



JUNE
2013

Controversial companies



DO INVESTOR
BLACKLISTS
MAKE A
DIFFERENCE?

novethic RESEARCH



EXECUTIVE SUMMARY

Norm-based exclusion is rapidly gaining ground in northern Europe. This responsible investment approach, which consists in excluding companies guilty of serious and repeated breaches of major international agreements, is being applied to growing volumes of assets. Between 2009 and 2011, the use of norm-based exclusions increased by 54% in Europe, covering more than €2,340 billion-worth of assets. In France, assets totalling €136 billion were subject to this type of filter in 2010; by the end of 2012, the figure had risen almost ten-fold to €1.3 trillion.

Novethic's first piece of research into norm-based exclusion^[1] pointed to various international investment practices and showed how **blacklists of controversial companies were gradually being drawn up**. While these lists rarely overlap, they include some of the world's largest and highest-profile companies. Novethic's research centre has therefore attempted to **measure the impact of norm-based exclusion on companies' controversial practices in the specific area of human rights violations**.

By analysing lists provided by some 20 northern European investors managing a total of €1.5 trillion, we were able to identify the **different types of reasons for exclusion on the grounds of human rights violations**. These violations have been grouped into three categories: **breaches of employment law, failure to respect the rights of indigenous peoples**, and activities undertaken in regions where **abuses are committed by public authorities and companies accused of complicity**. In each case, **the grounds for exclusion cited by investors are often different**. In Burma, explanations provided by investors who exclude the same companies involved in building oil and gas pipelines range from a simple reference to the country's regime to specific information about controversies involving those companies.

To better understand how responsible investors define controversial companies, we have analysed six of them:

- **Walmart** for working conditions at its subcontractors and a lack of freedom of association
- **Yahoo!** for violations of freedom of expression in China
- **Chevron**, massively fined for polluting the Amazon in Ecuador
- **PetroChina**, accused of being complicit in abuses of power in Burma and Sudan
- **Vedanta** for failing to respect the rights of indigenous peoples
- **Shell** for the situation in the Niger Delta.

Controversial companies come under pressure from various sources, including the courts, NGOs, local populations and the media. **It is hard to precisely identify cases in which investors alone have played a part in corrective action**. However, Novethic's research shows that, **while norm-based exclusion**

^[1] "Norm-based exclusions: how responsible investors handle controversial companies", January 2012, www.novethic.com, in the section "The SRI and CSR Reports"

cannot change things on its own, it gives substance to the concept of risk from environmental, social and corporate governance (ESG) factors. By unambiguously condemning economic models that lead to human rights violations, shareholders show their conviction that such violations ultimately carry too high a cost for the companies themselves. They thus protect their own reputation while challenging those economic models.

If supported by public opinion and the media, investor criticism can push the boundaries. **Investors need to coordinate their efforts in order to give their movement greater momentum.** If they work together and adopt common definitions of the human rights they wish to defend, substantive progress will be made.

At present, appeals to the investment community by non-governmental organisations (NGOs) such as Amnesty International over the Niger Delta have failed to trigger joint action by Shell's shareholders. However, **more and more companies are being discreetly sidelined because of excessive social risks, including in France**, where investors have generally been hostile to such an approach.

There is a correlation between the development of norm-based exclusion and the idea that **shareholders are indirectly responsible for corporate criminal conduct.** One example is the Norwegian sovereign wealth fund, which came under fire from NGOs at the end of 2012 for indirectly breaching OECD guidelines in its capacity as a shareholder in a company accused of human rights violations in India.

Whatever the outcome of that particular battle – which the Norwegian fund is taking very seriously – it marks the beginning of a new stage for norm-based exclusion. **In future, the focus will undoubtedly shift away from pinning down existing controversies to identifying emerging ones so that responsible investors can avoid being accused of complicity.**



BLACKLISTED: WALMART

Key figures

- **2.2 million employees** in 2012 (no. 1 US employer)
- Present in **27 countries**
- Revenue: over **\$469 billion** in 2012, **ranked third worldwide**
- Listed **on the New York stock exchange**

The issues

While Walmart is a symbol of economic and market success, it is also seen as a risky stock by a number of responsible investors. That paradox is the result of a series of lawsuits on gender-based and trade-union discrimination issues and the regular tabling of resolutions concerning poor labour conditions, which are taking a toll on the company's reputation – and its value. As many as 8% of Walmart customers have stopped shopping at the chain owing to its poor reputation, and litigation has already cost the brand over one billion dollars.

To ward off the many-fronted attack, Walmart adapts its strategy to the subject in hand. It has taken corrective measures on diversity and the respect of human rights in the subcontracting chain, and addresses these issues in its external communication. Regarding anti-union practices and working conditions in the United States, Walmart denies the charges made against it and counter-attacks with public relations and communication campaigns aimed at improving its image.

The controversy

Walmart has been attacked many times for labour rights violations, both in-house and in the subcontracting chain, including anti-union practices, very low salaries and unpaid overtime, sexual and racial discrimination, child labour and poor working conditions at suppliers. Criticisms and litigation targeting the company have increased since the mid-2000s.

Working conditions and human rights in the subcontracting chain

Lawsuits against Walmart began in the mid-1990s, initially concerning working conditions in the company's subcontracting chain. The controversy gained momentum in 2001 with the publication of an article in *Business Week*. Based on a three-month investigation at a Chinese subcontractor, the story revealed that workers were paid a pittance, had their papers confiscated and were sometimes beaten by factory managers. In late 2005, International Labor Rights Forum, an NGO, filed a suit against Walmart in the name of the workers employed by its suppliers in China, Bangladesh, Indonesia, Nicaragua and Swaziland for the company's inability to enforce its code of conduct. Walmart's ethical supply policy was called into question once again in 2012 following a fire at the Tazreen Fashions factory in Bangladesh, one of the company's second-tier suppliers.

Anti-union practices

Walmart is openly hostile to the unionisation of its US workforce. The AFL-CIO union led a national protest campaign against the retailer in 2002. In 2005, the US trade unions launched a new offensive

against the company with the Wake Up Walmart and Walmart Watch campaigns, which featured in the “Walmart: The High Cost of Low Price” documentary. Human Rights Watch reviewed Walmart’s anti-union practices in its 2007 report entitled “Discounting rights: Walmart’s violations of US workers’ right to freedom of association”. The report describes how Walmart systematically prevents union organisation in its US stores (anti-union video screenings for new hires, special hotline for managers to report union activity, etc.). It lists the numerous lawsuits brought against Walmart for discrimination, particularly against women, and forced and unpaid overtime. The report also criticises Walmart for its very low salaries and health insurance plan, which is too expensive for many employees.

OUR Walmart, a movement initiated by Walmart employees, has been calling on the retailer since 2011 to recognise freedom of association and expression. In 2012, it organised demonstrations in front of Walmart stores across the United States.



Source: makingchangeatwalmart.org

Responsible investment

Responsible investors initially rallied around the issue of subcontracting, tabling a number of resolutions at the company’s annual general meeting, notably on respect of human rights at Walmart’s subcontractors. In 2012, the Interfaith Center on Corporate Responsibility, a coalition of North American investors, called on Walmart to organise audits at its suppliers by independent bodies. Similar resolutions were submitted in 2002 and 2003. Walmart was asked to provide reports on equal opportunities and diversity every year between 2002 and 2005 and on sustainable development in 2004, 2005 and 2006. It declined to do so every time.

