

COUNCIL ON ETHICS

THE GOVERNMENT PENSION FUND GLOBAL

To the Ministry of Finance

Recommendation 26 May 2010

(Unofficial translation)

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1 Introduction

This recommendation concerns the risk of contributing to human rights violations in connection to the construction of two oil and gas pipes in Burma by the Chinese company China National Petroleum Corporation (CNPC). The Government Pension Fund Global (GPF) invests in PetroChina, a subsidiary of CNPC. As of 31.12.2009, GPF owned shares in PetroChina worth some USD 92 million, corresponding to an ownership of 0.03 percent. CNPC owns 86.71 percent of PetroChina's shares. The Council on Ethics has evaluated whether PetroChina contributes to ongoing and future violations of human rights in connection with the construction of these pipelines in Burma through its close ties to CNPC.

Ever since the Council submitted its recommendation in November 2005 concerning the activities of the French company Total in Burma, the Council has closely observed companies with operations in the country.¹ Total was the operator of an international consortium which was responsible for the construction of the so-called Yadana-pipeline in 1995-98. Associated with the preparation of the pipeline corridor and the construction of the pipeline, the Burmese military committed extensive and severe abuses against local people, including the forced relocation of villages, forced labour, torture and killings. In the Council's view there are a number of similarities between the Yadana project and the project referred to in the present recommendation, both with regard to the type of project, the use of military forces, and the risk of human rights violations.

In October 2007 the Ministry of Finance requested that the Council on Ethics account for the Council's research on companies with operations in Burma. In its response to the Ministry, the Council states: *"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."*²

In this specific case, the point of departure is that the governments of China and Burma signed an agreement on 27 March 2009 to build two onshore pipelines: A gas pipeline which will carry gas from the Shwe field and a parallel crude oil pipeline for the transportation of oil. The Burmese part of the pipeline route is close to 800 km long and will traverse central Burma, from the town of Sittwe to Yunnan-province in China. It was also made clear that CNPC and MOGE, a Burmese state-owned company, will have 50.9 and 49.1 per cent share respectively in the project. On 20 December 2009, representatives of CNPC and the Burmese Ministry of Energy signed an agreement on the rights and obligations concerning the pipeline. According to the agreement, CNPC shall build, own and operate the pipeline, while the Burmese government shall ensure its security.

The pipeline will pass through areas populated by ethnic minorities where extensive use of forced labour and severe human rights violations have been reported. There have also been reports of increased militarization along CNPC's pipeline corridor. The Council assumes that the construction of a nearly 800 km-long pipeline through areas inhabited by a number of different ethnic groups will entail serious or systematic human rights violations. As the

¹ The Council on Ethics' recommendation on Total is available at www.etikkradet.no

² The Council's letter to the Ministry of Finance 11 October 2007 regarding the Council on Ethics' assessment of companies with operations in Burma. The letter is also attached to this draft recommendation

Burmese government will be responsible for the security of the project, it is highly probable that CNPC, through its involvement in the project, will contribute to human rights violations. Although it is the Burmese government and not the company which in principle commits the violations, there is a link between the violations and the company's operations insofar as the violations take place to facilitate for the company's operations.

Seeing that the Fund owns shares in PetroChina but not in CNPC, it is necessary to consider whether also PetroChina contributes to the human rights abuses through its relationship with CNPC. The Council, therefore, has evaluated the corporate structures of PetroChina and CNPC and the relationship between the companies. The Council has found PetroChina's position in relation to CNPC to be so particular that PetroChina can be said to contribute to human rights violations in Burma.

In accordance with the Fund's guidelines for the observation and exclusion of companies, the Council's draft recommendation was sent to PetroChina for comments on 26 March 2010. As of 26 May 2010, PetroChina has not responded to the Council.

In its assessment of whether PetroChina may contribute to the human rights violations through its relationship with CNPC, the Council has stressed the following aspects pertaining to the company group: It is a fundamental starting point that the main part of the operations of the CNPC company group are carried out by PetroChina. PetroChina is responsible for more than 80 per cent of the income of the CNPC company group and the equivalent of 70-80 per cent of the company group's total oil and gas production.

CNPC's entire management are members and constitute the majority of PetroChina's board. Four members of PetroChina's top management concurrently have senior management positions in CNPC. Furthermore, most of PetroChina's departments are headed by individuals with identical positions in the parent company. This is extraordinary in all kinds of corporations. The leading persons of PetroChina are at the same time the leading people of CNPC, which means that the companies are under common management.

Executives in both companies are appointed by structures outside the corporate structure – including the so-called Leading Party Members' Group of the company group. The entire CNPC senior management, the same individuals who make up the majority of PetroChina's board, are also members of the Leading Party Group of the company group. The concurrence of identities between members of the management and administration suggests that the Leading Party Member Group views the company group as a whole, and that leaders are selected on the basis of an overall assessment of the needs of both CNPC and PetroChina.

Finally, there appears to be a considerable coordination of operations within PetroChina and CNPC, including the transfer of assets from CNPC to PetroChina. The Council finds it noteworthy that only CNPC may enter into production-sharing agreements with other states. CNPC can, however, transfer these agreements to PetroChina after some time. It is well-known that CNPC has negotiated state-to-state deals, like those with Sudan and Burma. It is also known that CNPC after some time has transferred such deals to PetroChina, for example in Kazakhstan and Turkmenistan.

Based on an overall assessment of the governance issues outlined above, the Council concludes that the management of PetroChina and CNPC is so uniform, and the operations of PetroChina so significant within the company group, that CNPC's activities in Burma should be perceived as directed by PetroChina's management in that which pertains to §2 of the ethical guidelines. Concerning the question of the risk of contributing to human rights violations, the companies should be perceived as one single unit insofar as CNPC's activities in Burma cannot be separated from PetroChina's operations.

Based on this, the Council has reached the conclusion that the Fund's investment in PetroChina entails an unacceptable risk of contributing to ongoing and future, serious or systematic violations of human rights in connection with the construction of the pipelines in Burma.

The Council therefore recommends the exclusion of PetroChina from the Norwegian Government Pension Fund Global's investment universe.

2 Sources

The Council has commissioned its own research to clarify the factual relationship between PetroChina and its parent company, CNPC. The recommendation is mainly based on this research. Regarding human rights violations, the Council has communicated with a number of civil-society organisations which carry out fact-finding activities in Burma. The Council has also made use of publicly available sources.

Sources are referred to in footnotes throughout this recommendation.

3 The Council's considerations

In accordance with section 2 § 3.a of the Fund's guidelines for the observation and exclusion of companies, the Council has assessed whether an unacceptable risk exists of PetroChina being complicit in serious or systematic human rights violations through the activities of its parent company in Burma. The assessment is based on whether there is a direct link between the company's activities and the violations of human rights in question.

