Council will assess each case individually. Even though it is the Burmese authorities and not the company who in principle will commit the violations, there is a link between the violations and the company's operations in the sense that the violations take place in order to facilitate the companies' future operations.

The pipeline is being built by a joint venture company, managed and controlled by the Chinese state owned company CNPC. The pipeline's security appears to be organised in the same way as was the case at the Yadana pipeline and at other pipelines in Burma

of which the Council has knowledge. The Burmese state-owned oil company MOGE is responsible for security, but the work is carried out by the military on behalf of the company. Daewoo, ONGC, GAIL and KOGAS have minority shares in the joint venture. GAIL and ONGC therefore claim to have little leverage on decisions pertaining to the management and construction of the pipeline, while Daewoo points out that it is entitled to take part in decisions concerning the development of the pipeline. In this case the Council finds that the degree of influence in the project is not decisive. The companies have entered into a joint venture with one single purpose: to build a pipeline through Burma. When choosing to participate in the project, the companies also accepted that the Burmese military would be in charge of securing the pipeline. In other words, it is the kind of project – and the military’s role in it – which pose a significant risk for human rights violations.

The Council considers it positive that the companies are concerned about preventing human rights violations, and that this is an issue which is conveyed to CNPC and the Burmese government. This notwithstanding, the Council emphasizes the fact that human rights violations continue to take place in Burma, and that the UN, the ILO and other international actors are deeply worried about the situation in the country. Considering that the pipeline which is being built by CNPC, Daewoo, KOGAS, GAIL and ONGC is 15 times longer than the Yadana pipeline, and that it runs through areas of serious ethnic conflict, the Council finds reason to believe that human rights violations associated with the gas pipeline will be similar to, and more extensive than, those which occurred during the construction of the Yadana pipeline.⁴³ The Council finds it unlikely that the companies’ involvement and leverage will prevent the Burmese forces to commit abuses in connection with the construction of the pipeline.

The construction of the pipeline seems so far to be on-going in the coastal areas where the gas will be landed. NGOs have reported abuses against civilians in these areas. This is rejected by the companies. The Council’s task is to assess whether there is an unacceptable risk of gross or systematic human rights violations in the future. Even in the event that abuses have not taken place to date, this does not necessarily reduce the future risk of their taking place.

It is a fact that the construction of the 800 km pipeline has just started. It will run through populated areas and across areas of serious ethnic conflicts, which in itself increases the risk of conflicts with security forces and serious human rights abuses. Moreover, it is probable that the militarisation of areas along the pipeline corridor will increase as the construction work proceeds. As previously mentioned, the building of the Yadana pipeline at the end of the 1990s led to extensive and serious human rights violations. Reports from among others, the UN Special Rapporteur on the human rights situation in Myanmar, confirm that systematic abuses perpetrated by the military against local people are on-going, extensive and follow the same pattern as before. It is well-documented that when Burmese soldiers, who often are insufficiently equipped and lack basic supplies, are stationed in an area, the scope of forced labour and other abuses against civilians increases. Local inhabitants may be forced to carry the soldiers’ equipment, build barracks, supply food and carry out other services. This appears to be a basic, structural

characteristic of the regime and of how the military uses this kind of projects. The situation today is not substantially different from how conditions were 20 years ago when the Yadana pipeline was first built. It is therefore difficult to see how such extensive and systematic abuses will be avoided in regards to the on-going construction of the gas pipeline. In the Council's opinion this carries with it an unacceptable risk of the companies contributing to future violations of human rights.

6 Recommendation

The Council on Ethics recommends the exclusion of Daewoo International Corporation, Oil and Natural Gas Corporation Ltd, GAIL India Ltd. and Korea Gas Corporation from the investment universe of the Government Pension Fund Global because of an unacceptable risk of the companies contributing to serious or systematic human rights violations associated with the construction of a gas pipeline in Burma.

Ola Mestad
Chair
(sign.)

Dag Olav Hessen
(sign.)

Ylva Lindberg
(sign.)

Gro Nystuen
(sign.)

Bente Rathe
(sign.)

Notes

- 1 ONGC's letter to the Council on Ethics 30 December 2010.
- 2 MOGE is a wholly-owned Burmese state corporation.
- 3 http://www.daewoo.com/english/online/brand/invest.jsp?d_id=5 and Shwe Gas Movement 2006: *Supply and Command. Natural gas in western Burma set to trench military rule*, p 11, available at <http://www.shwe.org/>
- 4 The stakes in the two gas blocks currently appear to be distributed as follows: Daewoo International, 51 per cent, ONGC Videsh 17 per cent, GAIL India 8.5 per cent, KOGAS 8.5 per cent and MOGE 15 per cent. http://www.businessworld.in/bw/2010_02_18_ONGC_GAIL_Allowed_To_Take_China_Gas_Pipeline_Stake.html
- 5 http://www.atimes.com/atimes/South_Asia/KD03Df03.html
- 6 <http://www.ongcvidesh.com/Assets.aspx>.
- 7 http://www.cnpc.com.cn/en/press/newsreleases/MyanmarChinaOilandGasPipelineprojectcommenced_.htm.
- 8 ONGC's letter to the Council 30 December 2010.
- 9 <http://www.cnpc.com.cn/en/press/newsreleases/RightsandobligationagreementsignedofMyanmar-ChinaCrude-Pipeline.htm> 'The agreement explicitly defines the obligations of the CNPC- holding Southeast Asia Crude Pipeline Company Ltd. and the rights authorized by the Myanmar government to the company. According to the agreement, the Southeast Asia Crude Pipeline Company Ltd. is endowed with franchise rights of the Myanmar-China Crude Pipeline, and will be responsible for the construction and operation of the pipeline. The company also has related rights of tax remission, crude transit, import and export customs clearance and right-of-way operation. The agreement also stipulates that Myanmar government shall ensure the company's ownership and exclusionary right to the pipeline and guarantee the safety of the pipeline.'
- 10 Confirmed in ONGC's letter to the Council 28 February 2011.
- 11 This is apparent from the joint venture agreement between MOGE and the Total-consortium on the Yadana-pipeline, see the Council's recommendation on Total, available at www.etikkkradet.no.
- 12 Production Sharing Contract for Appraisal, Development and Production of Petroleum in the Moattama Area Between Myanmar Oil and Gas Enterprise and Total Myanmar Exploration and Production §17.1 (c) Rights and Obligations of MOGE and Contractor.
- 13 Production sharing contract between MOGE and CNPC.
- 14 See footnote 7.
- 15 <http://www.reuters.com/article/rbssEnergyNews/idUSPEK1796020090616>.

- 16 CNPC confirms that: ‘ the Myanmar -China Crude Pipeline starts from Madeira [Island of Maday] at the west coast of Myanmar, running 771 kilometres through Rakhine (Arakan), Magway, Mandalay and Shan State, and enters into China from Ruili of Yunnan Province.’ <http://www.cnpc.com.cn/en/press/newsreleases/2009/210a7949-5718-4248-a913-697f672b67a1.htm>.
- 17 http://news.xinhuanet.com/english/2009-06/16/content_11552020.htm.
- 18 Earthrights International, March 2011: *The Burma-China Pipelines: Human Rights Violation, Applicable Law and Revenue Secrecy, Situation Briefer No. 1*, available www.earthrights.org, and the Council’s own research
- 19 See footnote 18.
- 20 Reuters is the source of the figure, which is available at http://www.irrawaddy.org/article.php?art_id=21030
- 21 See footnote 18.
- 22 <http://www.hrw.org/en/world-report-2011>
- 23 Human Rights Foundation of Monland 2009: *Laid Waste: Human Rights along the Kanbauk to Myaing kalay gas pipeline*, available at <http://rehmonnya.org/archives/793>
- 24 Earth Rights International 2000: *Total Denial Continues* p. 84-87 and 100-121, La Federation des droits de l’Homme 2005: *Total pollutes democracy*, p.26, 28.
- 25 A battalion counts 300-1000 soldiers.
- 26 http://www.irrawaddy.org/print_article.php?art_id=20985
- 27 <http://www.unhcr.org/4a97cb0e9.html> ;
- 28 <http://www.hrw.org/en/world-report-2011/burma>
- 29 Earthrights International, March 2011: *The Burma-China Pipelines: Human Rights Violation, Applicable Law and Revenue Secrecy, Situation Briefer No. 1*, available www.earthrights.org, and the Council’s own research.
- 30 Minority Rights Group International, *World Directory of Minorities and Indigenous Peoples - Myanmar/Burma: Shan*, 2008, available at: <http://www.unhcr.org/refworld/docid/49749cdb28.html>.
- 31 United States Department of State, *2009 Country Reports on Human Rights Practices - Burma*, 11 March 2010, available at: <http://www.unhcr.org/refworld/docid/4b9e530b87.html>.
- 32 For example UN General Assembly 10 March 2010, Human Rights Council, 13th session, *Progress report of the Special Rapporteur on the situation of human rights in Myanmar*, Tomás Ojea Quintana, available at <http://daccess-dds-ny.un.org/doc/UNDOC/GEN/G10/119/15/PDF/G1011915.pdf?OpenElement> and other reports at http://ap.ohchr.org/documents/dpage_e.aspx?m=89.
- 33 Daewoo’s letter to NBIM/Council on Ethics 31 October 2008.
- 34 GAIL’s letter to the Council, 6 August 2010, and ONGC letter to the Council 20 December 2010.
- 35 Daewoo’s letter to the Council, 23 February 2011.
- 36 GAIL’s letter to the Council, 6 August 2010.
- 37 See footnote 35.
- 38 ONGC letter to the Council 20 December 2010.
- 39 Daewoo’s letter to the Council 9 March 2010.
- 40 See footnote 39.
- 41 Daewoo’s letter to the Council on Ethics, 9 March 2010.
- 42 The Council on Ethics letter to the Ministry of Finance regarding the Council’s assessment of companies with operations in Burma, 11 October 2007.
- 43 See the Council on Ethics recommendation on Total.

To the Ministry of Finance

21 June 2012

UNOFFICIAL ENGLISH TRANSLATION

Recommendation on the exclusion of Daewoo International Corporation, Oil and Natural Gas Corporation Ltd., GAIL India, Korea Gas Corporation and POSCO from the investment universe of the Norwegian Government Pension Fund Global

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1 Summary

The Council on Ethics upholds its recommendation of 2 May 2011 concerning the exclusion of the companies Daewoo International Corporation, Korea Gas Corporation, Oil and Natural Gas Corporation Ltd. and GAIL India Ltd. from the investment universe of the Government Pension Fund Global (GPF) because of an unacceptable risk of the companies contributing to severe or systematic human rights violations in connection with the construction of an overland gas pipeline in Myanmar. The companies take part in a joint venture with the Chinese state-owned company China National Petroleum Corporation where the latter is responsible for the construction and operation of the pipeline. The Council on Ethics also recommends that the Korean company POSCO, which has a controlling ownership of Daewoo International, be excluded for the same reason.