In June 2003, the Norwegian pension fund KLP dropped Walmart from its portfolio. The Danish pension fund ATP did the same in 2005. In 2006, Government Pension Fund Global, a Norwegian sovereign wealth fund, which until then held \$400 million in Walmart shares, excluded the company from its investment universe.

A group of investors including the New York City Pension Fund and Sweden's AP1, AP2, AP3 and AP4 pension funds attempted a new approach at Walmart's 2007 annual general meeting, tabling a resolution that asked the company to

"issue a report to the shareholders, by September of 2007, on the negative social and reputational impacts of reported and known cases of management non-compliance with International Labour Organization (ILO) conventions and standards on workers' rights".

Garnering 4% of votes, the resolution was presented again in 2008. In parallel, the same shareholders initiated direct engagement approaches with the company, which failed to produce results. Walmart has subsequently been excluded by the large Dutch pension funds, including APG, confirming its high-profile blacklist status.

Walmart has been excluded by 14 panel investors managing over €1,065 billion.

Company strategy

Walmart responds to different controversies in different ways.

Concerning the respect of human rights in the subcontracting chain, Walmart launched a code of conduct for its suppliers in 2012 called "Standards for Suppliers". But the application of the code was called into question owing to a lack of transparency and the absence of independent audits. In its 2005 Ethical Sourcing Report, Walmart claimed to have made improvements to its ethical purchasing programme, in particular by increasing the number of auditors. In 2006, Walmart took part in the creation of the Global Social Compliance Programme, an initiative launched by large international retail companies to harmonise their policies on social requirements with suppliers. Following a fatal accident at the Tazreen factory in Bangladesh in January 2013, Walmart issued a letter to suppliers, requiring them to designate a Walmart-dedicated head of compliance in each of their operating countries and announced a new, zero-tolerance policy on the unauthorised use of second-tier suppliers.

Walmart has responded to charges of discrimination by vaunting its multicultural workforce and introducing the "Diversity Office" program. In 2005, it set up a \$25 million fund aimed at supporting, among its suppliers, entrepreneurial women and companies managed by minorities. Faced with a massive lawsuit on discrimination against women, Walmart published reports on equal pay between men and women. In 2009, it set up the President's Global Council of Women Leaders, comprising high-ranking women at Walmart and tasked with developing the careers of talented women at the company in collaboration with the CEO.

However, Walmart has chosen not to respond to charges concerning the lack of respect for the freedom of association. In 2005, the company posted the following statement on its website: "At Walmart, we respect the individual rights of our associates and encourage them to express their ideas, comments and concerns. Because we believe in maintaining an environment of open communications, we do not believe there is a need for third-party representation."

To counter campaigns by NGOs and trade unions using the internet and special websites such as Making Change at Walmart, the company called on a public relations firm to restore its image. The firm has produced a range of communication media, including a documentary presenting it in a more favourable light and several websites, among them the Walmarting Across America blog, which has sparked considerable controversy and been cited as an example of a “fake blog” by Wikipedia.

In line with its previous image-enhancement efforts, Walmart launched a communication campaign in 2013 aimed at showing the “real Walmart” through television advertisements and a website, www.therealwalmart.com, providing the group’s answers to thorny questions.

FREEDOM OF EXPRESSION: YAHOO!

Key figures

- **11,500 employees**
- Present in **25 countries**
- Revenue: nearly **\$5 billion** in 2012
- Listed on the **New York stock exchange**

The issues

Yahoo! was accused of supplying data that was used in the identification and arrest of Chinese dissidents in the 2000s. The much-publicised case called into question the behaviour of Western internet operators in China.

The respect of human rights has become a real-life issue for Yahoo!. In its 2009 and 2010 annual reports, the company identified possible violations of those rights as well as the risks likely to impact its operating income and financial health.

The Chinese controversy also jeopardised the image of Yahoo!, especially with users. Jerry Yang, co-founder and then CEO, said he was aware that “our success as a business is built upon the trust we maintain with our community of global users, including citizens around the world, advertisers, publishers, and business partners”.

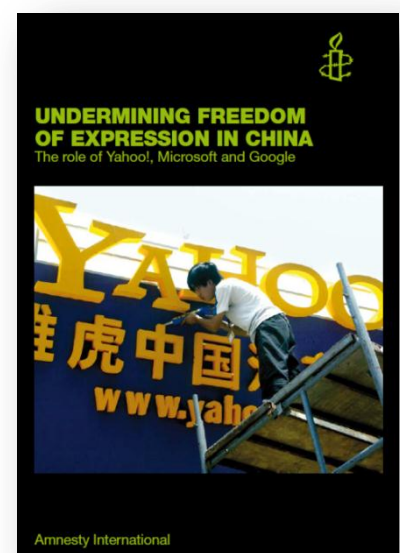
Reporters Without Borders, an NGO, called on investors to sign Joint investor statement on freedom of expression and the Internet and to help change the behaviour of players in the new technology sector. These initiatives have been taken up by the US authorities, although specific legislation has yet to be introduced.

The controversy

Yahoo! was accused of complicity in the freedom of expression violations that took place in China in the early 2000s. The Chinese judiciary sentenced at least four dissidents to prison on the basis of information provided by Yahoo!. The US web giant transmitted information hosted on its servers to the authorities, which used it as evidence.

In 2006, Reporters Without Borders, which in 2003 had run a campaign on the respect of the freedom of expression by web companies, publicly denounced the implication of Yahoo! in the convictions. In 2007, Amnesty International published a report called “Undermining freedom of expression in China. The role of Yahoo!, Google and Microsoft”.

In February 2006, Yahoo! and several other sector giants were called to testify before the Foreign Affairs Committee of the US



Source: Amnesty International

House of Representatives over complicity in the arrests of the Chinese dissidents. The controversy heightened in 2007 when the World Organization for Human Rights sued Yahoo! in the name of one of the convicted dissidents, journalist Wang Xiaoning, accusing the company of turning information over to the Chinese authorities that led to his ten-year prison sentence.

Yet the US authorities' attention to this subject would seem to have its limits. Several years on, the Global Online Freedom Act, a draft bill on the presence of web companies in countries ruled by authoritarian regimes, has still not been passed.

Responsible investment

In 2005 Reporters Without Borders launched the Joint investor statement on freedom of expression and the Internet. By signing the document, investors express their attachment to the respect of human rights by companies, and the respect of freedom of expression in particular. Signatory companies commit to monitoring the activities of web companies in countries with repressive regimes. By 2005, 27 institutional investors, mainly US and managing \$21 billion, had signed the declaration. Other investors have since joined them. Reporters Without Borders now counts 35 on its website, managing a total \$104 billion. The sole French investor on the list is Meeschaert AM, an asset management company that manages the main French religious and ethical funds.

Yahoo! has been targeted more directly by other initiatives taken by investors. At its 2007 annual general meeting, New York City Comptroller, which manages the five pension funds of the City of New York, tabled a resolution calling on Yahoo! to undertake not to actively censor its websites in China or in other countries seeking to implement the same strategies. Another draft resolution, submitted by Harrington Investments, a Californian asset management company, called for the creation of a human rights committee at Yahoo!. Starting in 2005, Jing Zhao, Chinese activist and chairman of the NGO Humanitarian China, sought to present a resolution encouraging the company to introduce a policy on human rights respect. Yahoo! blocked the resolution several times with the authorisation of the Securities and Exchange Commission (SEC). But in 2011 the SEC changed its mind and the tabling of the resolution enabled the NGO to engage in direct dialogue with Yahoo! on the issue in 2006.