The Council is familiar with allegations voiced against CNPC of contributing to human rights violations in Sudan. The Council has not assessed this.

As advanced in the Council's letter to the Ministry of Finance dated 12 December 2007,³ the Council has recommended the exclusion of PetroChina based on the understanding that the construction of an onshore pipeline in Burma carries an unacceptable risk of the company contributing to serious violations of human rights in the future. CNCP has entered into an agreement with the Burmese government to construct the pipeline, and in this case the Council does not consider it necessary to wait until the violations actually take place before issuing a recommendation.

In the present recommendation, the Council has in particular assessed whether a subsidiary can be complicit in the unethical activities of its parent company. Normally a subsidiary cannot be held accountable for the actions of the parent company. The Council on Ethics works under the premise that the exclusion of companies for activities that are contrary to the ethical guidelines can only take place when the company in which the Fund owns equity is itself – or through its ownership or other controlling positions – involved in the unethical activity. One consequence of this interpretation of the guidelines is that whenever the Fund owns equity in a company which is itself a subsidiary of the leading group company, only the actions or omissions which can be attributed to the company in which the Fund owns equity will provide grounds for exclusion.

In this case however, the Council has found the connection between the parent company and its subsidiary to be so close that the two companies can be regarded as a unit, making the

³ PetroChina has been notified of this letter in a letter from the Council on Ethics to PetroChina dated 20 November 2007.

subsidiary complicit in the parent company's actions. The preparatory work for the ethical guidelines emphasises that the company's legal structure cannot be decisive in the ethical assessment of complicity, including cases where “*the links between a company in the Petroleum Fund's portfolio and a company where there is an ethical risk are so close that the two can be identified with each other.*” And furthermore: “*Factors that could be decisive for such identification are the size of the ownership interests, whether the companies act as one externally, and whether shareholdings in one of the companies have implications for the other. Even if there is no identification, it may still be reasonable to argue that complicity exists.*”⁴

The Council considers the views of the Graver committee as guidance, but also considers other factors to be pertinent to its assessment of whether ownership in a subsidiary can be regarded as equivalent to ownership in the parent company. This would be the case if it could be proven likely that the real power over the parent company lays in the leadership of the subsidiary, or that the businesses of the two companies and their respective subsidiaries are so intertwined as to make them inseparable from each other in reality.

4 The construction of the pipeline and violations of human rights

4.1 The construction of the pipelines

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 oil pipeline.⁵ The oil pipeline will carry crude oil that is currently transported by ship from the Middle East and Africa.

Both pipelines will start from the port of Kyauk Phyu in the Rakhine (Arakan) State, on the west coast of Burma, and will cross the Chinese border at Ruili in China's Yunnan province.⁶ An estimated 800 km of the pipelines will traverse Burmese soil.⁷ The oil pipeline will end in Kunming, the capital of Yunnan Province, and have an annual capacity of 22 million tons of crude oil. It is expected that the gas pipeline will go through Kunming and end up in Nanning, the capital of the Guangxi Zhuang Region.⁸ The pipelines are expected to be completed by 2013.

PetroChina has gained the distribution rights of the gas in China's Yunnan province⁹ and is currently planning the construction of an oil refinery in Kunming to receive the oil from the pipeline.¹⁰

⁴ The report from the Graver Committee, available at http://www.regjeringen.no/nb/dep/fin/tema/statens_pensjonsfond/ansvarlige-investeringer/graverutvalget/Report-on-ethical-guidelines.html?id=420232

⁵ http://www.atimes.com/atimes/South_Asia/KD03Df03.html

⁶ <http://www.reuters.com/article/rbssEnergyNews/idUSPEK1796020090616>

⁷ According to CNPC “*the Myanmar -China Crude Pipeline starts from Madeira [Island of Maday] at the west coast of Myanmar, running 771 kilometers 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>

⁸ http://news.xinhuanet.com/english/2009-06/16/content_11552020.htm

⁹ Through its subsidiary PetroChina Kunlun Gas Ltd, PetroChina Annual report 2009 p46, and

<http://www.chinastakes.com/2008/11/myanmar-china-pipeline-to-start-construction-in-2009.html>

¹⁰ See for example http://en.kunming.cn/index/content/2010-02/04/content_2086838.htm

On June 16, CNPC informed that the company's Vice President Liao Yongyuan and Burma's Ambassador to China had signed a memorandum of understanding making CNPC responsible for the construction, operation and management of the pipeline from Burma to China. In addition to the pipeline, CNPC will also build a large-scale crude oil unloading wharf and a terminal at Kyaukryu port, with oil storage and transportation facilities.¹¹ The construction costs are expected to amount to USD 1.5 billion for the gas pipeline and USD 1 billion for the oil pipeline. CNPC and MOGE's shares in the projects are 50.9 and 49.1 per cent respectively, but CNPC will carry all the costs of the project.¹²

On 20 December 2009, representatives of CNPC and the Burmese Ministry of Energy signed an agreement on the rights and obligations relating to the oil pipeline, granting CNPC exclusive rights to build and operate it. CNPC's press release confirms that: "*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*" This shows that CNPC's subsidiary Southeast Asia Crude Pipeline Company is responsible for building and operating the pipeline. Furthermore the press release states that: "*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.*"¹³ Thus CNPC confirms that the Burmese authorities shall ensure the company's ownership to the pipeline and guarantee security. The Council assumes that this applies to the construction period as well as to the operation of the pipeline.

The Council therefore assumes that, as with similar pipeline projects previously, the Burmese government will be responsible for the preparation of the pipeline corridor and the security for the pipeline, thereby facilitating the company's operations.

