

To The Ministry of Finance

Recommendation of 15 February 2006

(Unofficial English translation)

1 Introduction

At a meeting held on 4 October 2005, the Council on Ethics for the *Norwegian Government Pension Fund - Global* decided to assess whether the investments in Freeport McMoRan Copper & Gold Inc.¹ may constitute a risk of the Fund contributing to severe environmental damage under the Guidelines, Point 4.4.

As of 31 December 2005 the Government Petroleum Fund, currently the *Norwegian Government Pension Fund – Global*, held shares worth NOK 116.3 million in the aforementioned company, the equivalent to an ownership interest of 0.174 per cent.

This is the Council's first recommendation on exclusion of a company on the grounds of contribution to severe environmental damage. In Chapter 2 of this recommendation, the Council interprets this concept, outlining the factors that will decide whether there is an unacceptable risk that the Fund may contribute to severe environmental damage.

In connection with its mining operations in Indonesia, Freeport has been accused of causing extensive damage to the natural environment. Freeport owns and operates one of the world's biggest copper mines in Papua, Indonesia, where it uses a natural river system for tailings disposal. Acid rock drainage from the company's overburden and waste rock dumps has also been reported. There is ample documentation that the company's activities have caused considerable and lasting damage to the riverine ecosystem, and that the company has taken very few steps to prevent or reduce such damage. These factors are described in further detail in Chapter 3.

In accordance with the Guidelines, Point 4.5, the Council contacted Freeport through Norges Bank, requesting the company to comment on the abovementioned accusations.. Norges Bank received a reply from the company on 20 January 2006. Freeport argues that the Council's presentation of its operations is inaccurate and based on outdated information and tendentious reports from anti-mining or politically motivated organisations. Freeport denies the allegations, but has not provided data or scientific evidence to support its claims that the mining does not cause severe and long-term environmental damage.

In order to establish whether there is a risk of complicity in severe environmental damage, a direct connection between the company's operations and the violations must be found. The

¹ In this paper also referred to as Freeport.

Council assumes that the damage must be significant, emphasizing whether it leads to irreversible or lasting effects and whether it has a negative impact on human life and health. Furthermore, the extent to which the company's actions or neglect have caused the environmental damage must also be assessed, including whether the damage is a result of violations of national laws and international standards, and whether the company has failed to take adequate action in order to prevent or amend the damage. The likelihood of the company continuing its unacceptable practice in the future should also be taken into account. In the present case the Council considers that all these conditions have been met.

The Council concludes that the Ethical Guidelines, Point 4.4, second paragraph, third bullet point provide a basis for determining that the Fund is currently contributing to severe environmental damage through its ownership in Freeport McMoRan Copper & Gold Inc., and does recommend exclusion of the company.

2 The Council's considerations

The Council shall assess whether the *Government Pension Fund – Global* can be said to contribute to unethical actions through its ownership interests in Freeport McMoRan Copper & Gold Inc.

2.1 The Council's mandate regarding severe environmental damage

The Ethical Guidelines, Point 4.4, second clause, third alternative, states: "*The Council shall issue recommendations on the exclusion of one or several companies from the investment universe because of acts or omissions that constitute an unacceptable risk of the Fund contributing to: Severe environmental damage.*"

The Council will consider the question of exclusion of Freeport according to this rule.

The remaining alternatives listed in Point 4.4 concerning serious violations of individuals' rights in situations of war and conflict; serious or systematic human rights violations; gross corruption; or violations of other ethical norms may also be considered relevant in light of the serious allegations that have been raised against the company. The Council will briefly describe these accusations, but has chosen not to evaluate them with reference to breaches of the Ethical Guidelines as it deems that the company's contribution to severe environmental damage is sufficient to recommend exclusion.

2.2 On complicity and unacceptable risk

The Ethical Guidelines are based on the presumption that investors can be complicit in violations of ethical norms. Point 4.4 thus infers that the Fund may contribute to unethical acts through its ownership of shares in companies responsible for unethical acts or neglect.

Moreover, the company's acts or omissions must constitute an *unacceptable risk* of the Fund contributing to severe environmental damage (Point 4.4). The preparatory work preceding the Guidelines does not explicitly define the term 'unacceptable risk', but states that: "*Criteria should be established for determining the existence of unacceptable risk. These criteria can be based on the international instruments that also apply to the Fund's exercise of ownership interests. Only the most serious forms of violations of these standards should provide a basis for exclusion.*"² Hence, the unacceptability of the risk is linked to the seriousness of the act and how severe the environmental damage is.

The term 'risk' is associated with the probability of unethical actions occurring in the future. The basis for withdrawal is that the Fund must avoid placing itself in a position where it may contribute to an ethically unacceptable practice. The wording of Point 4.4 makes it clear that the likelihood of contributing to present and future acts or omissions is the issue in question; hence, the Council assumes that actions or omissions which have taken place in the past will not normally provide a basis for exclusion under this provision. However, previous patterns of behaviour may give some indications as to what will happen in the future, and certain violations of ethical norms which have been initiated in the past could also be regarded as ongoing violations. This is particularly pertinent with regard to certain types of environmental damage where the result of previous acts or omissions continue to inflict serious harm on humans and the natural environment.

2.3 On severe environmental damage

The preparatory work³ does not present a clear definition of the term 'severe environmental damage', indicating that it is not possible to determine with precision what the term encompasses, and that this must be assessed in each case: "*The Committee finds it reasonable that the exclusion mechanism is considered with regard to acts that cause considerable damage to the natural environment through pollution of air, water and soil; storage and disposal of waste; or interventions which have severe irreversible effects on the natural environment, for example in relation to biodiversity, protected areas or human health*".