On 8 May 2012, the Ministry of Finance requested that the Council update its recommendation of 2 May 2011 on the exclusion of these companies in light of the recent political developments in Myanmar. The country's government has decided to carry out important political reforms, of which a number have been implemented this past year. Political prisoners have been released, freedom of expression has been extended, supplementary elections were carried out in April this year and ceasefires have been agreed with a number of ethnic groups in the country. The EU and Norway removed their economic sanctions against Myanmar in April of this year in order to support the democratisation process.

In accordance with the Ministry's request, this recommendation assesses whether these political changes have led to changes, especially as concerns the military's behaviour in the areas affected by conflict.

The companies' participation in the project has not changed, but because POSCO has acquired a 68.15 per cent ownership in Daewoo the Council has decided to include the company in the recommendation insofar as POSCO has a controlling ownership over Daewoo.

The gas pipeline is scheduled for completion in early 2013. Construction work continues in Rhakine State but is being concluded in Myanmar's central regions. In the northern part of Shan State, the northern route towards the Chinese border has been delineated but work does not yet seem to have been initiated.

Myanmar's army has increased its presence in areas along the pipeline during the course of the last 12 months. To the Council's knowledge they now amount to 13,000-15,000 soldiers who are particularly grouped around the beginning of the pipeline in Rhakine State and towards the end of the pipeline in Shan State. In the latter, forces have been strengthened during the last year in order to secure land for the pipeline. This is an area with numerous ethnic groups; the pipeline seems to have become a catalyst for conflict and the focus of violent activities which are taking place in the area. There are reports of severe and systematic human rights violations in this area, perpetrated by military forces against civilians. These include murder, torture, rape, forced labour and other serious abuses following patterns which are well known from earlier infrastructure projects in Myanmar involving the military. These abuses are currently taking place and appear to

have increased as the military has sought control over new areas along the pipeline corridor. The Council therefore finds it plausible that the construction of the pipeline leads to serious and systematic human rights violations.

In the Council's view, the positive political development in Myanmar has had little practical impact on how Myanmar's military behaves towards civilians in conflict areas. It is the Council's understanding that the basis for excluding the companies in the joint venture – including POSCO as Daewoo's parent company – remains in place and is in fact strengthened since the Council's recommendation of 2 May 2011. Even though it is Myanmar's military, not the companies, who are carrying out these violations of human rights, there is a clear connection between the violations and the companies insofar as they are being perpetrated in order to facilitate the companies' future activities. The Council is of the opinion that the measures taken by the companies to avoid human rights violations are insufficient to hinder them from taking place.

As the pipeline will also be secured by military forces once it comes into operation, it is reasonable to assume that there will continue to be a strong military presence along the corridor beyond 2013. The Council attaches importance to the fact that forced labour and other abuses carried out by military forces appear to be commonplace, also in areas which are not characterised by a high level of conflict. The Council therefore finds an unacceptable risk that the companies in the future will continue to contribute to human rights violations in connection with the pipeline.

The Council therefore recommends excluding Daewoo International Corporation, Korea Gas Corporation, Oil and Natural Gas Corporation Ltd., GAIL India Ltd. and POSCO from the investment universe of the GPFG because of an unacceptable risk of the companies contributing to on-going and future severe and systematic human rights violations.

2 Introduction

On 27 March 2009, the Chinese and Myanmar authorities concluded an agreement for the construction of two pipelines: a pipeline to transport gas from the Shwe field off the coast of Myanmar, and a parallel pipeline to transport oil. The Myanmar part of the pipeline is almost 800 km long and crosses Myanmar, from the port of Kyauk Phyu (Sittwe) in Rhakine State to Yunnan Province in China. The pipeline crosses areas populated by various ethnic groups. Construction work is ongoing, and is expected to be completed in 2013. Myanmar's military is responsible for the security of the pipeline. There has been increased militarisation along the route of the pipeline, and there have been reports of the use of forced labour and other gross human rights violations.

The Chinese state-owned company China National Petroleum Corporation (CNPC) is the operator for the construction and operation of the pipeline. The Korean companies Daewoo International Corporation (Daewoo) and Korea Gas Corporation (KOGAS), along with the Indian companies Oil and Natural Gas Corporation Ltd. (ONGC)¹ and GAIL India Ltd. (GAIL) take part in the construction of the pipeline through a joint venture company with CNPC.²

On 26 May 2010, the Council on Ethics recommended the exclusion of CNPC's subsidiary, PetroChina, due to PetroChina's unusually close relationship with CNPC and the risk of the company contributing to gross human rights violations in connection with the construction of the pipelines.³ The Ministry of Finance did not follow the recommendation regarding PetroChina, as it took the view that PetroChina's links with CNPC were not such that the two companies should be regarded as one unit.

On 2 May 2011, the Council on Ethics recommended the exclusion of CNPC's partners in the joint venture from the investment universe of the GPFG on the same grounds. In the Council's opinion, by participating in the project the partners in the joint venture were accepting that the military would be responsible for the security of the pipeline. In the Council's view, both the type of project and the role of the military in the project would present an unacceptable risk of the companies contributing to gross human rights violations.

On 22 February 2012, the Ministry of Finance requested the Council on Ethics' opinion concerning companies in the GPFG operating in Myanmar, given the recent changes to the political situation in the country. The Council on Ethics responded on 11 April 2012 that companies' activities in Myanmar would thereafter be assessed under the same conditions as their operations elsewhere, but that the Council will continue to be vigilant concerning companies' possible contribution to any human rights violations in connection with the development of large infrastructure projects.

On 8 May 2012, the Ministry of Finance requested that the Council update its recommendation of 2 May 2011 on the exclusion of Daewoo, KOGAS, GAIL and ONGC in light of the latest political developments in Myanmar. This recommendation therefore considers whether this development has led to changes in the military's practice in the areas where the companies are building the pipeline.

By the end of 2012, the GPFG owned shares in POSCO worth NOK 1,357 billion, corresponding to a 0.79 per cent ownership in the company. The Fund's ownership in ONGC amounted to NOK 218.8 million (0.4 per cent) and NOK 211 million in GAIL India (0.09 per cent). The GPFG did not own shares in Daewoo International Corporation or KOGAS by the end of 2012, but both of these companies remain in the Fund's investment universe.

2.1 WHAT THE COUNCIL HAS ASSESSED

There is no doubt that the political situation in Myanmar has changed since the Council issued its recommendation to exclude the four companies. Important democratic and political reforms have taken place in the country during the last year. Political prisoners have been released, freedom of expression has been extended, supplementary elections were carried out in April this year and ceasefires have been agreed with a number of ethnic groups in the country. The EU and Norway removed their economic sanctions against Myanmar in April of this year in order to support the democratisation process. Sanctions concerning the import of weapons remain in place. According to the United Nations' Special Rapporteur on Human Rights in Myanmar, this development has been positive for the Human Rights situation in the country but there remains a lot to be done:

‘The steps taken by the Government have had a positive impact on the

human rights situation in Myanmar. Nonetheless, many serious human rights issues encompassing the broad range of civil, political, economic, social and cultural rights remain and should be addressed. There is also a risk of backtracking on the progress achieved to date.⁴

The Council has considered whether the basis for the exclusion of the companies Daewoo, KOGAS, ONGC and GAIL continues to be present in light of the political development in Myanmar. The Council has also included the Korean company POSCO, Daewoo's parent company, in the recommendation.

2.2 SOURCES

The Council has commissioned its own research aimed at clarifying the status of the construction of the pipelines, gathering information on the military presence in the pipeline corridor and on human rights abuses known to have taken place along the pipeline route. Information gathering has been carried out in Burma, China and Thailand during the course of February and March 2012. This includes on-the-ground enquiries with a wide range of individuals familiar with the pipeline project, the military and the human rights situation in Myanmar. It also includes fact-finding in areas around the pipeline corridor in the Shan state.

The recommendation is mainly based on this research. Other sources are referred to in footnotes.

3 Update of the situation along the corridor

3.1 THE STATUS OF THE PROJECT

The companies

The Council has provided a detailed account on the joint venture and the partners' rights and obligations in the recommendation of 2 May 2011. According to information on the companies' web sites and annual reports, there appear to be no changes in their participation or in the distribution of shares in the joint venture.

The Korean company POSCO has acquired a 68.15 per cent share in Daewoo, and Daewoo is consequently considered a subsidiary of POSCO. The Council has therefore included POSCO in this recommendation as it has a controlling interest in Daewoo.

Status of the construction work

The pipelines are expected to be operational in early 2013. Construction is underway in Rhakine State, including where the pipeline crosses the Bengal Bay from Maday Island to the mainland. Work on associated infrastructure is also underway, including the building of a deep-water port. Work on the pipeline is nearing completion in Myanmar's central areas (Magway and Mandalay Divisions) which have not been characterized by ethnic conflict. In the northern part of Shan State, the Northern route towards the Chinese border has been delineated, but work does not yet seem to have been initiated.

3.2 THE MILITARY PRESENCE

Myanmar's military has increased its presence along the pipeline corridor during the last 12 months. To the Council's knowledge there are now 44 battalions positioned in these areas. Each battalion is thought to have 250-300 soldiers. All in all some 13,000-15,000 Burmese soldiers appear to have been deployed along the pipeline route, mainly around the southern and northern ends of the pipeline (Rakhine State and Shan State respectively, see figure 1). There are important ethnic populations in both of these states, where conflict and unrest have increased during the last year.

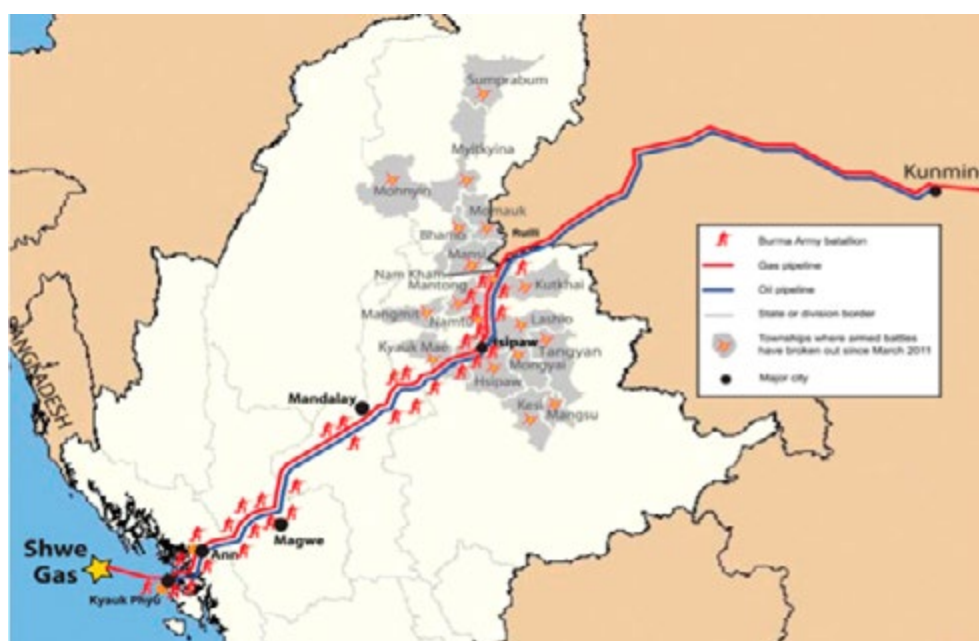


Figure 1: Map over the pipeline corridor showing the position of Myanmar's military forces⁵

There appears to be a growing unrest in Rhakine State, especially among ethnic Rhakine groups. The unrest seems to be particularly linked to growing resentment against the Chinese presence and the assertion that locals should benefit from the resource extraction.⁶ This has been a contributing factor to the creation of a new, armed guerilla group this past year. This is in addition to the Arakan Liberation Army (ALA), the largest armed ethnic insurgency in Rhakine State, which is in open conflict with the military.⁷ In January 2012, the ALA was invited for peace talks with Myanmar's government, and there are reports that a preliminary ceasefire agreement was signed in May.⁸ The increased military presence in southern Burma is seen as a response to the increased opposition in the area.