4.2 Human Rights Violations

The Council anticipates that human rights violations associated with the construction of the pipelines can be expected to resemble those which took place before and during the construction of the Yadana-pipeline in 1995-1998, where Total was the operator.¹⁴ In parallel with the increased militarisation of the area, there were numerous reports on extensive violations committed against the local population, including accusations of forced labour, the forced relocation of villages, torture, killings and rape. The violations were perpetrated by the Burmese military in connection with the clearing of the pipeline's corridor and the construction of the pipeline. Similar abuses have been reported in association with the construction of other pipelines and infrastructure projects.¹⁵

¹¹

http://www.cnpc.com.cn/en/press/newsreleases/MOU_signed_of_Myanmar%EF%BC%8DChina_Oil_Pipeline.htm

¹² <http://www.burmalibrary.org/docs08/SGB03-09.pdf>

¹³ <http://www.cnpc.com.cn/en/press/newsreleases/RightsandobligationagreementsignedofMyanmar-ChinaCrudePipeline.htm>

¹⁴ See the Council's recommendation regarding Total, available at www.etikkradet.no

¹⁵ 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>

The onshore part of the Yadana pipeline is 64 km long, while CNPC's pipelines will run for nearly 800 km in Burma. The pipeline will pass through 22 townships across central Burma, including the Arakan and Shan states, where there is an ongoing conflict between the regime and local ethnic groups. The ILO and NGOs have long reported that the Burmese military, present in these states, systematically uses forced labour. The extent of the abuses led the ILO to include both the Arakan and Shan states in its priority program for field observations in 2003.¹⁶ The situation, however, has not improved. 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 Arakan and Shan states. The report states that the military force 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.*"¹⁷ Also the US State Department's 2009 report on the human rights situation in Burma¹⁸ and not least the report of the UN Special Rapporteur,¹⁹ confirm that the military's unacceptable practice continues.

Considering that CNPC's pipeline is 15 times longer than the Yadana pipeline, the Council finds it reasonable to believe that the human rights violations associated with the construction of CNPC's pipelines will be more extensive than those which occurred during the construction of the Yadana pipeline.²⁰

In September 2009, reports described an increased military presence along the CNPC-pipeline corridor. Apparently, close to 44 battalions (some 13,000 soldiers) are stationed along the pipeline's route, including areas inhabited by ethnic groups where the military previously has had no presence.²¹ There are also reports that villages have been forcibly relocated and land has been confiscated on Maday Island in the Kyaukphyu Township among others.²²

In comparison, 16 battalions were deployed along the Yadana corridor between 1991 and 1996. The increased military presence was intended to secure the area and ensure full control

¹⁶ International Labour Conference, 91st Session, Geneva, June 2003, Committee on the Application of Standards: Special sitting to examine developments concerning the question of the observance by the Government of Myanmar of the Forced Labour Convention, 1930 (No. 29), s 19 Part III/30, available at http://burmalibrary.org/docs/ILC2003special_sitting.htm

¹⁷ 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>

¹⁸ 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>

¹⁹ 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>

²⁰ See Council Enithics recommendation regarding Total.

²¹ Shwe Gas Movement 2009: *Corridor of Power*, s.20, tilgjengelig på <http://democracyforburma.wordpress.com/2009/09/07/corridor-of-power-china%E2%80%99s-trans-burma-oil-and-gas-pipelines/> og <http://democracyforburma.wordpress.com/2009/12/31/burma-china%E2%80%99s-oil-gas-pipelines-recipe-for-abuse-warn-activists/>

²² The following are the villages in Kyaukphyu Township where involuntary land confiscation and forced relocation are reported: *Gown Chewin, Thit Pate Taung, Saba Shar, Pone Nay Gyi, Lake Khamaw, Kalar Bar, Gaw Da*. se <http://www.burmapartnership.org/2010/02/relocation-land-confiscation-on-madae-island-for-gas-pipeline/>

over the local population, which was assumed to be essential for the development of the project.²³ Many villages were forced to relocate for the clearing of the pipeline corridor and for security reasons. According to the organisation *La Federation des droits de l'Homme* (FIDH), a total of 30,000 people living in the pipeline area were forcibly relocated.²⁴ The heavy presence of soldiers led to the extensive and systematic use of forced labour. Local people were required to build military camps and the necessary infrastructure for the construction work, including heliports, roads and other buildings, as well as clear land for the corridor itself.²⁵ Other accusations of atrocities on the part of the security forces against the civilian population include violence, torture and summary executions of what the military regarded as ethnic rebels, as well as punishment and violence in connection with the forced labour – not least against women and children.²⁶

In the Council's opinion, nothing indicates that the present situation in Burma is any different from 20 years ago, when preparations for the Yadana pipeline started. The reports of the UN Special Rapporteur and other sources confirm that the Burmese military's systematic abuses against the civilian population are extensive and follow the same pattern as before. The Council therefore assumes that the construction of CNPC's pipelines will entail severe and systematic human rights violations.

5 CNPC and PetroChina

5.1 CNPC and PetroChina's operations

According to its website, CNPC is a state-owned, integrated energy company with businesses covering oil and gas operations, technical services, engineering and construction, equipment, manufacturing, financial services and renewable energy development. The company is China's largest oil and gas producer and supplier, and has oil and gas assets in 29 countries including Azerbaijan, Burma, Chad, Canada, Ecuador, Equatorial Guinea, Indonesia, Iraq, Libya, Peru, and Sudan.²⁷

Since the restructuring of the CNPC company group in 1999 (see below), CNPC has engaged in crude oil and natural gas exploration and production outside China, as well as the limited production of chemicals and the retail sale of refined products.²⁸

CNPC is entirely owned by the Chinese government. It is one of 132 companies that are managed by the State-owned Assets Supervision and Administration Commission (SASAC).²⁹ SASAC invests on behalf of the state and among other things is responsible for the appointment of top management in these companies: “*SASAC appoints and removes top executives of the enterprises under the supervision of the Central Government, evaluates their*

²³ Earth Rights International 2000: Total Denial Continues, pp 39, 43, available at <http://www.earthrights.org/publication/total-denial-continues>

²⁴ La Federation des droits de l'Homme 1996: Burma, Total and Human Rights: Dissection of a project. Situation Report, p. 23.

²⁵ Earth Rights International 2000: Total Denial Continues p. 84-87, La Federation des droits de l'Homme 2005: Total pollutes democracy, p 26.

²⁶ Earth Rights International 2000: Total Denial Continues p. 100-121, La Federation des droits de l'Homme 2005: Total pollutes democracy, p 28.

²⁷ www.cnpc.com

²⁸ PetroChina 20 F filings 2009 to the Security and Exchange Commission (SEC), p 87, available at <http://www.sec.gov/Archives/edgar/data/1108329/000114554909000914/h03279e20vf.htm>

²⁹ http://www.petrochina.com.cn/Ptr/About_PetroChina/Company_Profile/

performances, and grants them rewards or inflicts punishments.”³⁰ SASAC is subject to the Chinese government (the State Council).

PetroChina is a public limited company established in November 1999 as part of the restructuring of CNPC. Virtually all of CNPC’s core business and assets relating to the exploration, production, refining and marketing of chemicals and natural gas were transferred to PetroChina. CNPC retained assets relating to international exploration, production, refining and pipeline operations, as well as non-core assets such as hospitals and schools.³¹

Among the original 1.54 million employees of CNPC, about 1 million were retained by the remaining enterprise while the other 0.5 million were employed by PetroChina. PetroChina was listed on the Hong Kong and New York stock exchanges in April 2000, and on the Shanghai Stock Exchange in November 2007.