That dialogue led in 2008 to the formation of the Global Network Initiative (GNI), involving NGOs, academics, responsible investors in the USA (Domini Social Investments, Trillium Asset Management, Calvert) and the UK (F&C Investments), together with Google and Microsoft. By signing the GNI's principles, new technology companies commit to respecting the human rights of freedom of expression and privacy in their international operations. As set forth in the GNI's Implementation Guidelines, signatory companies assess their risks in terms of human rights violations by conducting special impact studies and set up whistle-blowing mechanisms through which violations can be reported. The effectiveness of the GNI was criticised on launch by some investors, who considered that the only way to bring about real change would be to modify a company's articles of association so as to broaden the board of directors' responsibilities on human rights. It is true that the initiative has thus far produced somewhat mixed results. The GNI has just six member companies, including Facebook, which joined in May 2013. The five others consist of the three founding members – Yahoo!, Google and Microsoft – and two lesser known companies, Websense and Evoca.

Some European investors, especially in Scandinavia, also responded to the controversy by initiating dialogue, and some of them even excluded Yahoo!."In 2005, KLP, one of Norway's largest life-insurance companies, decided to drop Yahoo! from its investment universe. Sweden's AP7 pension fund did the same in 2007. At the time, Sweden's AP1, AP2, AP3 and AP4 pension funds, which pooled their engagement policies by establishing an ethics committee, began discussions with Yahoo! on respect for human rights, and notably freedom of expression.

Yahoo! has been excluded by two panel investors managing €45 billion.

Company strategy

The first line of defence of Yahoo! was to insist that companies are obliged to obey the laws of the countries in which they do business. But given the intensity of the criticisms, it quickly changed tack.

In 2006, Michael Samway, then vice-president and legal director at Yahoo!, wrote on the company's blog that a specialised organisation, Business for Social Responsibility, had been mandated to facilitate dialogue in the sector on freedom of expression and security of private data. He also announced that discussions were underway with a range of stakeholders, including socially responsible investors, UN experts on companies and human rights, and NGOs. This process led in 2008 to the formation of the GNI, of which Yahoo! is a founding member. The company highlighted this commitment in its response to the controversy.

Yahoo! set up the Yahoo! Human Rights Fund in 2007 after signing an agreement with the families of the Chinese dissidents to put an end to the lawsuit that the families had brought against the company. The fund's remit was to provide legal and financial support to the dissidents, imprisoned for having expressed their views online, and to their families. But in 2012, the effectiveness of the fund was called into question when Jing Zhao, a Chinese human rights activist, filed a lawsuit against Yahoo!. He asked the company to provide records on the establishment and operation of the fund, following suspicions that one of the fund's administrators had misappropriated assets for his personal use.

The company also launched the Yahoo! Business and Human Rights Program in 2008. The dedicated website states that the programme's aim is to factor human rights into the company's decision-making process and foster respect of privacy and freedom of expression through real-life initiatives. The programme is managed by a two-person team assisted by a cross-sector, multi-disciplinary team of employees from Yahoo! entities worldwide. The company says that it is committed to respecting the main international principles on human rights and that it has translated these principles into operational guidelines. Yahoo! has also undertaken to conduct impact studies on human rights when it enters new markets and launches new products. Lastly, it organises an annual summit on business and human rights and offers grants to researchers and journalists working on freedom of expression and respect of private data in new information and communication technologies. Yahoo!'s code of ethics, updated in 2008, addresses issues such as the use of private data and respect for human rights and the freedom of expression.

Yahoo! defends its case through its initiatives and by highlighting its partial withdrawal from the Chinese market. It relinquished operational control of the Yahoo! China portal in 2005, the year it sold its Chinese branch to Alibaba.com, one of the country's largest e-tailers, for \$1 billion and a 40% share in the company. Yahoo! claims it exerts an influence over Alibaba in terms of respect for human rights. It is also strong on repentance. In a 2008 letter to Condoleezza Rice, US Secretary of State in the Bush administration, Jerry Yang called on the US government to exert its influence with the Chinese government and press for the release of the dissidents. He also wrote that "Yahoo! deeply regrets the circumstances that led to the imprisonment of individuals in China".

The controversy over the human rights violations in China, as well as the possible introduction of a US law requiring companies to place respect for human rights above domestic legislation, poses fundamental questions for multinationals. At what price should they conquer new markets? What sanctions do they risk if they flout the values of their home countries? And is the risk of damaging controversy enough to make companies change their practices?



LEGAL RISK: CHEVRON IN ECUADOR

Key figures

- **61,000 employees** at end-2011
- Present in **36 countries**
- Revenue: **\$245 billion** in 2011, **ranked eighth worldwide**
- Listed on the **New York stock exchange**

The issue

Chevron's is a classic case of a controversial company that totally denies the controversy and its consequences. The US oil company has gone so far as to omit from its financial disclosures the \$20 billion fine awarded to Chevron by an Ecuadorian court for polluting the Amazon – an amount equivalent to roughly 10% of its revenue.

On an even more aggressive note, the company is suing the responsible investors that have asked it to explain itself for collusion with justice-seeking NGOs and Ecuadorians. The stakes are enormous for the company and, by extension, for its shareholders. But the company's lack of transparency, governance problems and environmental damage are building up, and Chevron ranks high on blacklists as the epitome of an oil company thoroughly indifferent to the charges levelled at it. Responsible investors understand the extent of the risk.

The controversy

Chevron has been involved in a number of controversies on human rights and the environment around the world. But the case in Ecuador is perhaps the one with the most tangible consequences for the company today.

Texaco, bought out by Chevron in 2001, is accused of having polluted an entire region of the Ecuadorian Amazon. The US group drilled for oil in the area from 1972 to 1992 in partnership with the national oil company Petrocuador. NGOs accuse the company of using obsolete technology to operate its oil wells, contaminating rivers with large quantities of toxic waste water, instead of using less polluting technology that was readily available but more expensive. On pulling out of the country, Texaco also left behind over 900 open-air pits full of toxic waste. According to NGOs, the company released more than 68 billion litres of sludge containing heavy metals into the environment.

In 1993, 30,000 inhabitants of the Ecuadorian Amazon filed a lawsuit against Texaco with the Federal Court of New York. The Amazonian Defense Coalition was formed in 1994 to bring together the associations and indigenous communities that built the lawsuit against Chevron. The aim was to make the company accept responsibility for the pollution in the region and for violations of the



Source: savethecodestinations.com

human rights of the inhabitants, and thereby obtain compensation. In 1996, the Federal Court of New York ruled that the case did not fall under US jurisdiction. In 2002, Amazon Watch, a US NGO, launched the Clean Up Ecuador campaign to demand justice for the Ecuadorian communities affected by Texaco's operations. The plaintiffs filed a case in Ecuador in 2003. In February 2011, the Ecuadorian court found Chevron guilty and fined it \$8 billion, subsequently re-evaluated at \$9.5 billion. The fine rose to \$19 billion a year later, as Chevron failed to apologise to the victims as instructed by the court. The fine is equal to 10% of the company's value. A report published in 2012 confirmed that Chevron had refused to disclose the financial impact of the legal and financial threat. The US oil giant refuses to acknowledge or comply with the verdict of the Ecuadorian court. With Chevron no longer owning assets in Ecuador, the defense lawyers are now seeking to seize assets overseas. In 2012, an Argentine court froze some of the company's assets, with a view to seizing around \$2 billion. Similar lawsuits with similar aims have been initiated by plaintiffs in Canada and Brazil.