Environmental damage can be defined as a measurable adverse change in a natural resource or in the environment caused directly or indirectly by external agents. According to the preparatory work, this change must be considerable, and the damage must be directly linked to the company's acts or omissions. Consequently, the assessment of severe environmental damage must include the damage per se as well as the company's acts or omissions that have caused it.

2.3.1 Extent of damage

In assessing the extent of the damage, the following must be emphasized:

- the kind of environmental impact in question;
- the kind of damage caused by such impact; and
- the consequences of the environmental damage on the natural area's present and future qualities and on human living conditions.

² NOU 2003: 22, p. 35.

³ Governmental White Paper on Ethical Guidelines, NOU 2003:22, p. 167.

Environmental impact

The preparatory work contains only limited considerations regarding the kind of environmental damage which qualifies for exclusion, but refers to various factors that may cause damage, such as air, water and soil pollution; waste disposal; and interventions in protected areas.

The Council accepts as a fact that pollution may include pollution associated with both the company's production and its products. The Council also regards waste management as a potential pollution problem, depending on how waste is handled, transported and treated.

Human intervention in natural areas can cause substantial environmental damage. According to NOU 2003:22, intervention in protected areas is a kind of environmental impact that can provide a basis for exclusion. To what extent intervention in protected areas constitutes severe environmental damage may, however, be difficult to assess, particularly if national authorities have revoked or given dispensation from the protection status of the area. Given that the Guidelines only recommend exclusion in cases of severe environmental damage, it is the Council's opinion that intervention in protected areas should not automatically qualify for exclusion, but be evaluated on a case-by-case basis.

A number of international conventions (with additional protocols) aim at protecting the natural environment or at limiting pollution and the dispersion of environmentally hazardous substances and waste from industrial production.⁴ Such conventions reflect a global consensus regarding which environmental values should be protected and which pollutants should be limited or phased out due to their grave environmental or health impact. Even though the conventions are aimed at States, it is the Council's opinion that they provide a sound basis for deciding what kind of environmental impact related to companies' activities should be taken into account.

The Council's point of departure is that all types of pollution, intervention or exploitation of natural resources associated with individual companies' operations have the potential to cause severe environmental damage. The impact may occur continuously over time or through accidents. The Council sees the environmental effects mentioned in the NOU 2003: 22 as examples and not as an exhaustive list.

Environmental damage

The environmental damage caused by emissions or interventions will depend on the kind and the extent of the impact or the intervention, as well as the receiving environment's vulnerability and

⁴ The Convention on Biological Diversity (5 June 1992); the World Heritage Convention (16 November 1972); the Convention on Long-Range, Transboundary Air Pollution (13 November 1979); the Vienna Convention for the Protection of the Ozone Layer (22 March 1985); the Stockholm Convention on Persistent Organic Pollutants (23 May 2001); the Basel Convention on Control of Transboundary Movements of Hazardous Wastes and their Disposal (22 March 1989); and others.

resilience.⁵ The harmful effects referred to in the preparatory work include damage caused by air, water and soil pollution, as well as severe irreversible impact on the natural environment, which for example afflicts human health and biodiversity.

Irreversible effects include the loss of species and natural areas (biodiversity), climate change, high concentrations of environmentally hazardous substances⁶ and radioactive substances. Irreversible changes are serious due to their lasting consequences. The Council finds, however, that also other types of environmental damage can be regarded as severe, even though they are not necessarily irreversible in the strict sense of the word. Certain kinds of environmental damage resulting from extensive and prolonged contamination of water or soil may be gradually recovered if the pollution flow ceases. Nevertheless, the damage will generally persist over a long period of time, and a clean-up will require vast resources. Depending on the consequences, the Council is of the opinion that such damage may also be considered for exclusion.

Many pollutants released from manufacturing processes or product use have been proven harmful to human health. According to the NOU 2003: 22, serious damage to human health may provide grounds for exclusion. However, it is often difficult to *prove* that pollution from a particular company is harmful to public health. In such cases, the Council is of the opinion that it may be sufficient to establish such a correlation with a *high degree of probability*; however, an evaluation needs to be made on a case-by-case basis.

2.3.1.1 Consequences of environmental damage

The severity of environmental damage may be assessed in different ways, depending on the affected area's present or future functions, and whether economic, ecological, social or other values are given primary importance. Interventions in natural areas may often lead to the loss of ecological heritage for present and future generations. The question is whether this might be acceptable if the profits or social gains the intervention yields outweigh the benefits of preserving the area. Such gains must be measured against the actual loss of ecological value, taking into account whether endangered species or their habitats are adversely affected, whether the area contains unique values in terms of biodiversity, or whether it fulfils important ecological functions (water balance, protection against erosion, etc).

This assessment cannot be made on a general basis. However, the Council will emphasise that in order to regard loss of ecological value as severe environmental damage, the damage must be extensive, there must be degradation of special natural heritage features, or the damage must be

⁵ Vulnerability can be defined as an ecosystem's susceptibility to degradation or damage from adverse factors or influences. Resilience is an expression for the ability for an ecosystem to rebound from a disturbance.

⁶ Environmentally hazardous substances are characterised by the fact that they can cause damage even in small concentrations, due to their toxicity, their low degradability and/or accumulative potential in living organisms (bioaccumulation). The toxicity can be acute or cause long-term effects such as cancer, reproductive or genetic damage. Both heavy metals such as lead, cadmium and mercury, and organic substances such as PCB, DDT and dioxins are considered environmental toxins. It is not possible to determine safe levels for these substances in nature. Furthermore, environmental hazardous substances can be spread over long distances, even to other parts of the planet, where they may cause considerable damage to the environment and human health. See examples at Environmental Status in Norway, http://www.environment.no/templates/themepage_2153.aspx#B.