PetroChina states that it is “the largest oil and gas producer and distributor, playing a dominant role in the oil and gas industry in China.”³² PetroChina is involved in all key sectors in the petroleum and petrochemical industry “*from exploration and production of crude oil and natural gas in the upper stream to the refining, chemicals, pipelining and marketing in the middle and down stream*”³³ The company is also engaged in the construction and operation of oil and gas pipelines. PetroChina’s main operations are in China, but the company also operates in 11 other countries.

PetroChina constitutes the dominant part of CNPC’s operations. According to PetroChina, the company produced 117.8 million tons crude oil and 52.8 m³ natural gas in 2008.³⁴ Corresponding figures for CNPC are 138.5 million tons crude oil and 66.5 m³ natural gas.³⁵ Consequently, PetroChina’s part of the total production of oil and gas within the CNPC company group amounts to 85 and 80 per cent respectively. In 2009 PetroChina’s part of oil production was reduced to 66 per cent, while the production of gas was maintained at the same level as in 2008.³⁶

PetroChina’s income represents a corresponding part of the CNPC company group’s operations. In 2008, PetroChina’s operating revenue amounted to RMB 1,072,604 million, while the operating revenue of the CNPC company group was 1,273,002 million RMB. Thus, PetroChina’s part of the income of the consolidated group was 84 per cent in 2008. This share was maintained in 2009.³⁷

There can therefore be no doubt that the main operations of the CNPC company group occur within PetroChina. To a large extent, CNPC’s operations seem to serve as a support for PetroChina. This is also evident from PetroChina’s annual report to the SEC, where the company informs: “*CNPC’s primary business activities relate to the provision of various services and products to PetroChina.*”³⁸

³⁰ <http://www.sasac.gov.cn/n2963340/n2964712/3049579.html>

³¹ See footnote 28, p 17.

³² http://www.petrochina.com.cn/Ptr/About_PetroChina/Company_Profile/

³³ See footnote 32.

³⁴ PetroChina Company Ltd: *Results Announcement for the year ended December 21, 2009. (Summary of the 2009 Annual Report)*, p 16, available at www.petrochina.com. The calculation is based on that 1 ton of oil corresponds to 7 289 barrels and that 1 m³ equals 33 314 feet³, as PetroChina states in its Annual Report..

³⁵ CNPC *Annual Report 2008*, p 8-9, available at www.cnpc.com

³⁶ See footnote 34 and CNPC *Annual Report 2009* pp 29-30, available at www.cnpc.com

³⁷ See footnote 34 and CNPC *Annual Report 2009* p 71.

³⁸ PetroChina *20 F SEC Filings 2009*, p 87.

5.2 More about the relationship between CNPC and PetroChina

As of 12 May 2009, CNPC owned 86.71 per cent of PetroChina's shares, making it the company's controlling owner. According to PetroChina: *"China National Petroleum Corporation (CNPC) is the sole sponsor and controlling shareholder of PetroChina. This ownership percentage enables CNPC to elect our entire board of directors without the concurrence of any of our other shareholders."* PetroChina adds that CNPC is accordingly in a position to *"control our policies, management and affairs."*³⁹

Based on the fact that CNPC is the formal controlling owner of PetroChina, and that PetroChina represents the decidedly main part of the CNPC company group's operations, the Council has in its assessment of the relationship between PetroChina and CNPC given particular consideration to the following governance aspects:

- The concurrence of identities between the members of the Board, the management and the administration at PetroChina and CNPC.
- The concurrence of identities and executive power through the Leading Party Members' Group at the CNPC company group.
- Common and coordinated activities through internal agreements within the CNPC company group.

The Council stresses that it is not uncommon for the management of a parent company to be represented in the board of its subsidiary. The existence of internal agreements within the business group regulating transactions between the parent company and its subsidiaries is not uncommon either. On the basis of a holistic approach, the Council nevertheless considers it relevant to include these aspects in its evaluation. This because the different elements together show that the two companies are unusually closely intertwined.

5.2.1 Concurrence of identities between members of the Board at PetroChina and CNPC

There are 14 members on the board of PetroChina, which consists of a chairman, a vice-chairman, PetroChina's CEO, six non-executive directors and five independent non-executive directors, see table 1.

³⁹ See footnote 38, p 13.

Table 1: PetroChina's Board and Supervisory Board as of February 2010.⁴⁰ Board members affiliated to CNPC are marked *⁴¹

Directors		
Chairman	Jiang Jiemin* ⁴²	
Vice Chairman	Zhou Jiping* ⁴³	
Executive Director	Liao Yongyuan* ⁴⁴	
Non-executive Directors	Wang Yilin* ⁴⁵	Zeng Yukang* ⁴⁶
	Wang Fucheng* ⁴⁷	Li Xinhua* ⁴⁸
	Wang Guoliang* ⁴⁹	Jiang Fan* ⁵⁰
Independent Non-executive Directors	Chee-Chen Tung	Liu Hongru
	Franco Bernabé	Li Yongwu
	Cui Junhui	
Secretary to the Board of Directors	Li Hualin	
Supervisors		
Chairman	Chen Ming* ⁵¹	
Supervisors	Wen Qingshan* ⁵²	Sun Xianfeng* ⁵³
	Yu Yibo* ⁵⁴	Wang Yawei
	Qin Gang	Wang Shali* ⁵⁵
Independent Supervisors	Li Yuan	Wang Daocheng

The Board was reorganised in 2007. Among other things the number of independent board members was increased from three to six, expanding the Board from 11 to 14 members.⁵⁶

The Council has examined the period from 1999 to 2010 (with the exception of 2003 and 2004). A review of the positions in both of these companies reveals a considerable concurrence between the top management at CNPC and the members of the Board at PetroChina during this time. The President of CNPC is normally the Chairman of the Board at PetroChina. CNPC's management also holds the vice-Chairmanship of the Board at PetroChina. Until 2007, all of the Vice Presidents at CNPC had positions in PetroChina's

⁴⁰ www.petrochina.com

⁴¹ Information about the CNPC affiliation is obtained from the *CNPC Annual Report 2008 and 2009*, available at www.cnpc.com, *PetroChina 20 F SEC Filings 2009*, and PetroChina's homepage www.petrochina.com

⁴² President of CNPC who also holds prominent positions in the Chinese Communist Party.

⁴³ Vice President of CNPC.

⁴⁴ Vice President of CNPC.

⁴⁵ Vice President of CNPC.

⁴⁶ Vice President of CNPC.

⁴⁷ Vice President of CNPC.

⁴⁸ Vice President of CNPC.