The ethnic conflict in Kachin State and in the north of Shan State is long-lasting and severe, and during the last year the fighting between ethnic groups and military forces has increased in Shan State's northern areas, which the pipeline will cross.⁹ The pipeline will pass through territory held by the Kachin Independence Army (KIA) and ruled by the Kachin Independence Organisation (KIO), the KIA's political counterpart.¹⁰ Originally the pipeline was not intended to cross KIO's territory, but in 2011 the government decided to reroute the corridor through the northern Shan State and into KIO-controlled

territory.¹¹ Since the summer of 2011 there have been regular reports of fighting between the armed ethnic groups and Myanmar's forces in areas which the pipeline is to cross.¹² As late as in March 2012, the military is to have sent 1,500 additional soldiers to the region in order to control the territories which the pipeline will traverse.¹³ There has been fierce fighting during the last few months along the pipeline in the KIA-controlled territory.

According to the Council's findings, there has been an increased militarization in the northern areas of the Shan State where the pipeline is scheduled to cross, and the military presence (batallions, military camps and artillery) continues to grow. Despite peace talks in the region, armed clashes have been continuous in various parts of Kachin State and northern Shan State since July 2011, and appear to be ongoing.¹⁴ The fighting seems to be directly linked to the military's task of securing territory for the pipeline.

3.3 HUMAN RIGHTS VIOLATIONS

Numerous human rights violations have been reported in areas along the pipeline route where the Burmese military is present. As with previous infrastructure projects in Burma, there appears to be a relationship between the increased militarisation along the pipeline corridor and human rights violations, especially in areas with ethnic populations. A similar view is expressed in a recent report by the independent organization International Crisis Group:

‘The worst abuses take place in areas of insecurity or armed conflict, which are almost exclusively in ethnic minority areas. Though human rights abuses - and even atrocities- have been committed by all sides, the Myanmar army is responsible for the vast majority of such incidents.’¹⁵

Human rights violations appear to take place primarily in the southern and northern ends of the pipeline corridor, in Rhakine State and Shan State, while the central areas of Myanmar (Magway and Mandalay divisions) appear to be less affected.

The human rights violations which seem to have taken place in Rhakine State appear to be different from those reported further north, along the pipeline corridor. Rather than physical violence, the concern here is that the project damages the livelihoods of many through the confiscation of territory and loss of fishing rights. There are also reports that compensation being paid is often in violation of prior agreements. Reports indicate further that there are numerous work-related accidents and that those affected rarely receive compensation for any resulting damages. As previously mentioned, the fact that the project only marginally will result in benefits for local populations is an important source of discontent.

Human rights violations appear to be far more serious in areas along the pipeline's corridor in the north of the Shan State. These range from very serious and violent abuses, including rape, torture and extrajudicial killings, to persecution, discrimination, land confiscation, and inadequate compensation. The most serious allegations – those of rape, murder and torture – are difficult to corroborate; however, a number of the individuals contacted in connection with the Council's research reported such violations this last year in areas along the pipeline where military troops are stationed.

The organization Human Rights Watch published a report in March 2012 entitled “Untold Miseries” which provides a grim picture of human rights abuses committed by the Burmese Army in Kachin State:

‘The Burmese army has been responsible for numerous human rights violations since armed conflict resumed in Kachin State in June 2011. It has forced men, women, and children to serve as porters in the front lines of the fighting, at grave risk. It has deliberately attacked ethnic Kachin villages, killing civilians, engaging in torture and other ill-treatment of detainees, and committing rape and other forms of sexual violence. Violent threats have often been made with ethnic slurs. The Burmese army has pillaged and razed homes and destroyed civilian property, impacting immediate and long-term food security. The Burmese army—as well as the KIA [...] has used antipersonnel landmines that have caused dozens of deaths and seriously wounded many others. Children under 18 have been conscripted into Burmese army ranks.’¹⁶

Also the The Kachin Women’s Association Thailand (KWAT) has documented human rights violations in Kachin and Shan States over the past year. In October 2011, the group released a report entitled “Burma’s Cover up War: Atrocities Against The Kachin People” in which it documents abuses carried out by the Burmese army, including killings, torture and 34 cases of rape.¹⁷

Testimonies gathered in the pipeline corridor in connection with the Council’s study give similar accounts of how the Burmese Army operates. There are reports that the Burmese Army enters villages, harshly interrogates civilians and has tortured and killed civilians, including children. The rape and harassment of ethnic women has also been reported as common, and people are reportedly forced into relocation sites where they can be controlled and used for forced labour (so-called “portering”). This practice of conscripting forced labour affects men, women and children and implies civilians carrying equipment and supplies under the threat of violence and other reprisals.

There are also reports of a growing number of internal refugees as a result of the fighting. Many have been displaced from their homes or have chosen to flee to avoid attacks. This is explained in the aforementioned Human Rights Watch report and in other media reports:

‘Towards the end of last year when fighting became increasingly severe in northern Shan state, several thousand villagers who live along the proposed route of the pipelines were forced to flee their homes. Few if any of the displaced people appear to know anything about the pipeline project’.¹⁸

An important element in the military’s strategy in areas with ethnic conflicts is to focus their activities against civilians in order to sever supply lines, access to information and recruitment to ethnic militia groups.¹⁹ Villagers are forcefully relocated to areas under military control while their villages are burnt down and their crops and other belongings are plundered or destroyed. According to International Crisis Group, abuses of this kind are part of the military’s *modus operandi* and the aim of ensuring that military units be self-sustaining incentivizes and legitimizes behaviour of this kind:

‘While it is not clear whether such abuses stem from direct orders by the military hierarchy, they have occurred with enough regularity for decades that they undoubtedly form a part of military culture that senior commanders must be aware of and for which they should be held accountable. The long-standing “self-reliance” policy of the army, whereby units in the field are expected to be self-sufficient - leading to confiscation of and, forced labour for cultivation of food and informal taxations - also has a significant impact on local populations.’²⁰

In areas of ethnic conflict, abuses against civilians are neither investigated nor punished, and consequently there is nothing to stop this practice from continuing.²¹

4 Information provided by the companies

The Council’s communication with the companies in the joint venture is presented in the recommendation of 2 May 2011. The Council has not contacted the companies since then. Meanwhile, on 29 May 2012 Daewoo sent two reports to the Council of its own initiative entitled “A Comprehensive Report to better understand the Shwe Project” and “Land Acquisition Activities - Kyauk Phyu, Rakhine State 2009-2010”. According to Daewoo, the former shows that the company’s approach to the project ‘meets and goes beyond what are the generally accepted international standards in fulfilling our corporate social responsibility to the people of Myanmar.’ The latter explains how territories in Kyauk Phyu have been appropriated in connection with the transportation of gas from the Shwe-field off the coast of Myanmar.

The Shwe project concerns the extraction and transportation of gas from two off-shore blocks to a land-based terminal in Kyauk Phyu. Daewoo is the operator. Both reports concern this project. The Shwe project is not part of the Council’s recommendation insofar as the Council only has assessed the transport of gas *from* the gas terminal and through Myanmar’s territory. The aforementioned reports are therefore not discussed further.

Since POSCO was not included in the original recommendation, and since the Ministry of Finance had not reached a decision concerning the recommendation of 2 May 2011, the Council on Ethics sent a copy of the draft recommendation from 2011 to POSCO for comments on 16 May 2012.

POSCO responded to the Council on 8 June 2012. The company stressed that it is not possible to base an evaluation of human rights violations today on what took place when the Yadana pipeline was built: ‘it will be overestimated to deduce what happened in the past would happen again in the future. Daewoo carefully studied the Yadana case, and is determined to avoid such mishap not only for the project we are operating, but also the project we take part in.’²² The company also states that Daewoo has contributed with advice to the project based on experiences resulting from the Shwe-project:

‘Daewoo reiterated the significance of avoiding human right violation to the Chinese party and advised them to establish the Code of Corporate Conduct and Ethics as well as the proper procedure and mechanism for land/crop compensation program complying with international standard. The detailed information in respect of such manuals and whole process was provided to the management of SEAGP.’²³

According to POSCO more than half of the territory necessary for the pipeline had been acquired by the end of April 2012, and the SEAGP ‘has paid its utmost attention to prevent human rights violation and consequently there was no single report of human rights abuse.’ POSCO believes that this means that participating in the construction of the gas pipeline does not necessarily lead to the violation of human rights. In this regard, the company also points to the aforementioned Human Rights Watch report and states that nothing in this report indicates that it is the pipeline which has led to the conflict between the KIA and the military.

POSCO also states that the Group has a code of conduct and that it has strengthened its human rights efforts but does not go into further detail. The company has also introduced a risk management system. Through these measures ‘POSCO tries to improve human rights management and prevent human rights risk around POSCO Family. Concerning Myanmar issues, POSCO will protect human rights by monitoring them.’

5 The Council on Ethics’ assessment

On 2 May 2011, the Council on Ethics recommended the exclusion of Daewoo, KOGAS, GAIL and ONGC from the GPFG because of an unacceptable risk of contributing to violations of human rights in connection with the construction of an 800 km-long gas pipeline through Myanmar. At the request of the Ministry of Finance, the Council has again assessed the situation in light of Myanmar’s recent political development. The political and economic reforms have certainly been positive for the situation of human rights in the country. Political prisoners have been released, freedom of expression has been extended and supplementary elections were carried out in April this year.

The Council has consequently assessed whether there continues to be an unacceptable risk of the companies contributing to serious violations of human rights. In this regard the Council has considered whether there have been changes to the companies’ participation in the project, the status of the pipeline, whether there has been an increase in the militarisation of the pipeline corridor and whether there have been reports of human rights violations perpetrated by the military in connection with the building of the pipeline.

As concerns the companies’ participation in the project, the Council is not aware of any changes to their participation or ownerships. Since POSCO has acquired a 68.15 per cent ownership in Daewoo, the Council considers that POSCO should be included in the recommendation as it has a controlling interest in Daewoo.

The pipeline is expected to be completed in 2013. Large sections of the pipeline appear to be finished, but construction has not yet started in the Shan State in the north. This is

an area characterised by ethnic conflicts. It is uncertain whether the conflict with ethnic groups will affect the conclusion of the project. POSCO points out in its letter that the construction of the pipeline has not *caused* the conflicts in the area. This is irrelevant to the Council's assessment of whether human rights are being violated in connection with the project.