Responsible investment

At Chevron's 2002 annual general meeting, US company Trillium Asset Management tabled a resolution requesting the development and adoption of a global and measurable human rights policy, referring to the controversies in which Chevron was involved, including the legal case linked to the pollution in Ecuador. In 2003, a group of shareholders presented a further resolution on the Ecuadorian affair, asking Chevron to draft a report on the initiatives taken by the company to respond to the health and environmental concerns of the people living near the sources of pollution in Texaco's drilling region. The proposal was backed by 9% of the shareholders. Every Chevron general meeting since 2003 has been the stage for a number of resolutions questioning Chevron's management and transparency regarding the pollution in the Amazon. In 2005, a group of responsible investors tabled a resolution requiring Chevron to publicly state how much the controversy was costing the company (in legal and expert fees and lobbying and public relations

expenditure). The resolution was backed by 9% of the shareholders. In 2011, Trillium Investment Management asked the SEC to assess the transparency of Chevron's disclosures to shareholders regarding the scale of the operational and financial risks stemming from the fine awarded by the Lago Agrio Court in Ecuador. In May 2011, a coalition of shareholders, comprising 22 responsible investors managing \$156 billion in assets, wrote a letter to Chevron. In it they reformulated their doubts over the management of the Ecuadorian affair and asked the company to review its strategy on the issue with a view to negotiating an out-of-court settlement.

Seeking to rally coalitions of responsible investors around a shared engagement, the NGO ShareAction took a close look at the Ecuadorian controversy in 2012. It started a special page on the issue on its website, providing investors with documents on the affair and a range of engagement topics that could be addressed by the investors. In 2013 Chevron blocked a resolution requesting it to explain its strategy of accusing some of its responsible shareholders of collusion with local NGOs.

Chevron has been excluded by two panel investors managing €120 billion.

Company strategy

From the start of legal proceedings in 2003, Chevron's strategy has been to deny any responsibility for pollution in the Ecuadorian Amazon. The US oil giant has waged a legal battle against the plaintiffs, contesting the legal and scientific grounds for the case, and going so far as to question the probity and legality of the plaintiffs' actions.

As the controversy has dragged on, Chevron has made one argument after another, always aimed at denying any liability for any damages. In its 2003 CSR report, Chevron explained that its oil production complied with local laws and profited Ecuador, whose government, Chevron claimed, collected 95% of drilling revenues. While it was solely responsible for operations between 1972 and 1992, Chevron claims that any liability for pollution lies with its partner, Petrocuador, which it notes was the majority owner of their joint venture. It claims that the Ecuadorian company took over operations after the departure of Texaco in 1992. Chevron also points to the agreement it reached with the Ecuadorian government in 1998 as a reason to contest the ruling. Following efforts by Chevron to clean up pollution in the region, the company was cleared by the Ecuadorian government, theoretically discharging it of any further legal obligation to the government. In 2003, Chevron sued to have the case heard in Ecuadorian rather than US courts, saying that it would accept the ruling of the former. A battle of experts ensued between the two parties in the case, with Chevron seeking to refute the evidence of Texaco's liability brought by the plaintiffs. In 2008, the Ecuadorian court appointed an expert, Richard Cabrera, to determine the causes of the pollution and assess what sort of measures would be required to fix the problem. In his initial report, he advised the Court of Lago Agrio to order Chevron to pay \$16.3 billion in damages, before later revising his estimate to a range of \$18.1 billion to \$27.3 billion in damages. In response, Chevron brought a series of lawsuits, most in the USA, in an attempt to shield itself from a possibly adverse ruling by the Ecuadorian courts.

Chevron's strategy is to stay on offensive. The company has tried to wrong-foot the plaintiffs. It pieced together a documentary showing them in a bad light, and uploaded excerpts to its website. In

February 2011, Chevron accused the plaintiffs, their lawyers and their scientific experts of committing fraud with the goal of extorting millions of dollars. In late 2012, Chevron demanded access to the correspondence of certain investors who engaged in shareholder activism on this topic in Ecuador, accusing them of colluding with the plaintiffs' lawyers and consultants.

The company has launched a PR campaign and laid out its position on the controversy on a dedicated website entitled "History of Texaco and Chevron in Ecuador", in which it refutes the accusations made against the company one by one. It has also launched a blog, the Amazon Post, designed to spread the word on the company's position on the Ecuadorian affair. Lastly, a section of the company's main website is devoted to the subject.



INDIRECT RESPONSIBILITY: PETROCHINA AND CNPC

Key figures

CNPC

- **1.6 million employees** in 2011
- Present in **29 countries**
- Revenue: **\$352 billion** in 2011, **ranked sixth worldwide**
- **Unlisted**

PetroChina

- Revenue: **\$18 billion** in 2012
- Listed on the **New York, Hong Kong and Shanghai stock exchanges**

The issue

Given that China's state-owned oil company, China National Petroleum Corporation (CNPC), is usually the company operating in sensitive areas, what impact can responsible investors have by blacklisting its listed subsidiary, PetroChina, their only avenue for sanctioning the company?

The blacklisting of PetroChina by responsible investors in Northern Europe for violations in Sudan and Burma is intended to protect their reputations by avoiding an association with operations carried out in volatile regions with known human rights violations (genocide in Sudan, forced labour in Burma). It is also a way of putting indirect pressure on the parent company, CNPC, to encourage it to explain its strategic decisions and what it is doing to respect human rights in countries where they are not respected.

The strategy has had some impact. In its public communications, CNPC has mentioned human rights, taking a stand against forced labour and child labour. It has also highlighted the positive impact of its local outreach work. By contrast, it has not cited any preventive or corrective actions regarding human rights violations in Sudan.

That said, it appears the often uncoordinated efforts of European investors have had less of an impact than those of players in the USA, where a law passed in 2007 makes it illegal to invest in companies present in Darfur.

The controversy

Since the mid-2000s, China National Petroleum Corporation (CNPC), the Chinese state-owned oil company, and its listed subsidiary PetroChina, have been accused of complicity in human rights violations in Sudan and Burma. Their collaborations with these authoritarian regimes have generated oil and gas revenues and thereby make them guilty of serious violations of the rights of locals committed in the course of developing the oil and gas projects.

Burma: sour gas reserves

To exploit gas reserves in the Bay of Bengal, offshore Burma, the Burmese government signed a concession agreement with a consortium of Indian and South Korean companies. In June 2008, CNPC

signed a contract with the consortium to procure natural gas and build a pipeline that would transport the gas to China's Yunnan province. A complaint was filed with the South Korean National Contact Point for violation of the OECD Guidelines, but it was dismissed.

In June 2009, CNPC signed a protocol of agreement with the government of Burma to build and operate a new pipeline alongside the first for transporting oil to China from the Middle East, Africa and Latin America. In June 2010, the Chinese company began construction of the two pipelines and expects to finish in 2013. In December 2010 the NGO Earth Rights International (ERI) published a report entitled "Broken Ethics" for the Council of Ethics of Norway's sovereign wealth fund, informing it of human rights violations committed by the Burmese

authorities with respect to extraction industries and asking it to examine its investments in the companies involved. ERI lists violations of civil and political rights, forced displacement and expropriations, an influx of Burmese military personnel that could heighten ethnic tension, damage to local populations' subsistence resources, the lack of prior consultation of and consent by local populations, and the failure to perform an environmental impact study. In March 2011, ERI issued a further report, entitled "Human Rights Violations, Applicable Law, and Revenue Secrecy: The Burma-China Pipeline". In March 2012, other steps were taken directly with the Chinese government via its embassies.