⁴⁹ Chief Financial Officer of CNPC.

⁵⁰ General Manager of Dalian Petrochemical Company, which is a CNPC subsidiary.

⁵¹ Chief of Discipline and Inspection Group at CNPC.

⁵² Deputy Chief Financial Officer and Director of the Finance and Assets Department at CNPC.

⁵³ Director of the Audit Department and the Audit Services Centre at CNPC.

⁵⁴ Director of Capital Operation Department at CNPC.

⁵⁵ Senior Deputy General Manager and the General Legal Counsel at CNPC Exploration and Development Company Limited, which is a CNPC subsidiary.

⁵⁶ www.petrochina.com

Board or management. After 2008, six of CNPC's eight Vice Presidents have been represented on PetroChina's Board, in addition to CNPC's Chief Financial Officer.⁵⁷

Chinese corporate law requires joint-stock companies to create a so-called "Supervisory Board". This committee is composed of nine members, four of which represent the shareholders and two are independent representatives chosen by the General Assembly, while three represent the company's staff. The Supervisory Board monitors financial matters and controls that the company's board and management do not abuse their power. PetroChina states that four of the representatives are related to CNPC, but this does not take into account that one of the representatives of the employees is also linked to CNPC (see below).⁵⁸ The Council's findings indicate that CNPC's "Chief of Discipline and Inspection Group" is usually also the leader of the Supervisory Board. Three of PetroChina's remaining Supervisors are also heads of their respective departments at CNPC, namely the Finance and Property Department, the Capital Operation Department and the Audit Department respect. The leader of the Finance and Property Department seems to always be a member of the Supervisory Board.

Ms Wang Shali is one of Petro China's three employee-representatives on the Supervisory Board.⁵⁹ At the same time and according to PetroChina's SEC filings, she is the "Senior Executive, Senior Deputy General Manager and the General Legal Counsel of CNPC Exploration and Development Company Limited."⁶⁰ It is unusual that employees will choose an employee at another company in a company group to represent their interests. This helps to reinforce the impression that there is no distinct difference between the companies.

The Council's study indicates that PetroChina's Board has been dominated by leaders at CNPC since its establishment. As mentioned previously, this is not uncommon in corporate relations, but it does show a strong degree of integration between the companies. In this case, however, the concurrence of identities on the board means that these persons who in principle shall protect the interests of all of PetroChina's shareholders, simultaneously are top-managers at CNPC. In other word, the same persons will make strategically important decisions both for PetroChina and CNPC's operations. The Council finds it noteworthy that also the Supervisory Board is dominated by persons holding leading positions at CNPC. The Supervisory Board is responsible for controlling PetroChina's board and management. The Council assumes that this duty may be influenced by the fact that these persons in practice shall control their own colleagues and superiors among CNPC's management.

5.2.2 The concurrence of identities between top-management at PetroChina and CNPC

Table 2 below shows the composition of PetroChina's top-management in 2010. The Council's review goes back to 1999 and shows that the CEO of PetroChina normally also is a Vice President of CNPC. Zhou Jiping holds these positions in 2010. An exception to this norm can be found in 2006 and 2007, when Jiang Jiemin was president of both CNPC and Petro China. Two other directors in PetroChina also have leading positions at CNPC or CNPC's subsidiaries. A further two directors have had leadership positions at the CNPC

⁵⁷ Based on CNPC's and PetroChina's Annual Reports, *Zhongguo Shiyou Tianranqi Jituan Gongsi Nianjian* (Annual Book of China National Petroleum Corporation) and the companies' home page..

⁵⁸ PetroChina's *20 F SEC Filings 2009*, p 76.

⁵⁹ PetroChina *Form 6K Filings* to the US Security and Exchange Commission (SEC), May 2008: "*The Board of Directors further announces that Mr Wang Yawei, Mr Qin Gang and Ms Wang Shali were elected by employees of the Company on 15 May 2008 as the employee representative Supervisors at the Fourth Session of the Supervisory Committee.*"

⁶⁰ PetroChina *20 F SEC Filings 2009*, p 83.

company group before taking over their present positions at PetroChina. There seems to be a consistent tendency for two or three directors at CNPC, besides the President of the group, to hold leading positions at PetroChina in the years investigated by the Council on Ethics.

The concurrence between the leadership of the two companies is striking, meaning that PetroChina's board (which mainly consist of the top-managers at CNPC) appoints the same persons to manage PetroChina who also manage CNPC. Also at this organisational level, the same persons will manage and make decisions in both companies.

*Table 2: Management of PetroChina in 2010.⁶¹ Individuals with executive positions in CNPC are marked**

President	Zhou Jiping ^{*62}	
Executive Director	Liao Yongyuan ^{*63}	
Vice Presidents	Sun Longde	Shen Diancheng
	Liu Hongbin ⁶⁴	Li Hualin
	Zhao Zhengzhang ⁶⁵	Sun Bo ^{*66}
	Bo Qiliang ^{*67}	
Chief Financial Officer	Zhou Mingchun	
Other Senior Management Members	Lin Aiguo	Wang Daofu
	Huang Weihe	

Within this overlap of individuals it is worth highlighting that two of the vice presidents in PetroChina are concurrently senior managers in other subsidiaries of CNPC. Both are managers of companies with important international relations. Sun Bo is the General Manager of Trans-Asia Gas Pipeline Company, and Bo Qiliang is the General Manager of China National Oil and Gas Exploration Corporation, which is the subsidiary of CNPC that is responsible for CNPC's overseas investments. This even appears to bring the control of CNPC's international investments under PetroChina's leadership.

5.2.3 Concurrence of identities between management of departments at PetroChina and CNPC

The interwoven relationship between the companies is even clearer further down the administrative ladder. Both companies' administrations and number of departments have increased over time, from PetroChina's 10 departments and CNPC's 14 in 1999, to the current level of 19 and 21 respectively (see table 3). It looks as though there was an administrative separation between the companies until 2005. It was then that five of the same sections in both companies first were placed under concurring leaderships, a number that was to rise to

⁶¹ www.Petrochina.com

⁶² President of PetroChina and Vice President i CNPC.

⁶³ Executive Director of PetroChina og the Deputy General Manager and Safety Director of CNPC

⁶⁴ Director for CNPC Planning Department 2005-2007, Vice President of PetroChina 2007.

⁶⁵ Different management positions at CNPC 1996-2008. Senior Executive and Deputy General Manager of CNPC Exploration and Production Company 2006-2008.