The Council finds that the increased militarisation of the area around the pipeline is documented, especially in Rhakine State and Shan State, at the southern and northern ends of the pipeline respectively. These are areas with important ethnic populations. It looks like the conflict around the northern area has been intensified by the pipeline, which is central in the acts of violence taking place in the area. In these areas the military forces have strengthened their presence during the last year in order to ensure the pipeline's territories.

Based on the information assembled by the Council, together with reports from reputable organisations such as Human Rights Watch and news reports, it does not look like the political development in Myanmar has had any effect on how Myanmar's forces behave towards civilians in areas of ethnic conflict. The Council attaches importance to the fact that many different sources confirm that the military in Myanmar continues to carry out systematic and serious human rights violations, and that torture, murder, rape, forced labour and other forms of abuse continue to take place in areas through which the pipeline will pass. These abuses are on-going and appear to have increased as the military has sought to control the territories along the pipeline corridor. Consequently, the Council finds it plausible that the construction of the pipeline leads to serious and systematic human rights violations.

In the Council's opinion, the basis for recommending the exclusion of the companies in the joint venture and POSCO, Daewoo's parent company, continues to be present and has in fact been strengthened since the Council's recommendation of 2 May 2011. Even though it is Myanmar's military – not the companies – who carry out the violations of human rights, there is a clear connection between the violations and the companies insofar as these take place in order to facilitate the companies' future activities. It is also clear that the companies have formed a joint venture with a single purpose: building an overland pipeline in Myanmar. They have also accepted that the military be responsible for securing the territories and ensure security along the pipeline.

There has been considerable media-coverage of the conflict in the north of Shan State. The Council considers it likely that the companies in the joint venture have or should have knowledge about the abuses taking place in connection with the preparations of the pipeline. In the Council's opinion, the measures initiated by the companies as described in the recommendation of 2 May 2011 and in section four above, are insufficient to prevent human rights violations.

The pipeline is expected to be finished in 2013. As the pipeline will also be secured by military forces once it comes into operation, it is reasonable to assume that there will continue to be a strong military presence along the corridor beyond 2013. The Council attaches importance to the fact that forced labour and other abuses carried out by military forces appear to be usual, also in areas which are not characterised by a high level of

conflict. It does not look like changes in the country's political situation so far have led to actual changes in the way the military treats civilians in conflict areas in Myanmar. The Council therefore finds that there continues to be an unacceptable future risk of the companies contributing to human rights violations in connection with the pipeline.

6 Recommendation

The Council on Ethics recommends the exclusion of Daewoo International Corporation, Oil and Natural Gas Corporation Ltd., GAIL India, Korea Gas Corporation and POSCO from the investment universe of the Norwegian Government Pension Fund Global because of an unacceptable risk of the companies contributing to on-going and future serious or systematic human rights violations in connection with the construction of a gas pipeline over Myanmar.

Ola Mestad
Chair
(sign.)

Dag Olav Hessen
(sign.)

Ylva Lindberg
(sign.)

Gro Nystuen
(sign.)

Bente Rathe
(sign.)

Notes

- 1 ONGC participates through its wholly-owned subsidiary ONGC Videsh Ltd.
- 2 CNPC owns a 50.9 percent share in this company through its subsidiary Southeast Asia Pipeline Company Ltd. Daewoo owns a 25.04 per cent share while ONGC owns 8.347 per cent through its wholly-owned subsidiary ONGC Caspian E&P BV (OCEBV). GAIL India and KOGAS own 4,1735 per cent each and Myanmar Oil and Gas Enterprise (MOGE) owns 7,365 per cent. <http://www.ongcvidesh.com/Assets.aspx>
- 3 The Council on Ethics' recommendation to exclude PetroChina is available at www.etikkradet.no.
- 4 Progress report of the Special Rapporteur on the situation of human rights in Myanmar, Tomás Ojea Quintana, http://www.ohchr.org/Documents/HRBodies/HRCouncil/RegularSession/Session19/A-HRC-19-67_en.pdf
- 5 Published by Shwe Gas Movement, 4 September 2011.
- 6 See for example Narinjara, 7 March 2012: "Local youths campaign for share of benefits from Shwe gas", <http://www.narinjara.com/main/index.php/local-youths-campaign-for-share-of-benefits-from-shwe-gas/>
- 7 Myanmar News International, 12 December 2011: "ALA and Burmese Army clash", <http://www.bnionline.net/index.php/news/narinjara/12260-ala-and-burmese-army-clash.html>
- 8 Democratic Voice of Myanmar, 6 April 2012: "Armed groups hold talks with government", <http://www.dvb.no/news/armed-groups-hold-talks-with-government/21433>
- 9 Kachin News writes on 23 March 2012: "Over the past few months heavy fighting has been frequent along a stretch of KIO-controlled territory between Namtu and Mandong townships where the massive Shwe gas pipeline project is currently under construction," <http://www.kachinnews.com/news/war/2254-fighting-resumes-after-kachin-talks-falter.html>
- 10 Besides the KIA there are other armed, active ethnic groups in the area including the Shan State Armies and the United Wa State Army.
- 11 According to Kachin News, the original corridor was to continue east of Hsipaw via Lashio before turning northwards towards Kunmin. The new corridor swings 90 degrees at Hsipaw and goes straight north through KIO-controlled territory (see figure 1). <http://www.kachinnews.com/news/2249-fighting-in-n-shan-state-continues-along-shwe-pipeline-route.html>. Changes to the corridor have also been confirmed by the Council's own studies.
- 12 Smith, Matthew, 26 July 2011: "Burmese Crossroads: Oil & Gas Rush Stokes Civil War." <http://www.corpwatch.org/article.php?id=15651&printsafe=1>, Kachinland News 28 September 2011: "Burmese Army arrived near KIA's 4th Brigade headquarter area" <http://kachinlandnews.com/?p=20181> Fighting took place around Kutkai (see figure 1). Human Rights Watch, March 2012: "Untold Miseries. War time abuses and forced displacement in Kachin State," p. 33, http://www.hrw.org/sites/default/files/reports/Myanmar0312ForUpload_1.pdf. Burma Net News 25

January 2012, <http://www.burmanet.org/news/2012/01/25/kachin-news-group-burma-army-sends-more-troops-to-fight-kia-along-shwe-pipeline-route/>. Local sources reported in January 2012 that Myanmar's army had sent reinforcements in the northern areas which the pipeline will cross. There were also reports that Myanmar's army had attacked the KIA in important points along the pipeline in Namtu, Mandong, Nam Kham and Muse (see figure 1).

- 13 According to Asian Tribune 15 March 2012, this took place in the area between Namtu and Mandong townships (see figure 1), <http://www.asiantribune.com/news/2012/03/14/peace-question-war-torn-kachin-state-Myanmar>.
- 14 Irrawaddy 12 May 2012, <http://www.irrawaddy.org/archives/3951>.
- 15 International Crisis Group, "A New Peace Initiative" Asia Report N°214; 30 Nov 2011, p. 13. <http://www.crisis-group.org>
- 16 Human Rights Watch, Untold Miseries. "War time abuses and forced displacement in Kachin State" p. 36.
- 17 The report is available at <http://www.kachinwomen.com/publications/reports/84-reported-atrocities-against-the-kachin-people-within-months-.html>
- 18 Kachin News 7 March 2012: "Fighting in N.Shan state continues along Shwe pipeline route," <http://www.kachin-news.com/news/2249-fighting-in-n-shan-state-continues-along-shwe-pipeline-route.html>
- 19 See footnote 16, p. 13.
- 20 See footnote 16, p. 13.
- 21 See footnote 16, p. 14.
- 22 Letter from POSCO to the Council on Ethics dated 12 June 2012. All quotes in this section are taken from this letter. The Council also received the report "Shwe-project; Socio-economic program; Annual report 2010". This concerns only the Shwe project and is therefore not discussed further here.
- 23 POSCO refers to SEGAP (South East Asia Gas Pipeline Company) as the operator of the gas pipeline.

To the Ministry of Finance

13 September 2013

UNOFFICIAL ENGLISH TRANSLATION

Recommendation regarding Daewoo International Corporation, Oil and Natural Gas Corporation Ltd., GAIL India, Korea Gas Corporation and POSCO

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1 Summary

The Council on Ethics no longer recommends the exclusion of the companies POSCO, Daewoo International Corporation, Korea Gas Corporation (KOGAS), Oil and Natural Gas Corporation Ltd. (ONGC) and GAIL India Ltd. from the investment universe of the Government Pension Fund Global (GPF). The companies participate in a joint venture with the Chinese state-owned company China National Petroleum Corporation (CNPC), which is responsible for the construction and operation of an 800 km overland gas pipeline across Myanmar. Construction of the pipeline was completed in June 2013.

Since May 2010, the Council on Ethics has made three recommendations to the Ministry of Finance recommending the exclusion of the companies involved in the construction of the pipeline, most recently on 21 June 2012. The exclusion recommendations were based on the risk that the companies might contribute to human rights violations in connection with the construction of the pipeline.

The Council considers it plausible that the companies have contributed to severe or systematic human rights violations in connection with the construction of the pipeline, even after the political situation in Myanmar changed. The Council's decision to no longer recommend the exclusion of the companies must be seen in light of the fact that the Council's earlier recommendations concerned the actual construction of the pipeline. As construction has now been completed, the situation has changed and the basis for the earlier recommendations is no longer present.

The Council does not ignore the possibility that further human rights violations will occur. Military forces will continue to protect the pipeline after it has entered into operation, and a heavy military presence will still be maintained along the entire route, particularly in conflict areas. However, any such breaches will be linked to the operation of the pipeline and will thus require a new assessment of the companies' contribution to human rights violations as well as the steps that must be taken to prevent the occurrence of such violations.

2 Background

On 27 March 2009, the Chinese and Myanmar authorities concluded an agreement for the construction of two pipelines: a pipeline to transport gas from the Shwe field off the coast of Myanmar, and a parallel pipeline to transport oil. The Myanmar part of the pipeline is almost 800 km long and crosses Myanmar, from the port of Kyauk Phyu (Sittwe) in Rhakine State to Yunnan Province in China. The pipeline crosses areas populated by various ethnic groups. Construction work began in 2010, and on 29 July 2013 it was reported that the gas pipeline had entered into operation.¹ Myanmar's military is responsible for the security of the pipeline. There has been increased militarisation along the route of the pipeline, and there have been reports of the use of forced labour and other serious human rights violations against the local population throughout the construction period.

The gas pipeline is operated by the Chinese state-owned company China National Petroleum Corporation (CNPC). The Korean companies Daewoo International Corporation (Daewoo) and Korea Gas Corporation (KOGAS), along with the Indian companies Oil and Natural Gas Corporation Ltd. (ONGC)² and GAIL India Ltd. (GAIL), are minority owners in a joint venture with CNPC.³

On 26 May 2010, the Council on Ethics recommended the exclusion of CNPC's subsidiary, PetroChina, due to PetroChina's unusually close relationship with CNPC and the risk of the company contributing to gross human rights violations in connection with the construction of the pipelines.⁴ The Council on Ethics considered *inter alia* the companies' management and corporate structures, as well as the composition and coordination of operations between the companies. As concerns the risk of contributing to human rights violations, the Council concluded that the companies had to be perceived as one single unit insofar as CNPC's operations in Myanmar could not be separated from those of its subsidiary in this context. The Ministry of Finance did not follow the recommendation regarding PetroChina, as it took the view that PetroChina's links with CNPC were not such that the two companies should be regarded as one unit.