Source: earthrights.org

Sudan: ethnic-religious conflicts and genocide

The Chinese government, via CNPC, has invested in the oil and gas sector in Sudan since 1996, when it acquired a majority stake in the Greater Nile Petroleum Operating Company (GNPOC) consortium. In 2005, the NGO Genocide Intervention Network launched its "Sudan Divestment Task Force", calling on investors to divest their stakes in the companies most implicated with the Sudanese government. The NGO claimed that foreign investment was used by the government to fund the Janjaweed militia and, hence, the genocide in Darfur. The campaign is aimed at universities, management firms and public institutional investors, particularly in the USA. The Save Darfur Coalition, an NGO network of 190 organisations representing one million activists, is also targeting investors to try to end the genocide with its "Investors against Genocide" campaign. In 2007, the US government passed the Sudan Accountability and Divestment Act, which makes it illegal for local and national authorities to do business with companies present in Sudan, forbids the US federal

government from having ties with those companies, and gives legal protection to management firms that decide to sell stakes in such companies.

Responsible investment

Investors aware of these two controversial issues targeted CNPC through shareholder engagement actions aimed at PetroChina, CNPC's listed subsidiary.

Burma

In 2007, PetroChina was excluded by the Danish pension fund ATP. In May 2010, the Council of Ethics of Norway's sovereign wealth fund, alerted by the Broken Ethics report, recommended divesting from PetroChina. It believed that there was a strong risk of CNPC contributing to human rights violations when it built its pipelines and that PetroChina would be complicit, as the parent company and its subsidiary could be considered a single entity. But in December 2011 Norway's finance ministry decided not to heed the recommendation, ruling that while a parent company can be held responsible for the actions of its subsidiaries, the reverse is not true, and that the two companies could not be considered a single entity.

In 2011, the Netherlands' largest pension fund, APG, blacklisted PetroChina on the basis of CNPC's activities. It concluded that PetroChina and CNPC were distinct legal entities but one and the same undertaking. Scotland's Strathclyde Pension Fund announced in 2012 that it had put PetroChina on its engagement list.

Sudan

Under pressure from NGOs, the movement to divest from companies operating in Sudan began in the USA in 2005 and arrived in Northern Europe two years later.

In 2007, a growing number of European investors developed engagement policies aimed at companies with Sudanese ties. The Dutch pension fund PGGM, which manages €88 billion, sold its shares in PetroChina the following year (€37 million worth) after realising that its engagement strategy had failed.

In the USA, the highly active Investors Against Genocide campaign is seeking to put the issue on the agenda when management firms' boards of directors meet. It has made a point of targeting JP Morgan, which holds €1.5 billion in PetroChina stock.

PetroChina has been excluded by seven panel investors managing more than €544 billion.

Company strategy

One way to measure the success of indirectly (via PetroChina) excluding CNPC is by the fact that most information on controversial topics is found on the state-owned company's website. Little of this information is posted on the English-language version of the listed company's website.

CNPC began implementing CSR reporting in 2006. In its first report, it emphasised its compliance with the laws of the countries in which it operates, its non-discriminatory hiring and human resources

policies, and its rejection of forced labour and child labour. CNPC added an Environment and Society section to its website in 2008, and in 2009 launched a mechanism to allow for dialogue with its stakeholders.

Burma

In its 2011 annual report, CNPC mentioned the construction of pipelines in Burma and the steps it was taking to reduce their environmental impact, without saying what those steps were. The company linked the construction to a \$6 million programme to help local communities along the pipeline with funds going to support health and educational initiatives. The report also stated that the project fully complied with local laws, used Burmese labourers, and that compensation for land used in the project corresponded to three principles: “voluntary decisions”, “minimal impact on farmland” and “compensation prior to construction”. The announcements about assistance to local residents were shared by PetroChina in a June 2012 press release entitled “Caring for communities along the Myanmar-China Oil & Gas Pipelines”. The release described CNPC’s efforts to help local communities, including a \$20 million donation to the Burmese government to support social initiatives, financial aid for building schools and hospitals, infrastructure building, and job creation for local residents.

Sudan

In its 2007 CSR report, CNPC announced a joint programme with the Sudanese government to train local workers for oil industry jobs. The report also highlighted CNPC’s financial contributions to philanthropic causes (orphanages, hospitals, etc.) and aid to people affected by the Nile River’s July 2007 flood. The report recounted Chinese President Hu Jintao’s visit to the conference marking 10 years of Sino-Sudanese oil industry cooperation and the fact that he congratulated CNPC for its contributions to Sino-Sudanese economic cooperation.

In 2010, CNPC published “CNPC in Sudan”, a report focused on its actions and principles in the areas of the environment, responsible human resources and social welfare.



RIGHTS OF INDIGENOUS PEOPLES: VEDANTA

Key figures

- **29,000 employees**
- Present in **7 countries**
- Revenue: **\$11.4 billion** in the financial year ended March 2011
- Listed on the **London stock exchange**

The issue

Vedanta is a textbook case of a controversial company paying a high price for proven human rights violations, which the company committed in India. The company lost big after ignoring the rights of indigenous peoples living in an area where it wanted to operate a bauxite mine. Vedanta was forced to give up its right to operate the mine, its shares lost a third of their value when the mining authorisation was rejected, and the company found itself on numerous SRI blacklists. Its governance policies, which appear to have made human rights violations common practice, sealed its fate. NGOs and socially responsible investors working together on certain causes can change things. That is the lesson to be learned from Vedanta's case.

The controversy

In the early 2000s, Anglo-Indian mining company Vedanta launched a project to produce aluminium that was to include a refinery and a working bauxite mine in the Indian state of Orissa. While many pointed out the project's environmental impact (risk of pollution from the toxic sludge generated by the refining activity, heavy water consumption, deforestation, loss of biodiversity), the issue that really grabbed and mobilised NGOs was the fate of the local Dongria Kondh tribe. Vedanta was accused of violating their rights through forced expropriations and by using threats and violence. The company failed to set up a process for consulting local communities and planned to locate its bauxite mine in the Niyamgiri Hills, which are sacred to the Dongria Kondh and contain resources vital to their survival. Vedanta was also accused of supplying authorities with



Source: survival.org

false information and omitting the fact that part of the refinery would be built on forested land. In 2004, Vedanta Aluminium, a subsidiary of the mining group, began construction of the refinery after getting the green light from the Indian Ministry of Environment and Forests. Opposition to the proposed bauxite mine gathered, and NGOs petitioned the Indian Supreme Court, asking it to consider the environmental consequences of the project. The Central Empowered Committee (CEC), with a mandate from the Supreme Court to investigate, issued an initial report in September 2005. It concluded that if Vedanta had given authorities accurate information on the refinery project, it would not have been approved. The CEC also recommended that the bauxite mine project be abandoned, citing the rich biodiversity of the Niyamgiri forest and its ecological fragility. In May 2005, the Ministry of Environment and Forests temporarily suspended construction of the refinery but reversed its decision after Vedanta made concessions. The refinery began operations in 2006. In January 2007, the CEC presented a new report on the proposed mine, reiterating its earlier recommendations.