⁶⁶ Vice President of PetroChina and the General Manager of Trans-Asia Gas Pipeline Company Limited, which is a CNPC subsidiary, see also http://google.brand.edgar-online.com/EFX_dll/EDGARpro.dll?FetchFilingHTML1?ID=5620618&SessionID=jV_wHC33MvPqol7

⁶⁷ In addition General Manager of CNPCs subsidiary China National Oil and Gas Exploration and Development Corporation which is responsible for CNPCs overseas operations. http://www.afdevinfo.com/htmlreports/org/org_69597.html

15 two years later. The weaving together of the two companies has in other words been reinforced over time, particularly the last 2-3 years.

Table 3: Overlap in administration of CNPC and PetroChina, 1999-2008

Overlapping administration	1999	2000	2001	2004	2005	2006	2007	2008
Number of PetroChina departments	10	12	13	14	17	17	19	19
Number of CNPC departments	14	16	15	14	17	20	21	21
Number of PetroChina departments with overlapping management with CNPC	0	0	0	0	5	5	15	15

The organisation in the two companies and the concurrence of the administrative leadership can be found in table 4.

The departments which overlap have important functions within the companies. PetroChina's Planning Department, for example, is to the Council's knowledge responsible for developing the company's investment plans. The Council assumes that this includes plans for acquisitions and other new investments, in other words what the company's capital is to be used for. The Human Resource department is, among other things, responsible for the company's recruitment and staffing. The Legal Department takes part in the negotiation of contracts for important projects and is responsible for the legal implications of important economic activities such as joint ventures, fusions and the transfer of assets in which the company may embark both nationally and abroad.⁶⁸ All of these functions are strategically important. That the leadership of these departments and functions is shared between the companies implies that the operational running of both companies is integrated with each other, and that decisions can be executed as if the company was one unit. In the Council's view, the concurrence of identities at the administrative level is strongly indicative that CNPC and PetroChina in practice have a shared management.

⁶⁸ PetroChina 1999: Functions of Departments and Scopes of Responsibilities of Specific Companies within PetroChina (1999), (Released as Shiyourenzi [1999] (No.7) on 10 December 1999 by PetroChina).

Table 4: Heads of Departments in PetroChina and CNPC (2008). Departments with concurrence in leadership are in italics⁶⁹

PetroChina: 19 departments		CNPC: 21 departments	
President's Office	Li Huamin	General Office Administration	Li Runsheng
<i>Planning Department</i>	<i>Wu Mei</i>	Policy Research Department	CaoZhengyan
Finance Department	Zhou Mingcun	<i>Planning Department</i>	<i>Wu Mei</i>
<i>Human Resources Department</i>	<i>WangYongchun</i>	Finance & Property Department	Wen Qingshan
<i>Budget Management Department</i>	<i>Jia Yimin</i>	<i>Human Resources Department</i>	<i>WangYongchun</i>
<i>Capital Operation Department</i>	<i>Yu Yibo</i>	<i>Budget Management Department</i>	<i>Jia Yimin</i>
<i>Legal Affairs Department</i>	<i>Guo Jingping</i>	<i>Capital Operation Department</i>	<i>Yu Yibo</i>
<i>Safety & Environmental Protection Department</i>	<i>He Rongfang</i>	<i>Legal Affairs Department</i>	<i>Guo Jingping</i>
<i>Quality Control & Energy Efficiency Department</i>	<i>Yu Hongjin</i>	<i>Safety & Environmental Protection Department</i>	<i>He Rongfang</i>
<i>Science Technology Management Department</i>	<i>Yuan Shiyi</i>	<i>Quality Control & Energy Efficiency Department</i>	<i>Yu Hongjin</i>
<i>Information Management Department</i>	<i>Liu Xijian</i>	<i>Science Technology Management Department</i>	<i>Yuan Shiyi</i>
<i>Purchase Management Department</i>	<i>Li Bin</i>	Engineer Technology & Market Department	Yang Qingli
<i>Foreign Affairs Department</i>	<i>Zhang Xin</i>	<i>Information Management Department</i>	<i>Liu Xijian</i>
<i>Supervision Department</i>	<i>Liu Xiaoli</i>	<i>Purchase Management Department</i>	<i>Li Bin</i>
<i>Audit Department</i>	<i>Sun Xianfeng</i>	<i>Foreign Affairs Department</i>	<i>Zhang Xin</i>
<i>Internal Control Department</i>	<i>Xie Geguo</i>	<i>Supervision Department</i>	<i>Liu Xiaoli</i>
<i>Enterprise Culture Department</i>	<i>Guan Xiaohong</i>	<i>Audit Department</i>	<i>Sun Xianfeng</i>
Secretary Bureau of Board of Directors	Li Huiqi	<i>Internal Control Department</i>	<i>Xie Geguo</i>
Board of Supervisors' Office	Zhang Jinzhu	<i>Enterprise Culture Department</i>	<i>Guan Xiaohong</i>
		Secretary Bureau of Board of Directors	Li Huiqi
		Board of Supervisors' Office	Zhang Jinzhu
		Retired Staffs Bureau	Fan Shengli

⁶⁹ As of 2008. The Department structure does not appeared to have been changed, and corresponds to information in CNPC's Annual Report 2009. Based on *CNPC Annual Report 2008 PetroChina Annual Report 2008*, *Zhongguo Shiyou Tianranqi Jituan Gongsi Nianjian* (Annual Book of China National Petroleum Corporation) 2008, CNPC's home page <http://www.cnpc.com.cn> and PetroChina's home page <http://www.petrochina.com.cn>

5.2.4 Concurrence of identities and of executive power through the Leading Party Members' Group at the CNPC company group

The so-called leading Party members' group plays an important role in the appointment of leaders at the CNPC company group.

According to Article 46 of the Chinese Communist Party Constitution, a leading Party members' group can be established at the management level of organisations that are not associated with the Party, such as companies: *“The leading Party members' group may be formed in the leading body of a central or local state organ, people's organization, economic or cultural institution or other non-Party unit. The group plays the role of the core of leadership.”*

The main tasks of the Leading Party Members' Group is to guarantee the implementation of the Party's principles and policies, to discuss and decide on matters of major importance in its unit, to manage affairs concerning *cadres*, and *“to unite with the non-Party cadres and the masses in fulfilling the tasks assigned by the Party and the state and to guide the work of the Party organization of the unit and those directly under it.”*⁷⁰

The composition of the Leading Party Members' Group is decided by the Party organisation that endorses the formation of the group, and the group must also accept the leadership of the Party organisation that endorses the formation of the group.⁷¹

To the Council's knowledge, the composition of the Leading Party Members' Group in state-owned companies, such as CNPC, is decided by the so-called *Organisation Department of the Communist Party* in cooperation with CNPC's owner, the *State-Owned Assets Supervision & Administration Commission (SASAC)*.⁷² These two bodies decide on the appointment of the president and vice presidents of CNPC. The Council has been informed that individuals that are selected for the Leading Party Members' Group are first granted a position in the party before receiving a management position in a state-owned enterprise.