On 2 May 2011, the Council on Ethics recommended the exclusion of CNPC's partners in the joint venture from the investment universe of the GPF on the same grounds. In the Council's opinion, by participating in the project the partners in the joint venture were accepting that the military would be responsible for the security of the pipeline. In the Council's view, both the type of project and the role of the military in the project would present an unacceptable risk of the companies contributing to severe human rights violations.

On 8 May 2012, the Ministry of Finance requested that the Council on Ethics update its recommendation of 2 May 2011 on the exclusion of Daewoo, KOGAS, GAIL and ONGC in light of the political developments that had taken place in Myanmar. A new recommendation was made on 21 June 2012 that also included the Korean company POSCO, as POSCO had acquired a controlling ownership interest in Daewoo. The Council concluded that the grounds for exclusion continued to be present and had in fact been strengthened since the Council's recommendation of 2 May 2011. The following was among the reasons given by the Council: 'The Council finds that the increased militarisation of the area around the pipeline is documented, especially in Rhakine State and Shan State, at the southern and northern ends of the pipeline respectively. These are areas with important ethnic populations. It looks like the conflict around the northern area has been intensified by the pipeline, which is central in the acts of violence taking place in the area. In these areas the military forces have strengthened their presence during the last year in order to ensure the pipeline's territories.' Further, 'The Council attaches importance to the fact that many different sources confirm that the military in Myanmar continues to carry out systematic and serious human rights violations, and that torture, murder, rape, forced labour and other forms of abuse continue to take place in areas through which the pipeline will pass. These abuses are on-going and appear to have increased as the military has sought to control the territories along the pipeline corridor.'

Reports of assaults committed by the military, including in Shan State in the north,

have also been received regularly since the recommendation was made in June 2012 as a result of the conflict and militarisation along the pipeline. The reports generally come from local human rights organisations and focus on forced labour (portering), harassment, confiscation of land and failure to pay compensation.⁵

3 The Council's assessment

The Council has considered whether the basis for recommending the exclusion of the companies POSCO, Daewoo, KOGAS, ONGC and GAIL is still present in light of the fact that the gas pipeline has now been completed. In the Council's two previous recommendations relating to these companies, the Council emphasised that both the type of project and the role of the military in the project carried an unacceptable risk that the companies would contribute to human rights violations.

In the first recommendation to exclude these companies (2011), the Council's point of departure was the imminent risk of severe or systematic human rights violations in connection with major infrastructure projects in Myanmar (then Burma). The Council had previously expressed its general view in this regard in a letter to the Ministry of Finance (11 October 2007) on the construction of pipelines in Burma: 'If companies in the Fund's portfolio were to enter into contract agreements regarding the construction of such pipelines, the Council may recommend the exclusion of these companies already from the time of entering into the agreements. Because such undertakings would most likely involve an unacceptable risk of contributing to human rights violations, it is not considered necessary to wait until the violations actually take place.'⁶

In view of the political development that has occurred in Myanmar in recent years, the Ministry of Finance requested a new general assessment in 2012. At that time, the Council concluded that it would assess companies' operations in Myanmar under the same criteria as in other countries, but would pay particular attention to companies' potential contributions to any human rights violations in connection with major infrastructure projects.⁷ This was followed up in the second recommendation to exclude the companies, made in June 2012. The basis for the Council's earlier conclusion was updated, including through the Council's own research of the ongoing human rights situation in areas along the pipeline. At that time, the Council did not doubt that severe or systematic human rights violations had been committed in connection with the construction of the pipeline even after the political situation in Myanmar had changed. Even though the human rights violations were committed by the Myanmar military and not the companies, there was a clear connection between the violations and the companies' operations in the sense that the violations took place in order to facilitate the future operations of the companies. It was also clear that the companies had entered into the joint venture with a single purpose – to construct an overland pipeline in Myanmar. Furthermore, they had accepted that the military should be responsible for securing land areas and organising the security along the pipeline. The Council also deemed it likely that the companies in the joint venture had, or should have had, knowledge of the violations committed in connection with the

preparation of the pipeline. The Council therefore concluded that the companies had contributed to the human rights violations.

The Council's present conclusion that the companies should no longer be excluded must be seen in light of the fact that all of the Council's recommendations and assessments in this case have related to the actual construction of the pipeline. As construction has now been completed, the situation has changed and the basis for the earlier recommendations is no longer present.

The Council does not ignore the possibility that further human rights violations may occur. Military forces will continue to protect the pipeline after it has entered into operation, and a heavy military presence will still be maintained along the entire route, particularly in conflict areas. Nevertheless, any such breaches will be linked to the operation of the pipeline, which is expected to cause less conflict than the construction phase, and will thus require a new assessment of the companies' contribution to human rights violations and the steps taken to prevent the occurrence of such violations.

4 Recommendation

The Council on Ethics no longer recommends that POSCO, Daewoo International Corporation, Oil and Natural Gas Corporation Ltd, GAIL India and Korea Gas Corporation be excluded from the investment universe of the GPFG.

Ola Mestad
Chair
(sign.)

Dag Olav Hessen
(sign.)

Ylva Lindberg
(sign.)

Marianne Olsson
(sign.)

Bente Rathe
(sign.)

Notes

- 1 <http://www.ft.com/intl/cms/s/0/870f632c-f83e-11e2-92f0-00144feabdc0.html#axzz2aVOEwBKp>, <http://www.irrawaddy.org/archives/40894>.
- 2 ONGC is participating through its wholly-owned subsidiary ONGC Videsh Ltd.
- 3 The Council provided a detailed account of the joint venture and the rights and obligations of the partners in the recommendation of 2 May 2011. The information available in the companies' annual reports and on websites suggests that there have not been any changes in the participants or ownership interests in the joint venture.
- 4 The Council on Ethics' recommendation to exclude PetroChina is available at www.etikkradet.no.
- 5 <http://business-humanrights.org/media/shan-pipeline-april-2013.pdf>, http://www.burmalibrary.org/docs14/Pipeline_Nightmare-en-red.pdf.
- 6 Letter from the Council on Ethics to the Ministry of Finance, 11 October 2007.
- 7 Letter from the Council on Ethics to the Ministry of Finance, 22 February 2012.



Other letters

The Ministry of Finance

21 January 2014

Comments from the Council on Ethics in connection with the Strategy Council's report on the responsible management of the Government Pension Fund Global

We refer to the Ministry of Finance's hearing memorandum of 29 November 2013 in connection with the Strategy Council's report on the responsible management of the Government Pension Fund Global.

In these comments, the Council on Ethics will primarily cover questions concerning the handling of individual companies in the Fund through the exercise of ownership and conduct-based exclusion.

By way of introduction, we would point out two overarching issues which are also treated in further detail in the main text:

- The Strategy Council proposes that the reasons for excluding companies from the Fund should no longer be made public, while more information should be provided on principles and strategies. The Council on Ethics is of the opinion that public recommendations have been one of the most important elements of the present system and disagrees with the proposal. The Council cannot see that the proposal would result in greater transparency about how ethical considerations are safeguarded in the management of the Fund.
- The Strategy Council takes the view that the Fund's overarching financial objective should guide its ownership activities. The Council on Ethics would point out that, given such a mandate, NBIM would probably conduct little dialogue with individual companies on ethical challenges. The Council on Ethics would question whether this is desirable.

The Council on Ethics' comments cover the following points.

Norway's work with responsible investments has received international recognition since it began. The Council on Ethics identifies strengths and challenges present in the current model in section 1.

The Ministry of Finance has to decide whether NBIM should influence individual companies on ethical – and not just financial – grounds. It is entirely possible, and desirable, for the Fund to have multiple objectives. This is detailed further in section 2.

Irrespective of the organisational model, the exclusion of companies for ethical reasons should be factually justified and made publicly available because this is important for the Fund's legitimacy in the eyes of the public and because it supports the development of standards in both the finance industry and the business sector in general; see section 3.

Ethical considerations in the management of the Fund must be independent of financial considerations. The Council on Ethics therefore recommends the establishment

of an independent council on ethics to make recommendations to the Executive Board of Norges Bank; see section 4.

The Strategy Council has only marginally commented on how the Fund should organise its work on responsible investment. The Council on Ethics proposes an alternative organisational model in section 5. It is important that exclusions are based on solid, expert assessments. Irrespective of the organisational model, therefore, it must be ensured that the expertise that is currently found in the Council on Ethics and its secretariat is retained and strengthened.

1 Experience gained through the work of the Council on Ethics

The exclusion of companies from the Fund has reduced the risk of the Fund contributing to gross breaches of standards, which was the original purpose of the system. The Council on Ethics' recommendations are publicly available and are therefore thoroughly reasoned. This has strengthened the legitimacy of the Fund and helped to promote the development of international standards.

The Council on Ethics has found that financial institutions, interest groups and other parties have faith in the information contained in the Council's recommendations and trust that the Council considers relevant cases. Several Norwegian and foreign investors follow the recommendations of the Council on Ethics, either by excluding the same companies or by using the recommendations as the starting point of their own ownership processes. Further, interest groups use the recommendations in their efforts to influence companies. The recommendations are also discussed in literature on – and research into – corporate social responsibility.

In the view of the Council on Ethics, the influence that exclusions and recommendations have results from a combination of the Fund's size, the fact that the threshold for exclusion is high and governed by a relatively small number of clear criteria, the fact that the recommendations are thorough and well-documented, and the fact that recommendations are made public.

In the course of its work, the Council on Ethics has identified the following main challenges:

Delay

It often takes a long time for a final decision to be made on a recommendation sent to the Ministry of Finance by the Council on Ethics, particularly in cases concerning exclusion based on conduct. The Council on Ethics does not carry on a dialogue with companies after a recommendation is made. As a consequence, recommendations are not updated after publication, companies remain in the Fund for too long, and opportunities to exercise influence are not utilised while the recommendation is being considered by the Ministry of Finance.

The separation between exclusion and the exercise of ownership

The guidelines are construed in such a way that the Council on Ethics is tasked with considering the worst breaches of ethical standards, while NBIM shall exercise ownership where the Fund's long-term return and ethical considerations pull in the same direction. There is a grey zone of cases that do not fully qualify for exclusion, but where NBIM also fails to intervene out of consideration for the Fund's long-term return.

Although the Council on Ethics and NBIM inform each other when they are engaged in dialogue with a company, there is no coordination on the use of instruments such that an agreement may be reached on how a given company should be dealt with. The Council on Ethics may only recommend exclusion or observation to the Ministry of Finance. The Council on Ethics is of the opinion that there are matters that should be addressed through the exercise of ownership which, given the current situation, are neglected because there is no effective cooperation between the Council on Ethics and NBIM.