In November 2007, the Supreme Court halted the bauxite mine project, before reauthorizing it in August 2008 in exchange for certain guarantees regarding development for local communities and environmental protection. A joint venture between state-owned Orissa Mining Corporation and Vedanta subsidiary Sterlite Industries was set up to operate the mine. In December 2008, Survival International, an NGO that defends indigenous peoples, brought a case against the mining operation to the British National Contact Point of the OECD, arguing that the mine project would imperil the rights and survival of the Dongria Kondh. Survival International attracted media attention to its fight by likening the tribe's situation to that of the Na'vi in the James Cameron film *Avatar*. Amnesty International joined the campaign. A demonstration was organised in 2009 by the NGOs ActionAid and Survival International in front of the corporate offices of Vedanta during its annual general meeting. In 2010, Amnesty published a report entitled "Don't mine us out of existence: Bauxite mining and refinery devastate lives in India", denouncing the violations of indigenous peoples' rights. According to the NGO, more than 30,000 of its members wrote to the Indian authorities.

In 2010, a committee of experts published a report whose conclusions were devastating to Vedanta: the mine would considerably alter the region's water resources and ecosystem, and threatened the survival of the Dongria Kondh tribe, the Kutia tribe, and hundreds of Dalit families. The Indian government halted Vedanta's mine project and rejected the company's request to expand the refinery. In September 2009, the British National Contact Point for the OECD concluded that Vedanta had violated the OECD Guidelines, notably with respect to the process for consulting local communities, and advised the company of actions it should take to bring itself into compliance with the guidelines. According to Survival International, the company did not follow the recommendations. In July 2011, Amnesty published a second report entitled "Generalisations, omissions, assumptions", in which the NGO pointed out the deficiencies of the environmental impact studies Vedanta performed for its refinery and bauxite mine project. Vedanta closed the refinery in December 2012 owing to a lack of bauxite supplies. In April 2013, the Supreme Court rejected the appeal filed by Orissa Mining Corporation, Vedanta's partner, seeking a reversal of the Indian government's decision.

Responsible investment

In 2007, the Norwegian sovereign wealth fund excluded Vedanta from its investments and sold its €9 million stake in the company. The Norwegian insurance group KLP soon followed suit. In 2009, the NGO ActionAid arranged to have a representative of the Dongria Kondh tribe attend Vedanta's annual general meeting and meet with several shareholders. The organisation also launched a campaign targeting some ten government pension funds in England to encourage them to enter into a dialogue with the company. Vedanta proved unresponsive, and in 2010 the Church of England joined the divestment movement. The Joseph Rowntree Charitable Trust quickly followed in its footsteps, along with PGGM, one of the major Dutch pension funds, which had also failed in its attempts to engage Vedanta. At Vedanta's 2010 annual general meeting, APG, another Dutch pension fund, refused to approve the annual report owing to the lack of information on this sensitive issue.

That same year, the UK extra-financial rating agency EIRIS published a report called "Improving Vedanta Resources' governance of responsible business practices", in which it recommended that Vedanta adopt measures to prove it takes the expectations of responsible investors seriously. EIRIS suggested, in particular, that the company's board of directors take responsibility for managing ESG risks and that a panel of independent experts be established to assess Vedanta's Orissa operations against international norms on human rights, indigenous rights and the environment. For responsible investors, the steep drop in Vedanta's share price after the Indian government put the proposed bauxite mine on hold "indicates the financial risk inherent in the poor management of social and environmental impact issues".

More investors pulled out of Vedanta in 2011. At the company's August 2012 annual general meeting, the percentage of votes against all the resolutions submitted stood at 12.34% and Vedanta was forced to answer new questions about its sustainable development policy. To coincide with this meeting, Amnesty International published a document called "Vedanta's perspective uncovered: Policies cannot mask practices in Orissa". The aim was to counter Vedanta's reassuring messages to shareholders on this Indian mining project.

Vedanta has been excluded by eight panel investors managing over €376 billion.

Company strategy

Vedanta did not initially seem particularly receptive to investors' engagement efforts, and failed to respond to the letter from the Norwegian fund's Council on Ethics. The mining group described its actions to promote the local communities' socioeconomic development in its 2008, 2009 and 2010 annual reports and on the project's microsite. Vedanta also launched a public relations campaign to underscore its commitment by posting videos on YouTube, including one called "Walking hand in hand with the Dongrias". Some of the videos were interviews with the Dongria Kondh saying they supported Vedanta's proposed mine. In 2009, Vedanta published its first sustainable development report, stating that it had set up a CSR advisory committee in Orissa, composed of prominent figures from this Indian state. According to Vedanta, this committee was tasked with periodically assessing CSR performance and suggesting improvements to better implement the company's policy toward the communities, based on its local knowledge and site visits.

Starting in 2010, Vedanta appeared to follow the recommendations made by responsible investors. It appointed a group chief sustainability officer, broadened the scope of its Health, Safety and Environment committee to include sustainable development, and made performance criteria relating to risk prevention — and more specifically concerning health, safety and the environment — an integral part of its compensation policy.

Vedanta's improvement initiatives have been acknowledged by responsible investors, who nonetheless point out their limits. The company has failed to establish a panel of truly independent experts to assess its Orissa operations, and has not commissioned independent social and environmental impact studies. It has not yet formalised procedures for a dialogue with stakeholders and it has room for improvement with respect to recognition of indigenous rights. In its sustainable development reports, Vedanta generally challenges the accusations about its operations in the Orissa region and says it is acting for the benefit of the local populations.

In early 2012, Vedanta launched another public relations effort called "Creating Happiness", which explained how the company benefits the local communities. A jury of Bollywood celebrities oversaw a competition for films depicting the "happiness" created by the company.

In August 2012, several days before its annual general meeting, Vedanta web-posted a report, "The Lanjigarh Development Story: Vedanta's perspective", in which it promoted its new sustainable development policy and sought to refute the findings of the reports on the project published by Amnesty International. Amnesty condemned Vedanta's efforts to brush off the criticisms levelled at it and to allay investors' fears about its controversial operations in Orissa state.



Key figures

- **90,000 employees** at end-2011
- Present in more than **70 countries** (in 2012)
- Revenue: **\$484 billion in 2011, the world's largest company**
- Listed on the **New York, London and Amsterdam stock exchanges**

The issues

The controversies surrounding Shell's operating conditions in Nigeria started in the 1990s, but the lawsuits and damning reports by NGOs have yet to prompt northern European investors to exclude the company from their portfolios.

The reasons are necessarily complex, but one of the difficulties is that Shell cannot take sole blame for the human rights violations in Nigeria. That it is a Dutch company is also a factor for the Dutch pension funds. Nonetheless, Shell's problems in Nigeria have an impact on its business model. The legal risks, crude oil trafficking, clean-up costs and need for pipeline renovations all combine to make oil production in Nigeria a risky proposition, although this has not yet prompted responsible investors to exclude it. Until now, they have not challenged the message put forward by the company, namely that the necessary programmes are in place to cope with a situation which has lasted for decades and which it claims is beyond its control.

The controversy

The Dutch oil group Shell has been active in the Niger Delta since the end of the 1950s. It operates there through a subsidiary, Shell Petroleum Development Company (SPDC), a joint venture 55%-owned by the state-owned Nigerian National Petroleum Corporation and 30% by Shell. Since the mid-1990s, Shell has been accused of responsibility for large-scale pollution, leading to violations of the human rights of the local population, as well as of complicity in the abuses committed by the Nigerian security forces against these peoples. The inhabitants of the Niger Delta, who depended mainly on farming, fishing and fish farming, have seen their livelihoods disappear, drowned in oil spilling out of the pipelines and poisoned by gas flaring. Shell is accused of failing to take the necessary measures to prevent the pollution, of not cleaning it up properly, and of lacking transparency — possibly to the point of untruthfulness — in its communications on this issue.