The Leading Party Members' Group is responsible for deciding appointments of executives below vice president level within the company. According to the Council's findings, all the vice presidents of CNPC – and therefore also the majority of PetroChina's board – are members of the Leading Party Members' Group. Furthermore the CNPC president is always the Chair of the Leading Party Members' group. The Leading Party Members' Group, under the leadership of Jiang Jemin, is responsible for the appointment of leaders both at CNPC and PetroChina. The fact that 15 of PetroChina and CNPC's departments have common management, suggests that CNPC and the Leading Party Members' Group select managers based on an overall assessment of the needs in both companies.

5.2.5 Common and coordinated activities through internal agreements within the CNPC company group

According to PetroChina's yearly filings to the US Security and Exchange Commission, transactions and transfers of assets between CNPC and PetroChina are common. PetroChina states that the company enters into extensive transactions with CNPC and other members of the CNPC company group, and that CNPC is the company's primary provider of a wide range of services and products.⁷³ In 2009 Petro China states that it spent around 32 billion RMB

⁷⁰ <http://www.learnworld.com/COURSES/PI41/CCP-Constitution-Nov-2002.html>

⁷¹ Constitution of the Communist Party of China, Article 47 and 48, http://news.xinhuanet.com/english/2007-10/25/content_6944738.htm

⁷² See also section 5.1.

⁷³ PetroChina 20 F SEC Filings 2009 s. 88.

(about 5 billion USD) on acquiring assets from CNPC, including the Turkmenistan natural gas project (RMB 8.1 billion/1.3 billion USD) and the acquisition of ten refineries within China (RMB 11 billion/ 1.7 billion USD).⁷⁴

At the time of PetroChina's initial public offering, CNPC and PetroChina signed a non-competition agreement. It is reported that the acquisitions from CNPC are carried out under this agreement.⁷⁵ In 2000, shortly after the IPO, the two companies also agreed to a "Comprehensive Products and Services Agreement, a Land Use Rights Leasing Contract, a Building Leasing Contract", and several other agreements involving the cross-provision of goods and services.⁷⁶

In this regard it is also relevant to mention that only CNPC has the right to enter into production-sharing contracts directly with foreign oil and gas companies for onshore crude oil and natural gas exploration and production.⁷⁷ PetroChina does not have this capacity but reports that: "*Accordingly, CNPC will continue to enter into production sharing contracts. After signing a production sharing contract, CNPC will, subject to approval of the Ministry of Commerce, assign to PetroChina most of its commercial and operational rights and obligations under the production sharing contract as required by the Non-competition Agreement between CNPC and PetroChina.*"⁷⁸ CNPC has previously transferred such contracts to PetroChina, for instance in Kazakhstan and Turkmenistan.⁷⁹ According to a statement in 2005 by the then CFO of PetroChina Wang Guoliang (who has been CFO of CNPC since 2007), PetroChina will also have the pre-emptive right to acquire CNPC's assets in Sudan.⁸⁰

In its Annual Report for 2009, however, PetroChina informs: "*As the laws of the country where ADS⁸¹ are listed prohibit its citizens from directly or indirectly financing or investing in the oil and gas projects in certain countries, CNPC did not inject the overseas oil and gas projects in certain countries to the company*".⁸² American authorities have implemented sanctions against a number of countries, including Burma and Sudan. With regard to Sudan, American citizens are not allowed to be involved in transactions or activities related to the petroleum industry in the country without special permission from the Office of Foreign Assets Control.⁸³ Concerning Burma, U.S. citizens are prohibited from purchasing shares in a third-country company if the company's profits are predominantly derived from its economic

⁷⁴ PetroChina Company Ltd: *Results Announcement for the year ended December 31, 2009 (Summary of the 2009 Annual Report)*, s. 38.

⁷⁵ <http://investorsagainstgenocide.net/2009-0803%20Robert%20Hormats%20letter.pdf>

⁷⁶ See 20F SEC filings 2009, p 89 and PetroChina Annual Report 2009, p 157. According to PetroChina b *The Comprehensive Products and Services Agreement* was amended in August 2008, but it is not clear what this involves.

⁷⁷ As authorised by the Regulations of the PRC on "Exploration of Onshore Petroleum Resources in Cooperation with Foreign Enterprises".

⁷⁸ PetroChina 20 F SEC Filings 2009, p 51.

⁷⁹ PetroChina Form 6 K SEC Filings to the SEC 31 August 2009: *Announcement dated August 28, 2009 relating to the connected transaction about the acquisition of rights under Product Sharing Contract*, <http://www.sec.gov/Archives/edgar/data/1108329/000095012309039565/h03613e6vk.htm>

⁸⁰ <http://www.sudantribune.com/spip.php?article10071>

⁸¹ ADS means American Depositary Shares, which is "a U.S. dollar-denominated equity share of a foreign-based company available for purchase on an American stock exchange. ADSs are issued by depository banks in the U.S. under agreement with the issuing foreign company; the entire issuance is called an American Depositary Receipt (ADR) and the individual shares are referred to as ADS," <http://www.investopedia.com/terms/a/ads.asp>

⁸² PetroChina Company Ltd: *Results Announcement for the year ended December 31, 2009 (Summary of the 2009 Annual Report)*, p 39.

⁸³ <http://www.treasury.gov/resource-center/sanctions/Programs/Pages/sudan.aspx>

development of resources located in Burma.⁸⁴ Apparently, these requirements may have prevented CNPC from transferring the operations in Sudan and Burma to PetroChina.

6 PetroChina's position

In accordance with the ethical guidelines, the Council sent a letter to PetroChina through Norges Bank on 20 November 2007 requesting information about the company's role in the planned gas pipeline from the Shwe field on the west coast of Burma. It had been reported in the press that PetroChina had signed a Memorandum of Understanding (MoU) with MOGE on the sale of gas from the Shwe field. The Council requested information on whether the agreement included the construction of the pipeline, as well as PetroChina's role and responsibilities in the pipeline project.

In its response to the Council, dated 12 December 2007, PetroChina states that the company *"does not have any direct business contacts with, ties to, or associations with Burma; it has no exploration, production or operations in Burma; nor does it maintain any joint ventures, offices or employees, sell any products or provide any services in Burma."* Furthermore the company informs that the agreement with MOGE was entered into by CNPC, *"the controlling shareholder of PetroChina. PetroChina and CNPC are two separate entities and PetroChina has no control over CNPC's business activities."*⁸⁵

On 26 March 2010, the Council sent a draft recommendation to PetroChina in order to give the company the possibility of providing comments to the Council's findings and assessments. The company was asked to provide a response by 15 April. The company has since been contacted on two occasions, responding in a message dated 27 April that it wished to respond to the Council's letter. The company was requested to respond by 10 May. As of 26 May 2010, PetroChina has yet to respond to the Council's request.