The allocation of responsibility between the Council on Ethics and NBIM is less clear now than when the system was established. One example of this is that NBIM this past year has independently sold its holdings in certain companies based on considerations of sustainability. In its annual report for 2012, NBIM stated that the Fund had sold its holdings in 23 companies because they "did not produce palm oil in a sustainable manner".¹ There was no dialogue between NBIM and the Council on Ethics in connection with the analysis and sales. Seen from the outside, it would appear that NBIM sold its holdings in companies that failed to meet certain overarching requirements without conducting a detailed assessment of each individual company. In the Council on Ethics' view, this is an efficient but imprecise way of removing undesirable investments from the Fund.

2 Objectives for responsible investment

The Council on Ethics is of the opinion that the Ministry of Finance should set objectives for the exclusion of companies, for the exercise of ownership on ethical grounds and for the safeguarding of climate considerations.

The Strategy Council has included objectives for the Fund in its first main recommendation (pillar one). The Strategy Council's proposal involves the retention of current objectives, namely to maximise the return on the Fund given a moderate level of risk and to avoid certain investments on ethical grounds. This raises a particular issue with regard to the exercise of ownership. Under the current economic mandate, NBIM has dealt with a limited number of individual companies through an ethics-centric dialogue. In the view of the Council on Ethics, retaining the same objectives will be counterproductive if the Ministry of Finance wants more individual companies to be dealt with through the exercise of ownership.

2.1 MORE ON THE FUND'S OBJECTIVES

The objective for the work of the Council on Ethics under the current rules is clear: to recommend to the Ministry of Finance the exclusion of companies whose activities contravene the criteria set by the Ministry.

The Council on Ethics takes the view that the primary purpose of exclusion should continue to be to prevent the Fund from contributing to particularly gross breaches of ethical standards. The basis for exclusion from the Fund should continue to be the grossest breaches of standards, and the mandate must be clear in this regard. This has proven operationally feasible throughout the Council's existence. The exclusion criteria should be retained, not only because they express an overlapping consensus in Norway, but also because the criteria reflect a minimum standard that is widely agreed on through international agreements and norms.

The objective for NBIM's exercise of ownership is less clear. Initially, NBIM was only supposed to take financial considerations into account when selecting its investment strategy, although the guidelines assumed that a diversified, long-term fund would profit if the companies in the Fund respected fundamental ethical standards. On this basis, NBIM was ordered to take ethical considerations into account in its exercise of ownership, based on, for example, the OECD Guidelines for Multinational Enterprises and the Global Compact.²

As a general assumption, this was an uncertain relationship for which there was no scientific evidence. As the Council on Ethics understands it, NBIM did little on breaches of ethical standards by individual companies and more on general expectations that were communicated to groups of companies. An imbalance arose between what the Fund actually dealt with and what was expected of it.

In the Report to the Storting (the Norwegian parliament) describing the audit of the guidelines conducted in 2009, greater emphasis was given to influencing companies to change and to achieving synergies between exclusion and the exercise of ownership. Even though the main aim of NBIM's management remained financial, the Ministry was also of the view that the Fund should 'contribute to positive changes in sustainability issues and with respect to companies' conduct in matters concerning corporate governance, society and the environment.³ Like the Strategy Council in its report, the Ministry described a progression of instruments where exclusion was to be the last resort when efforts to achieve necessary changes through the exercise of ownership were unsuccessful.

The Council on Ethics' internal processes, whereby the Council first obtains information, then contacts the company, obtains further information and, finally, asks the company to comment on a draft of the recommendation, is itself a progression of instruments like the one advocated by the Ministry. On the other hand, there have been no systematic synergies between NBIM's exercise of ownership and the Council on Ethics' recommendations. NBIM and the Council on Ethics rarely work with the same issues. This is not really surprising, given that the objectives for the exercise of ownership and exclusion are different. The Council on Ethics is required to conduct ethical evaluations, whereas NBIM primarily conducts financial ones.

The Ministry of Finance has to decide whether the Fund should deal with company-specific problems that would not generally result in exclusion. One such problem may,

for example, be a planned activity that could result in exclusion if it is implemented, or conditions in the supply chain that are perhaps too far removed from the company to justify exclusion but where the company does not meet expectations set out in international guidelines. This includes, for example, customers of the textile factories in Bangladesh that collapsed, or the company Posco, which has encountered resistance from the local population while planning a steel mill in India. Other funds that follow responsible investment practice often raise such issues with companies, but it is difficult to see how this can follow from a financial mandate. The Council on Ethics is therefore of the opinion that, to ensure consistency in the use of exclusion on ethical grounds and other exercise of ownership, the Ministry of Finance must explicitly require NBIM to deal with such issues through dialogue with individual companies.

Setting a clear, distinct objective for the Fund regarding the exercise of ownership on ethical grounds will also ensure that management is undertaken in accordance with increasingly stringent international requirements regarding responsible management. A number of international instruments target public bodies, companies and investors, such as the UN Guiding Principles on Business and Human Rights, the OECD Guidelines for Multinational Enterprise, the PRI and the Global Compact. The UN guiding principles and the OECD guidelines may be particularly relevant to the Fund as they also target public bodies in their official capacity, not simply in their role as a participant in business activity on a par with other stakeholders. The development of standards that has taken place since the ethical guidelines were introduced in 2004 has intensified the requirements applicable to authorities, companies and investors, and the objective of the Fund should reflect this development.

2.2 EXCLUSION AS THE CONCLUSION OF AN OWNERSHIP PROCESS

In its report, the Strategy Council describes a step-by-step process in which exclusion is to be the last resort when other instruments have been tried. At year end 2012, the GPFG was invested in almost 7,500 companies. The 200 largest investments accounted for half of the Fund's value. The value of the four largest companies in the Fund was twice that of the 4,000 smallest investments. In 2,170 companies, the investment totalled less than NOK 10 million. The cost of conducting a thorough study and implementing an ownership process cannot be justified in the case of small investments if the aim is to safeguard the Fund's financial interests. To ensure that companies in the Fund maintain a minimum ethical standard, it will probably be more effective from a financial point of view to sell small investments carrying a high ethical risk, rather than expending resources on a study or dialogue.

Given NBIM's strategic changes, this development will occur irrespective of the organisational changes proposed by the Strategy Council. NBIM sold its holdings in five of the nine companies recommended for exclusion made public during the last three years, ahead of the Ministry of Finance's decision to exclude. NBIM was aware of the Council on Ethics' assessment. Given the proposed main objective, dialogue at the individual company level will probably only be conducted with a few large companies facing ethical challenges that would otherwise necessitate a sale of the investments in the companies.

2.3 OBJECTIVES AND STRATEGIES SHOULD BE ADOPTED FOR CLIMATE CHANGE

The Council on Ethics is also of the opinion that the issue of climate change should be addressed in the ongoing process concerning the Strategy Council's report.

Norway considers the threat of climate change to be one of the greatest challenges the world is facing, and wishes to push forward efforts to counteract climate change. As long as international agreements provide that individual states shall determine how their emissions are to be distributed, it will be difficult to assign responsibility for climate damage to specific companies in the portfolio. Thus far, the Council on Ethics has not recommended the exclusion of any company from the Fund based solely on climate damage and, moreover, has made little use of this ground as a supplementary criterion.

It appears reasonable to assume that climate damage will have financial consequences for the Fund, which is why the Ministry of Finance has also taken steps to identify climate-related consequences and to reorient the investments in a climate-friendly direction. Climate change has also been a priority area for NBIM in its exercise of ownership.

In the Council on Ethics' view, the Ministry of Finance should continue to express clearly that the Fund is required to take the threat of climate change into account in its investments. In order for this to have the necessary weight, the Ministry must describe an objective and strategy for the work done in this area.

3 Transparency about exclusion decisions

The second of the Strategy Council's main recommendations, pillar two, concerns transparency and verifiability. The Strategy Council recommends that the reasons for excluding companies from the Fund should no longer be published. Only the names of companies excluded pursuant to a decision of the Executive Board should be published. The reasons given by the Strategy Council for this proposal are that a company dialogue has the greatest chances of bearing fruit if it takes place behind closed doors, and that the Fund's operational risk – including the risk of litigation – will be reduced. The Strategy Council assumes that publication of the Fund's guidelines and strategies will generate sufficient confidence that the Fund is meeting its ethical obligations.

The Council on Ethics disagrees with this. The Council on Ethics is of the opinion that the proposal will result in less information being published about the Fund, and that the Fund will thereby lose some of the influence and international recognition that its work on ethical issues currently enjoys. The Council on Ethics would also point out that no litigation has ever been pursued against the Ministry based on one of its recommendations.

The Council on Ethics' investigative process functions as a relatively closed ownership process potentially resulting in a publicly-reasoned exclusion, and there is often a relatively extensive dialogue between the Council and the company being assessed. In many such dialogues, companies have stated that they wish to avoid being excluded – not least due to reputational considerations. In other words, it is publication that the companies appear to be most worried about, not the actual sale of the Fund's holding. The Strategy

Council appears to assume that the chances of succeeding in a dialogue increase if nothing is published, either during or after the process. This is not consistent with the experience of the Council on Ethics. The experiences from boycotts of companies with operations in South Africa and Sudan to which the Strategy Council refers are only a narrow sample of examples, and appear largely inapplicable to the Council on Ethics' methodology in cases concerning exclusion.

Public information on specific companies encourages other stakeholders to tackle the same issues, meaning that influence is exerted by multiple stakeholders simultaneously. If influencing companies in a positive direction is to be an independent objective, this is a factor to which weight should be given.

The publication of the Council on Ethics' recommendations communicates to other companies how the Fund views different types of activity. The fact that several companies have contacted the Council on Ethics to discuss planned activities similar to activities previously considered by the Council on Ethics indicates that the recommendations are well-known, and that they can affect the conduct of companies. A general strategy or general CSR report by the Fund would not have the same effect.

Further, consideration for the Fund's legitimacy suggests that reports should show how principles and strategies are converted into concrete action affecting individual companies and problem areas in the portfolio. This means publishing the names of companies with which NBIM engages in dialogue, the problems raised in dialogues, and the reasons for exclusion from the Fund.

By way of example, it can be mentioned that in October of last year, the Ministry of Finance published the Council on Ethics' recommendations relating to the companies Royal Dutch Shell PLC and Eni Sp.A. Up until that date, no public information was available on how the Fund had dealt with the serious oil pollution in the Niger Delta. If the recommendations had not been published, the public would have had the impression that the Fund was not working on the issue. The same can be said about, for example, the construction of settlements on the West Bank, the management of mining waste, the exploitation of natural resources in Western Sahara and tropical deforestation.

Without public reports on how the Fund deals with companies, it will also be difficult for political authorities to develop guidelines, as it will be impossible to see how the guidelines result in concrete action.

The thorough, public explanations of the Fund's exclusions set standards. Internationally, there are various guidelines and expectations of companies but few concrete examples of how these guidelines can be applied. The public recommendations contribute to the international debate on what can be expected of companies and funds. The Strategy Council's report envisages removing this distinctive characteristic of the Norwegian model, which has functioned well and has received national and international recognition.

4 Independence in ethical decisions

When the Council on Ethics was established, it was emphasised that the Council should be independent of both financial considerations and the political authorities. The owner of the Fund had to make decisions on exclusion because they could have an effect on the Fund's return. The decisions were to be based on advice from an independent body to ensure that there was no mixing of political, financial and ethical considerations.

