To the Ministry of Finance

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UNOFFICIAL ENGLISH TRANSLATION

Summary of Recommendation to Observe ENI Sp.A
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 at 31 December 2012, the Government Pension Fund Global (GPFG) 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%) 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%) 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 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 practised 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 JV Agreement 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.