PetroChina treats its relation to CNPC on its website, where it reports that CNPC exercises its rights and interests as the controlling owner in accordance with the law. The website states further that *"CNPC is independent from the Company in all aspects, including personnel deployment, assets, finance, organisation and business operations. At the time of listing of the Company, the Company and CNPC had entered into a Non-competition Agreement which ensures that CNPC will not engage either directly or indirectly in any business that is or may be in competition with any core business of the Company. The Board of Directors, the Supervisory Committee and the management team headed by the President of the Company also work independently."*⁸⁶

7 The Council's assessment

The Council assumes that the construction of onshore oil and gas pipelines in Burma will entail severe and systematic human rights violations, including forced labour and extensive abuses against the civilian population. 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 to facilitate the company's future operations. 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*

⁸⁴ <http://www.treasury.gov/resource-center/sanctions/Programs/pages/burma.aspx>

⁸⁵ PetroChina letter to NBIM/Council on Ethics of 12 December 2007.

⁸⁶ http://www.petrochina.com.cn/Ptr/Investor_Relations/Corporate_Governance_Structure/gszljg_6.htm

*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”*⁸⁷

The Chinese state-owned company CNPC has entered into an agreement with the Burmese government to build two pipelines to transport oil and gas from the west coast of Burma to China. CNPC has made clear that the agreement on the oil pipeline gives CNPC exclusive rights to, and ownership of, the pipeline, while the Burmese government shall guarantee the safety of the pipeline. It is this safety guarantee which makes serious human rights violations probable. The Council therefore concludes that there is an unacceptable risk that CNPC will be involved in serious or systematic human rights violations associated with the construction of the pipeline.

The particular problem which must be assessed in this case is the fact that the Fund is not invested in CNPC, but in CNPC's subsidiary PetroChina. The Council has so far worked under the premise that the exclusion of companies for activities that are contrary to the ethical guidelines can only take place when the company in which the Fund owns equity, itself or through its ownership or through controlling positions, is involved in the unethical activity. Consequently, a parent company may be excluded as a result of a subsidiary's involvement in unethical actions, but normally a subsidiary cannot be excluded because of its parent company's actions.

On the other hand, the preparatory work for the ethical guidelines emphasises that the company's legal structure cannot be decisive in the assessment of complicity, for example in cases where the links between the company in the Fund's portfolio and a company which is involved in the unethical actions in question are so close that the two can be identified with each other.⁸⁸

The Council has assessed whether the relationship between the CNPC group company and its subsidiary PetroChina is so interwoven that the companies *de facto* cannot be separated from each other, and accordingly that the companies must be perceived as one unit when it comes to questions of human rights violations. If so the subsidiary will also be complicit in the company group's actions.

The starting point for this specific analysis is the fact that CNPC owns 86.71 per cent of PetroChina's share capital, while at the same time, the group company's main operations are carried out by PetroChina, and the parent company's primary function is to support the operations of its subsidiary. This is evident from the companies' accounting figures, the transactions between the companies and PetroChina's filings to the SEC.

Furthermore, the Council has emphasised the following circumstances: Formally, the companies are separated and both companies have large operations and many employees. In relation to the management of the companies, however, there are three special features. First, CNPC's entire senior management is composed of individuals who constitute the majority of PetroChina's Board. Second, four members of PetroChina's top management concurrently have senior management positions in CNPC. Third, 15 out of a total of 19 departments in PetroChina's administration are headed by individuals with identical positions in the parent company. In other words, these persons head the same departments in both companies. The

⁸⁷ The Council on Ethics letter to the Ministry of Finance regarding the Council's assessment of companies with operations in Burma, 11 October 2007.

⁸⁸ See footnote 4 and *Forvaltning for fremtiden*, NOU 2003:22, p 35-36.

overlapping departments are responsible for important functions within the company, which means that investments, acquisitions, contract negotiations and staffing decisions *inter alia* can be decided and implemented as if the companies were a single unit. In the Council's view, this demonstrates a very particular construction in the governance of the companies. Especially extraordinary is the fact that the mid-level management performs simultaneous roles for both companies. This means that the same people lead and make decisions in both PetroChina and CNPC.

This joint governance is further reinforced by the fact that executives in both companies are appointed by structures outside the corporate structure – through the Communist Party's organisation and through the mutual, so-called Leading Party Members' Group of the CNPC company group. The entire CNPC top-management, and consequently also the majority of PetroChina's Board, are members of the leading Party members' group. This clearly demonstrates not only the Chinese communist Party's influence on important strategic decisions in PetroChina, but also that executives at all levels may be selected on the basis of an overall assessment of the needs in both companies. In the Council's view, this supports the impression that the companies are managed jointly.

Based on the Council's research, there appears to be a considerable coordination of operations within PetroChina and CNPC, including the transfer of assets from CNPC to PetroChina. The Council finds it noteworthy that only CNPC may enter into production-sharing agreements with foreign states. CNPC can, however, transfer these agreements to PetroChina after some time. This may be particularly advantageous to PetroChina, which as a listed company is required to be more transparent and is more exposed to investor pressure than its parent company. Consequently, CNPC can negotiate state-to-state deals, like those with Sudan and Burma, and after some time transfer these deals to PetroChina, as has been the case in Kazakhstan and Turkmenistan. In the Council's opinion PetroChina and CNPC appear as two parts of the same organisation, which can perform different roles depending on what is appropriate for the company.

On the basis of an overall assessment of the aforementioned conditions, the Council finds that the administration of PetroChina and CNPC is so unified, and the activities of PetroChina are of such importance to the company group as a whole, that, insofar as §2.3 of the ethical guidelines is concerned, CNPC's activities in Burma should be considered directed by PetroChina's management. As concerns the question of risk of complicity in human rights violation, the companies must be perceived as one single unit and, in this context, that CNPC's activities in Burma cannot be separated from its subsidiary's operations.

The Council finds that there is an unacceptable risk of PetroChina being involved in severe or systematic human rights violations associated with the construction of gas and oil pipelines in Burma.

8 Recommendation

The Council on Ethics recommends the exclusion of PetroChina from the investment universe of the Norwegian Government Pension Fund Global due to an unacceptable risk of the company being complicit in severe or systematic human rights violations associated with the construction of oil and gas pipelines in Burma by its parent company, CNPC.