The Strategy Council proposes moving exclusion decisions to the Executive Board of Norges Bank. The Council on Ethics agrees that these decisions no longer need to be made by the Ministry. However, in the Council's view, it is important for decisions on exclusion to be made independently of financial considerations. This does not appear to be sufficiently safeguarded in the proposal to move decisions on exclusion to Norges Bank's Executive Board. In particular, the sale of significant shareholdings in large companies may involve a conflict between ethical considerations and financial considerations. Independence is also important for the credibility and legitimacy of the Fund's ethical work.

The independence of the Fund can be ensured by giving the Ministry of Finance continued responsibility for the appointment of a council on ethics that has its own secretariat and that advises the Executive Board on cases concerning withdrawal. If such a council were to be appointed by – and receive its mandate and budget directly from – the Ministry of Finance, it would be clear that the council's only task is to safeguard ethical considerations without taking other aspects of the Fund's management into account. The balance between financial considerations and ethical considerations, and the assessment of appropriate instruments, will be the Bank's responsibility. The Council on Ethics' proposal for the organisation of this work is discussed further in section 5.

5 The exclusion system in a new organisational model

The third main recommendation made by the Strategy Council (pillar three), concerns the integration of work on responsible investment issues. The Strategy Council proposes that exclusion decisions should be transferred to the Executive Board of Norges Bank. The report states that Norges Bank should receive sufficient expertise, and that Norges Bank's board could appoint a committee to give advice on withdrawal issues. The knowledge and experience that the secretariat of the Council on Ethics has developed should be integrated into NBIM. The report contains no other discussion of how the work on responsible investment issues should be organised.

The Council on Ethics is of the opinion that the Ministry of Finance must give more thorough consideration to the organisation of the work on responsible investment. This is not sufficiently discussed in the Strategy Council's report. Nevertheless, the Council on Ethics would like to make some comments on the outlined solution.

If Norges Bank is given a mandate to exercise ownership on ethical grounds, it may be appropriate to transfer the Council's secretariat to the Bank. The organisational model

must ensure that the Bank has the expertise and incentives to implement the mandate, and a control system must be established to ensure that the mandate is implemented as intended. Such control can be exercised by requiring a council on ethics, appointed by the Ministry of Finance, to make annual public reports to the Ministry on its activities. The council should also be able to refer to NBIM cases not suited for exclusion but well suited for the exercise of ownership. Dialogues with companies require detailed knowledge, and those participating in a company dialogue must have expertise on the issues being discussed. In addition to having an investigative function, the secretariat should also participate in dialogues with companies.

However, if the Ministry does *not* believe that the Fund should raise ethical issues with individual companies unless required by a financial objective for the work on responsible investment issues, it will not be appropriate to transfer the secretariat to the Bank. In that case, the Council on Ethics can continue as at present, albeit making its recommendations to Norges Bank instead of to the Ministry of Finance.

The Council on Ethics otherwise agrees with the Strategy Council that, irrespective of the model used, these activities require an independent budget.

NBIM's implementation of its ethical mandate will be the responsibility of the Executive Board, just as in the case of other major management decisions. Accordingly, the Executive Board also requires expertise on the ethical considerations that the Fund is meant to safeguard.

6 Conclusion

In recent years, international guidelines targeting *companies* have rapidly become more concrete and give practical guidance on, for example, how consultations should be run, how individuals who have to relocate due to expropriation should be compensated, and how companies should survey the consequences of their activities. A common feature of such guidelines is that they require transparency.

International guidelines aimed at *investors*, such as the Principles for Responsible Investment (PRI), are more general and contain less specific guidance on adequate courses of action. How managers deal with specific issues in practice is difficult to identify, despite a wealth of general objectives, principles and strategies. There is little reporting at company level.

The Strategy Council's recommendation would bring the GPFG into line with other similar funds. The Fund is to be more transparent about strategies and principles than at present, but is not to publish information on specific companies. The exercise of ownership is to be based on an overarching financial objective.

Rather than copying this management model, the Fund should be clear about how ethical considerations are to supplement or take priority over financial considerations in individual situations. Accordingly, the Fund should have clear guidelines in place that state how the Fund is to deal with ethical issues at the individual company level, and be transparent about both what problems the Fund has tackled and how individual companies have been dealt with. In this way the Fund can contribute to "best practice" by being involved in determining how general principles can be translated into action.

Yours sincerely



Ola Mestad
Chair of the Council on Ethics

Notes

- 1 Government Pension Fund Global Annual Report 2012, page 35.
- 2 Revised National Budget 2004, Box 4.2.
- 3 Report to the Storting No. 20 (2008–2009), page 90.



Recommendations on excluded companies

Summary of recommendations on excluded companies

Recommendations to exclude companies that produce cluster munitions

- 16.06.2005** **Companies producing cluster munitions**
The companies General Dynamics Corp. and Raytheon Co., are excluded on the basis of the production of components for cluster munitions.
(Published 2 September 2005)
- 06.09.2006** **Poongsan Corp.**
Poongsan Corp. is excluded on the basis of the production of cluster munitions.
(Published 6 September 2006)
- 15.05.2007** **Hanwha Corp.**
Hanwha Corp. is excluded on the basis of the production of cluster munitions.
(Published 11 January 2008)
- 26.08.2008** **Textron Inc.**
Textron Inc. is excluded on the basis of the production of cluster munitions.
(Published 30 January 2009)

Recommendations to exclude companies that produce key components for nuclear weapons

- 19.09.2005** **Companies developing and producing key components for nuclear weapons**
The companies Boeing Co., Honeywell International Inc., Northrop Grumman Corp., and Safran SA are excluded on the basis of the development and production of key components for nuclear weapons.
(Published 5 January 2006)

- 18.04.2006 EADS Co.**
EADS Co. (European Aeronautic Defence and Space Company) was excluded in 2005 on the basis of the production of cluster munitions. In 2006, this was no longer the case, but as the company was producing key components for nuclear weapons, the decision to exclude the company was upheld.
(Published 18 April 2006)
- 15.11.2007 GenCorp Inc.**
GenCorp Inc. is excluded on the basis of the production of key components for nuclear weapons.
(Published 11 January 2008)
- 15.11.2007 Serco Group Plc.**
Serco Group Plc. is excluded on the basis of the production of key components for nuclear weapons.
(Published 11 January 2008)
- 31.08.2012 The Babcock & Wilcox Co. and Jacobs Engineering Group Inc.**
The Babcock & Wilcox Co. and Jacobs Engineering Group Inc. were recommended for exclusion because of their involvement in the production of nuclear weapons.
(Published 11 January 2013)
- 02.05.2013 Alliant Techsystems Inc.**
Alliant Techsystems Inc. is excluded on the basis of the production of key components for nuclear weapons.
(Published 21 August 2013)
- 13.06.2013 Lockheed Martin Corp.**
Lockheed Martin Corp. is excluded on the basis of the production of key components for nuclear weapons.
(Published 21 August 2013)

Recommendations to exclude companies that produce antipersonnel landmines

- 22.03.2002 Singapore Technologies Engineering Ltd.**
Singapore Technologies Engineering Ltd. is excluded because of the production of antipersonnel landmines based on a recommendation from the Council on International Law, which preceded the Council on Ethics.
(Published 26 April 2002)

Recommendations to exclude companies that supply weapons and military equipment to Myanmar

- 14.11.2008 Dongfeng Motor Group Co. Ltd.**
 Dongfeng Motor Group Co. Ltd. is excluded because it supplies military trucks to Myanmar's Government.
(Published 13 March 2009)

Recommendations to exclude companies that produce tobacco

- 22.10.2009 Companies producing tobacco**
 The companies Alliance One International Inc., Altria Group Inc., British American Tobacco BHD, British American Tobacco Plc., Gudang Garam Tbk pt., Imperial Tobacco Group Plc., ITC Ltd., Japan Tobacco Inc., KT&G Corp, Lorillard Inc., Philip Morris International Inc., Philip Morris Cr AS., Reynolds American Inc., Souza Cruz SA, Swedish Match AB, Universal Corp VA, and Vector Ltd. Group are excluded due to the production of tobacco.
(Published 19 January 2010)
- 15.11.2010 Shanghai Industrial Holdings Ltd.**
 Shanghai Industrial Holdings Ltd. is excluded because a wholly owned subsidiary produces tobacco.
(Published 15 March 2011)
- 15.02.2011 Grupo Carso SAB de CV**
 Grupo Carso SAB de CV is excluded because of its involvement in the production of tobacco.
(Published 25 August 2011)
- 24.01.2013 Schweitzer-Mauduit International Inc. and Huabao International Holdings Ltd.**
 The Council on Ethics recommended the exclusion of the companies Schweitzer-Mauduit International Inc. and Huabao International Holdings Ltd. because of their involvement in the production of tobacco.
(Published 18 May 2013)

Recommendations to exclude companies that contribute to violations of human rights

- 15.11.2005 Wal-Mart Stores Inc.**
Wal-Mart Stores Inc. and its subsidiary Wal-Mart de Mexico are excluded because of unacceptable working conditions both in some of the company's own stores and among its global suppliers.
(Published 6 June 2006)
- 18.04.2013 Zuari Agro Chemicals Ltd.**
Zuari Agro Chemicals Ltd. was excluded from the Fund because of an unacceptable risk that the company contributes to the worst forms of child labour through its production of hybrid seeds.
(Published 14 October 2013)

Recommendations to exclude companies that contribute to violations of the rights of individuals in situations of war or conflict

- 16.09.2009 Africa Israel Investments Ltd. and Danya Cebus Ltd.**
Africa Investments Ltd., including its subsidiary, Danya Cebus Ltd., are excluded because of their activities in the building of Israeli settlements in the West Bank.
(Published 23 August 2010)
- 21.12.2012 Shikun & Binui Ltd.**
Shikun & Binui Ltd. was recommended for exclusion because of its activities in the building of Israeli settlements in East Jerusalem.
(Published 15 June 2012)
- 25.04.2013 and 201.11.2013 Africa Israel Investments Ltd. and Danya Cebus Ltd.**
On April 2013, the Council on Ethics recommend revoking the exclusion of Africa Investments Ltd. and Danya Cebus Ltd. The companies had been excluded since August 2010 because of their role in the building of Israeli settlements in the West Bank. The point of departure for the Council on Ethics was the understanding that these activities had ceased, meaning that the reason for recommending exclusion was no longer present. The companies were again recommended for exclusion on November 2013, when new information showed that the companies continue to build settlements in East Jerusalem.
(Published 21 August 2013 and 30 January 2014)

Recommendations to exclude companies that contribute to severe environmental damage