In 1993, more than 300,000 members of the Ogoni people, who live in one of the most polluted regions of the Niger Delta, protested against the oil production conditions. Shell was thus forced out of Ogoniland. Several leaders of the Ogoni protest, including the writer Ken Saro-Wiwa, were arrested in 1994 and hanged in 1995 after a sham trial orchestrated by a military court. Beginning in 1996, American NGOs made several attempts to sue Shell for complicity in human rights violations in Nigeria in the case of the execution of the Ogoni protesters. In May 2009, Shell paid \$15.5 million to

Ken Saro-Wiwa's family under an agreement that ended the legal battle the family had been fighting since 1996.

In 2004, Amnesty International published an initial report, "Are human rights in the pipeline?", condemning the impact of the extraction activity in the Niger Delta on the rights of the local communities.

In 2008, the inhabitants of Bodo in the Niger Delta sued Shell before the Dutch courts. Their lands and ponds had been destroyed by the 45 million litres of oil

that had been discharged into the environment over the course of several weeks. However, in early 2013 the court rejected the principle that the parent company should be held responsible for the offenses of its subsidiaries.

Ultimately, 69,000 Nigerians brought suit against Shell in the United Kingdom in 2011, and a trial may be imminent in the coming months.



Source : Amnesty International

Amnesty International published a second report in June 2009 called "Nigeria: Petroleum, Pollution and Poverty in the Niger Delta", in which it analysed the impacts of the massive pollution in the Niger Delta on the socioeconomic and cultural rights of its inhabitants. Amnesty asked Shell to publicly commit to clean up the contaminated sites and launched a wide-scale campaign to exert pressure on the company, adopting the slogan "Shell Hell".

In 2011, Amnesty International and Friends of the Earth filed two complaints with the Dutch National Contact Point for violation of the OECD Guidelines. They accused Shell of making misleading statements, by in essence stating that the oil leaks were due to sabotage, and condemned the human rights violations resulting from pollution associated with Shell's activities in the Niger Delta.

In 2011, a United Nations Environment Programme (UNEP) report condemned the massive pollution in the region and estimated that a full environmental clean-up would take 30 years. It also found the oil infrastructure inspections, maintenance and dismantling to be inadequate and singled out the ineffectiveness of the decontamination techniques employed.

Responsible investment

In 1994, the Ecumenical Council for Corporate Responsibility (ECCR), an organisation composed primarily of faith-based institutional investors, secular responsible investors and NGOs, began a

dialogue with Shell on its impact in the Niger Delta. At Shell's annual general meeting in 1997, the ECCR put a resolution on the agenda that concerned issues of the environment, respect for human rights and relations with local communities. The resolution garnered 10.5% of shareholder votes. According to the ECCR, this outcome paved the way for investors to initiate a dialogue with the company on these topics.

In 2009, the Norwegian fund's Council on Ethics stated that it was conducting an assessment of the oil operations in the Niger Delta; its findings have not yet been disclosed. In early 2012, a number of different stakeholders sought to pressure the Norwegian fund into excluding Shell. A group of scientists and NGO representatives sent a letter asking it to recommend excluding the Dutch group. The winners of the Right Livelihood Award (the "Alternative Nobel Prize" awarded by a Swedish foundation) and Friends of the Earth also subsequently called on the fund to divest.

At the same time, ShareAction, a British NGO active in shareholder engagement, and Amnesty International launched a campaign to raise shareholder awareness of the financial risks to which Shell was exposed owing to the significant social and environmental damage caused in the Niger Delta. They circulated information briefs on the risks incurred by investors, backed by the overwhelming findings of UNEP's 2011 report.

To date, Shell is not on any of the exclusion lists published by the investor panel

Company strategy

Shell's strategy has changed with the times. In the 1990s, the company seemed to acknowledge its share of responsibility for the pollution (spills associated with operational problems and the poor condition of the pipelines). A document dating back to 1995 explains that the company "is working hard to renew ageing facilities, reduce the number of oil spills in the course of operations, the amount of gas that is flared, and to reduce waste products". In 1997, Shell made a public commitment to respect human rights.

It subsequently sought instead to minimise its responsibility for the pollution in the Niger Delta. It explained that most of the spills resulted from attacks on its pipelines and that the security situation and hostility of the local communities were the main reasons for the delays in repairing the damaged facilities and in cleaning up the polluted areas.

In its 2007 annual report, it attributed 80% of the oil leaks to sabotage, caused by the theft of crude oil or militant attacks, and confirmed that the clean-up of pollution from old spills was ongoing. It highlighted the profits the Nigerian government had made via its joint venture with Shell and cited its agreements with the local populations, as well as its policy of respecting the Voluntary Principles on Security and Human Rights.

In its sustainable development reports from 2008 to 2012, Shell quantified its progress on the clean-up of polluted sites and on facility maintenance, and cited the steps it had taken to strengthen its overall human rights policy (in particular, an increased focus on human rights issues in its impact studies).

In January 2011, Shell launched a website where it publishes data on every oil spill associated with its facilities. Another exercise in transparency was its July 2011 webchat called “Shell in Nigeria - working in a complex environment” in which web users questioned a panel of Shell managers, including the managing director of the group’s Nigerian subsidiary.

In August 2011, Shell acknowledged its responsibility in two oil spills that had affected the Bodo community in 2008 and for which it was sued in the United Kingdom. The company attempted to negotiate an out-of-court settlement with the plaintiffs but the talks broke down.

As part of its ongoing efforts to improve transparency, Shell has addressed the controversies surrounding it at annual meetings with responsible investors – a sign that it takes these matters seriously. In the fall of 2012, the company organised a field trip during which investors visited a clean-up site and a gas facility, flew over the Niger Delta and met with group executives.



III. ARE RESPONSIBLE INVESTORS CHANGING THE GAME?

Novethic's research shows that comprehensive, concerted action on controversial companies by responsible investors is still a long way off, both in Europe and in the United States. However, investors' concerns over the risks entailed by an economic model that rides roughshod over the interests of local populations and employees are becoming more urgent.

This is not necessarily reflected in public blacklists, which often focus on longstanding controversies. It takes a very long time to react to and indict these companies, and thus for investors to blacklist them. This time lag is out of step with the most recent, high-profile controversies. Moreover, exclusions are publicised only in countries where public opinion, the media and even public authorities are sensitive to these issues.

That said, responsible investors are not turning a blind eye to recent situations. The concept of risk arising from human rights violations is beginning to take shape for shareholders in companies that are the target of often harsh campaigns. This is demonstrated by rapid growth in the volume of assets subject to norm-based exclusion filters, an increasing number of requests for alerts by specialist agencies, and reactions to the tragedies in Bangladesh.

A new era for norm-based exclusion is definitely dawning. Those who use this approach are no longer interested solely in shielding their reputations. They are also seeking to limit the potential for accusations of complicity in violations and the financial losses that could arise as a result. In major global controversies targeting multinationals, investors are key stakeholders whose involvement is a game changer. Michel Doucin, France's ambassador responsible for corporate social responsibility, is well aware of the important role they play in regulating the practices of multinationals. The need for norm-based exclusion increases when the profile of responsible investment is raised and when criticism is more direct. NGOs are also targeting investors through campaigns aimed at the general public. This is a new risk for participants who have so far been sheltered from media overexposure.

The growing power of controversy alerts

Sustainability rating agencies are gradually refining their controversy alert services and have noticed a growing interest among investors. In 2011, only two-thirds of the agencies identified by Novethic offered such alerts; in 2013 they all do. That trend is especially noticeable for engagement services, which involve pressuring companies to put an end to the violations they are accused of. Only 20% of agencies offered these services in 2011 compared with 75% today.