- 15.02.2006** **Freeport McMoRan Copper & Gold Inc.**
Freeport McMoRan Copper & Gold Inc. is excluded due to severe environmental damage caused by the company's practice of using riverine tailings disposal at the Grasberg Mine in Indonesia.
(Published 6 June 2006)
- 15.05.2007** **Vedanta Resources Plc.**
The metals and mining company Vedanta Resources Plc., including its subsidiaries Sterlite Industries Ltd. and Madras Aluminium Company Ltd., are excluded on the grounds of causing severe environmental damage associated with pollution and irresponsible waste disposal at the companies' copper and aluminium works in India, as well as human rights violations, including the abuse and forced displacement of tribal peoples.
(Published 6 November 2007)
- 15.02.2008** **Rio Tinto Plc. and Rio Tinto Ltd.**
Rio Tinto is a joint-venture partner to the Grasberg Mine operated by Freeport McMoRan in Indonesia. Freeport McMoRan was excluded from the Fund in 2005 due to environmental damage caused by the company's riverine tailings disposal. Rio Tinto was excluded because the company is regarded to be directly involved in the severe environmental damage caused by the mining operation.
(Published 9 September 2008)
- 15.08.2008** **Barrick Gold Corp.**
Barrick Gold Corp. is excluded on the grounds of severe environmental damage caused by the company's riverine tailings disposal from the Porgera Mine in Papua New Guinea.
(Published 30 January 2009)
- 16.02.2009** **MMC Norilsk Nickel**
MMC Norilsk Nickel is excluded because its nickel plant on the Taymyr Peninsula causes serious damage to the environment.
(Published 20 November 2009)
- 22.02.2010** **Samling Global Ltd.**
Samling Global Ltd. carries out forest operations in tropical rainforest. Samling is excluded on the grounds of illegal logging and severe environmental damage in Sarawak (Malaysia) and Guyana.
(Published 23 August 2010)

- 15.09.2010** **Lingui Developments Berhad**
Lingui Developments Berhad carries out forest operations in tropical rainforest. Lingui is excluded on the grounds of illegal logging and severe environmental damage in Sarawak (Malaysia). Lingui is a subsidiary of Samling Global Ltd. The exclusion of Samling was partly based on violations in Lingui's operations.
(Published 16 February 2011)
- 18.06.2012** **Zijin Mining Group Co. Ltd.**
A number of serious incidents have taken place at the company's facilities during the last few years as tailings dams for waste from mining and mineral processing have collapsed and led to extensive environmental damage and loss of life. The Council on Ethics found that there was an unacceptable risk of equivalent incidents taking place in the future and therefore recommended that the company should be excluded from the Fund.
(Published 16 February 2011)
- 21.06.2012** **Volcan Compañía Minera SAA**
The mining company Volcan Compañía Minera SAA operates an open-pit mine in the city of Cerro de Pasco, Peru. The company is excluded because its ongoing operations and older mineral deposits for which it is currently responsible result in an important contamination by lead and lead-poisoning in children.
(Published 14 October 2013)
- 25.06.2012** **WTK Holdings Berhard**
WTK Holdings Berhard carries out forest operations in tropical rainforests in Sarawak. The company is excluded because it severe environmental damage through its logging and conversion of tropical rainforests to plantations..
(Published 14 October 2013)
- 03.12.2012** **Ta Ann Holdings Berhard**
Ta Ann Holdings Berhard carries out forest operations in tropical rainforests in Sarawak. The company is excluded because it severe environmental damage through its logging and conversion of tropical rainforests to plantations in Sarawak.
(Published 14 October 2013)

13.09.2013 Sesa Sterlite

Vedanta Resources and its subsidiaries Sterlite Industries and Madras Aluminium Company Ltd. have previously been excluded from the Fund because the companies' activities in India cause serious environmental damage and contribute to violations of human rights. Vedanta has been restructured and both subsidiaries are included in a new company, Sesa Sterlite, where Vedanta Resources continues to have a controlling ownership. The restructuring does not affect the companies' activities. Both Vedanta and Sesa Sterlite are therefore recommended for exclusion from the Fund's investment universe.

(Published 30 January 2014)

Recommendations to exclude companies that violate fundamental ethical norms

15.05.2009 Elbit Systems Ltd.

Elbit Systems Ltd. is excluded because it supplies surveillance systems to the separation barrier on the West Bank.

(Published 3 September 2009)

15.11.2010 Potash Corp. of Saskatchewan

Potash Corp. of Saskatchewan is excluded because of its purchase of phosphate minerals extracted in Western Sahara.

(Published 6 December 2011)

Guidelines for the observation and exclusion of companies from the Government Pension Fund Global's investment universe

Adopted by the Ministry of Finance on 1 March 2010 pursuant to Act no. 123 of 21 December 2005 relating to the Government Pension Fund, section 7

Section 1. Scope

- (1) These guidelines apply to the work of the Ministry of Finance, the Council on Ethics and Norges Bank concerning the exclusion and observation of companies.
- (2) The guidelines cover investments in the Fund's equity and fixed income portfolio, as well as instruments in the Fund's real-estate portfolio issued by companies that are listed in a regulated market.

Section 2. Exclusion of companies from the Fund's investment universe

- (1) The assets in the Fund shall not be invested in companies which themselves or through entities they control:
 - a) produce weapons that violate fundamental humanitarian principles through their normal use;
 - b) produce tobacco;
 - c) sell weapons or military material to states that are affected by investment restrictions on government bonds as described in the management mandate for the Government Pension Fund Global Section 3-1 (2) c.
- (2) The Ministry makes decisions on the exclusion of companies from the investment universe of the Fund as mentioned in paragraph 1 on the advice of the Council on Ethics.
- (3) The Ministry of Finance may, on the advice of the Council of Ethics, exclude companies from the investment universe of the Fund if there is an unacceptable risk that the company contributes to or is responsible for:
 - a) serious or systematic human rights violations, such as murder, torture, deprivation of liberty, forced labour, the worst forms of child labour and other child exploitation;
 - b) serious violations of the rights of individuals in situations of war or conflict;
 - c) severe environmental damage;
 - d) gross corruption;
 - e) other particularly serious violations of fundamental ethical norms.
- (4) In assessing whether a company shall be excluded in accordance with paragraph 3, the Ministry may among other things consider the probability of future norm violations; the severity and extent of the violations; the connection between the norm violations and the company in which the Fund is invested; whether the company is doing what can reasonably be expected to reduce the risk of future norm violations within

a reasonable time frame; the company's guidelines for, and work on, safeguarding good corporate governance, the environment and social conditions; and whether the company is making a positive contribution for those affected, presently or in the past, by the company's behaviour.

(5) The Ministry shall ensure that sufficient information about the case has been obtained before making any decision on exclusion. Before deciding on exclusion in accordance with paragraph 3, the Ministry shall consider whether other measures may be more suitable for reducing the risk of continued norm violations or may be more appropriate for other reasons. The Ministry may ask for an assessment by Norges Bank on the case, including whether active ownership might reduce the risk of future norm violations.

Section 3. Observation of companies

- (1) The Ministry may, on the basis of advice from the Council on Ethics in accordance with section 4, paragraphs 4 or 5, decide to put a company under observation. Observation may be chosen if there is doubt as to whether the conditions for exclusion have been fulfilled, uncertainty about how the situation will develop, or if it is deemed appropriate for other reasons. Regular assessments shall be made as to whether the company should remain under observation.
- (2) The decision to put a company under observation shall be made public, unless special circumstances warrant that the decision be known only to Norges Bank and the Council on Ethics.

Section 4. The Council on Ethics for the Government Pension Fund Global – appointment and mandate

- (1) The Ministry of Finance appoints the Council on Ethics for the Government Pension Fund Global. The Council shall consist of five members. The Council shall have its own secretariat.
- (2) The Council shall monitor the Fund's portfolio with the aim of identifying companies that are contributing to or responsible for unethical behaviour or production as mentioned in section 2, paragraphs 1 and 3.
- (3) At the request of the Ministry of Finance, the Council gives advice on the extent to which an investment may be in violation of Norway's obligations under international law.
- (4) The Council gives advice on exclusion in accordance with the criteria stipulated in section 2, paragraphs 1 and 3.
- (5) The Council may give advice on whether a company should be put under observation, cf. section 3.

Section 5. The work of the Council on Ethics

- (1) The Council deliberates matters in accordance with section 4, paragraphs 4 and 5 on its own initiative or at the behest of the Ministry of Finance. The Council on Ethics shall develop principles that form the basis for the Council's selection of companies for closer investigation. The principles shall be made public.

- (2) The Council shall obtain the information it deems necessary and ensure that the case has been properly investigated before giving advice on exclusion from the investment universe.
- (3) A company that is being considered for exclusion shall be given the opportunity to present information and viewpoints to the Council on Ethics at an early stage of the process. In this context, the Council shall clarify to the company which circumstances may form the basis for exclusion. If the Council decides to recommend exclusion, its draft recommendation shall be presented to the company for comment.
- (4) The Council shall describe the grounds for its recommendations. These grounds shall include a presentation of the case, the Council's assessment of the specific basis for exclusion and any comments on the case from the company. The description of the actual circumstances of the case shall, insofar as possible, be based on material that can be verified, and the sources shall be stated in the recommendation unless special circumstances indicate otherwise. The assessment of the specific basis for exclusion shall state relevant factual and legal sources and the aspects that the Council believes ought to be accorded weight. In cases concerning exclusion pursuant to section 2, paragraph 3, the recommendation shall, as far as is appropriate, also give an assessment of the circumstances mentioned in section 2, paragraph 4.
- (5) The Council shall routinely assess whether the basis for exclusion still exists and may, in light of new information, recommend that the Ministry of Finance reverse a ruling on exclusion.
- (6) The Council's routines for processing cases concerning the possible reversal of previous rulings on exclusion shall be publicly available. Companies that have been excluded shall be specifically informed of the routines.
- (7) The Ministry of Finance publishes the recommendations of the Council on Ethics after the securities have been sold, or after the Ministry has made a final decision not to follow the Council on Ethics' recommendation.
- (8) The Council shall submit an annual report on its activities to the Ministry of Finance.

Section 6. Exchange of information and coordination between Norges Bank and the Council on Ethics

- (1) The Ministry of Finance, the Council on Ethics and Norges Bank shall meet regularly to exchange information about work linked to active ownership and the Council on Ethics' monitoring of the portfolio.
- (2) The Council on Ethics and Norges Bank shall have routines to ensure coordination if they both contact the same company.
- (3) The Council on Ethics may ask Norges Bank for information about how specific companies are dealt with through active ownership. The Council on Ethics may ask Norges Bank to comment on other circumstances concerning these companies. Norges Bank may ask the Council on Ethics to make its assessments of individual companies available.

Section 7. Notification of exclusion

- (1) The Ministry of Finance shall notify Norges Bank that a company has been excluded from the investment universe. Norges Bank shall be given a deadline of two calendar months to complete the sale of all securities. Norges Bank shall notify the Ministry as soon as the sale has been completed.
- 2) At the Ministry's request, Norges Bank shall notify the company concerned of the Ministry's decision to exclude the company and the grounds for this decision.

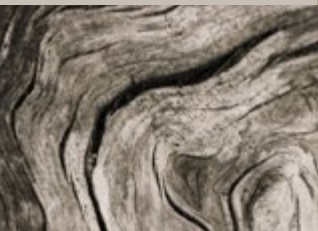
Section 8. List of excluded companies

The Ministry shall publish a list of companies that have been excluded from the investment universe of the Fund or put under observation.

Section 9. Entry into force

These guidelines come into force on 1 March 2010. The Ethical Guidelines for the Government Pension Fund – Global, adopted by the Ministry of Finance on 19 November 2004, are repealed on the same date.





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