Engagement services complement sustainability research, which enables investors to act swiftly on the basis of frequently updated lists. In principle, the companies caught up in the most serious controversies are already excluded as a result of overall assessments by sustainability analysts. For the remaining companies, the aim is to take action before it is too late and their valuations are seriously undermined. Hence the need to harness shareholder engagement and urge offenders to come back into line.

Demand for Sustainalytics alert services

Sustainalytics, a Dutch-Canadian rating agency with global reach, offers three kinds of controversy alert services. The first includes these alerts in a mainstream offering; the second is a simple alert service concerning the most controversial companies, rated from 1 to 5; and the third includes a controversy-related engagement service. Sustainalytics has noted sharp differences in demand from one country to another.

FRANCE

None of Sustainalytics' clients has subscribed to the controversy alert service alone, but between 15% and 20% use it alongside ESG analysis, a trend that is gathering momentum. By contrast, less than 5% request the engagement service.

NETHERLANDS AND NORTHERN EUROPE

Investors use the alert service in similar proportions, with four types of demands. For 30%, the service is an integral part of ESG analysis; 20% simply ask for a list of controversial companies; 30% require both services; and the remaining 20% use the engagement service.

UNITED KINGDOM

Demand for analysis that includes controversies is growing and now accounts for 60% of clients. By contrast, only 5% of clients request controversy alerts alone, while nearly one-third demand the engagement service.

GERMANY

As responsible investment gains ground, investors are expressing new demands. A growing number want to combine ESG analysis and controversy monitoring (5%-10% of clients) with engagement services (10%-15%).

Michel Doucin, France's CSR Ambassador, is well aware of the need to regulate multinationals that are reported to National Contact Points (NCPs) for misconduct. NCPs are agencies set up to monitor compliance with OECD Guidelines. Mr Doucin sits on the French NCP and chairs the Group of Friends of Paragraph 47, set up after the Rio+20 Summit by four countries, including France, to pioneer an international reporting framework for companies.



When major investors exclude controversial companies, what effect does this have?

It is hard to make a sweeping statement, but I believe investors are definitely having an influence. One edifying example is the speed with which companies complied with requests for information from the Norwegian sovereign wealth fund about human rights violations.

As a member of the French NCP for the OECD Guidelines, I have seen a major shift in attitude among French companies. Five years ago, they were refusing to answer requests for information and turning down offers of conciliation from plaintiffs. Today they are more cooperative.

In all probability, this is due not so much to the NCP's powers, still confined to discreetly posting press releases on a handful of government websites, but to the method used to highlight its work, orchestrated by NGOs. These organisations draw considerable attention by bombarding people with information as soon as a complaint is lodged, organising conferences and inviting politicians and the media to attend, and informing shareholder general meetings. Last but not least, thanks to the NGOs' powers of communication, the plan to amend the OECD Guidelines so that an NCP can ask a public financier to blacklist companies that breach the guidelines has become a reality. The proposals had initially been rejected owing to opposition from several countries.

In addition, NGO lobbying has had a major impact on public authorities. France recently announced reforms that call on all public finance institutions, such as the Public Investment Bank, COFACE and the French Development Agency, to exercise greater vigilance with regard to companies that behave controversially.

The OECD and the United Nations Group of Experts both have the power to endorse standards that shift the centre of gravity of companies' responsibilities along the value chain, using concepts such as "business relationship" and "due diligence". These concepts, which are clear in principle but complex in practice, give the NGO community a way – long sought-after – to pierce the legal "veil" between parent companies and their subsidiaries and also to give substance to the notion of "complicity".

The growing impact of "naming and shaming" is evident in the reactions of multinational garment manufacturers and mass retailers to news from NGOs that labels bearing the companies' names had been found amid the rubble of the building that collapsed on the outskirts of Dacca. This development also paves the way for advances in both legislation and case law. Prior to the disaster, all but two of these firms had refused to sign a code of conduct drawn up by the Clean Clothes Campaign. Two weeks later, nearly 40 of them had done so, for fear not only that consumers would desert them in droves but that investors would blacklist them. This is an encouraging sign.

Does excluding controversial companies protect investors?

Tazreen Fashions Ltd **was the world's most controversial company in 2012** according to RepRisk, a business intelligence provider, but **it is not on any of the blacklists published by the panel of investors**. A fire at Tazreen's garment factory in Bangladesh in late 2012, which killed over 120 people, triggered international protests about working conditions at Bangladeshi subcontractors of leading western fashion brands. The movement swelled to huge proportions after a building collapsed six months later, claiming the lives of more than a thousand workers. Today, **the whole world is aware of the fate of people sacrificed so that firms can produce more cheaply**.

Responsible investors took part in the protest movement **through a joint declaration calling on garment makers to respect human rights** and adopt responsible procurement policies across their entire supplier chain. Firms were urged to make a collective commitment to apply the main standards promulgated by the International Labour Organization. By end-May 2013, nearly **200 investors with \$1.5 trillion under management had signed the declaration**. It is not yet known whether or not the signatories were shareholders in the companies targeted by the NGO or, if so, whether they would remain so.

The disasters in Bangladesh have shown how investors can move into action **when faced with a global scandal, where NGOs and the media link up to force the companies involved to adopt credible measures**. This controversy has cast doubt on the effectiveness of the measures already in place, such as conduct of business codes and social audits, and it has made responsible investors **more demanding when assessing the quality of the CSR policies pursued by the companies they invest in**. These investors are spurred by the growing clout of approaches that are far more direct. For example, the Norwegian sovereign wealth fund and the Dutch fund APG are embroiled in an affair arising from complaints filed by a South Korean NGO with the OECD's National Contact Points in Norway and South Korea. The funds are **under attack for owning shares in a mining company, POSCO, accused of human rights violations in India**. Arguing on the basis of its responsible investment policy, **the Norwegian fund has denied liability, saying that a minority shareholder cannot be held responsible if a company behaves in a manner the investor has neither wished for nor decided upon**.

Other initiatives involving a direct approach to investors are taking shape. ShareAction, a British NGO, **has called on people to write to their pension funds** asking them to apply pressure on companies in which they hold minority stakes. The organisation has highlighted the successful campaigns it targeted at the oil industry and the financial sector. Since the **social acceptability** of both sectors is **tenuous** at this time, norm-based exclusion could help investors avoid **the charge that they might be responsible for – or even guilty of – human rights violations by a particular company**.

But to achieve a paradigm shift, not only in Bangladesh but in all the world's sensitive areas, investors must first use their powers as shareholders to encourage models that comply more fully with major international agreements. **Combining shareholder engagement with norm-based exclusion is certainly an effective form of responsible investment. But it is far from universal in Europe**.

Controversial companies



DO INVESTOR
BLACKLISTS
MAKE A
DIFFERENCE?

A study by **Sarah Meller** with **Anne-Catherine Husson-Traore**, Director of Publications, and the Novethic research centre.

Novethic studies

Novethic's research centre examines companies' approaches to responsible investment and public communication from environmental, social and governance (ESG) standpoints.

It analyses and assesses the impacts of the practices of CSR and SRI players.

Novethic is the leading research centre on Responsible Investment in France. It conducts studies and organises events to mobilise financial actors on Environmental, Social and Governance (ESG) issues into investment practices. In 2009, Novethic launched first French SRI Label, awarded to mutual funds whose management systematically takes into account Environmental, Social and Governance criteria. Novethic is part of Caisse des Dépôts.

www.novethic.com

