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Report on the Council on Ethics' observation of PetroChina Co Ltd

In December 2016, the Council on Ethics recommended that PetroChina Co Ltd (PetroChina) be excluded from investment by the Government Pension Fund Global (GPF) due to the risk of gross corruption. Many senior executives in various divisions of PetroChina and its subsidiaries have been investigated for allegedly receiving bribes in return, for example, for awarding oil and gas contracts to subcontractors. In some of these cases, the allegations of corruption cover a period extending from 1980 right up until 2014. In the Council's view, the company had failed to provide sufficient information about the corruption-prevention measures implemented since 2014 or to substantiate how the measures would be effectively implemented throughout the organisation. The Council also attached importance to the fact that the company's management was largely the same when the recommendation was made as when the alleged corruption took place.

On 5 May 2017, Norges Bank decided to place PetroChina under observation, since it was felt that the company's anti-corruption measures provided sufficient grounds to observe developments going forward. In 2018, the Council on Ethics has monitored what the company is doing to develop and implement its anti-corruption programme. The Council has also monitored whether allegations of new incidents of corruption have emerged.

The Council on Ethics met with PetroChina in May 2018. The company has subsequently provided written answers to the questions the Council still had after the meeting. The company has also been given the opportunity to comment on a draft of this report.

This is the Council's first annual report to Norges Bank on its observation of PetroChina.

Key events since the recommendation was made in December 2016

The legal proceedings against former representatives of PetroChina's management continued in 2017. In January 2017, a former vice-chair of the company was sentenced to 15 years'

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imprisonment for soliciting and receiving CNY 13.4 million in bribes in the period 2003–2015.¹ In July 2017, a former manager at PetroChina’s sales office in Guangxi was sentenced to ten years’ imprisonment and a fine of CNY 500,000 for soliciting and/or receiving more than CNY 3 million in bribes. This is said to have included CNY 1.4 million in bribes from a construction company in return for contracts in 2013 and 2014. In the same case, another manager at a sales office in the same region has also been indicted on similar charges.²

New investigations in Ecuador:

Between July 2009 and September 2016, PetroChina signed eight contracts with the state-owned Ecuadorian oil company Petroecuador for the purchase of crude oil. The publication of the “Panama Papers” in 2016 prompted questions asked about the way these contracts had been entered into. The contracts, which were entered into directly, without being put out to international tender, meant that the oil was traded through successive offshore companies before eventually being sold at a higher price to countries other than China.³ Calculations presented in 2017 and 2018 indicate that Petroecuador may have lost USD 2–4 per barrel through these contracts, which could amount to a total of more than USD 1 billion. Much of this money is alleged to have been paid to agents and intermediaries, who are also said to have connections with the Ecuadorian government.⁴

At the end of January 2018, the Ecuadorian prosecutors’ office announced that the circumstances surrounding the signing of the oil contracts between PetroChina and Petroecuador – referred to here as the “PetroChina Affair” – had been under investigation since early February 2017.⁵ In July 2018, it emerged that the case was still under investigation.⁶

The company’s anti-corruption efforts since 2016

Corporate governance:

The Council on Ethics’ recommendation pointed out that the company’s management was largely the same in 2016 as when the corruption took place. Both the board and group management were chiefly composed of individuals who had held senior executive positions at PetroChina and/or the parent company CNPC for a long time, including the period during which the corrupt practices occurred.

The Council has re-examined the composition of PetroChina and CNPC’s boards and group managements, and notes that further long-serving members of top management in PetroChina were replaced in 2017. At the same time, however, it is apparent that individuals who held

¹ Reuters, 19 January 2017: China jails former senior oil executive for 15 years for graft, <https://www.reuters.com/article/us-china-corruption-cnpc/china-jails-former-senior-oil-executive-for-15-years-for-graft-idUSKBN1530TY>.

² Procuratorial Daily, 20 July 2017: 原中石油广西分公司副经理与妻子共同受贿获刑, http://news.jrb.com/xwyc/201707/t20170721_1778684.html.

³ El Universo, 6 June 2016: *Ecuadorianos recibieron comisión por crudo prevendido a Petrochina*, <https://www.eluniverso.com/noticias/2016/06/06/nota/5620212/ecuatorianos-recibieron-comision-crudo-prevendido-petrochina>; El Comercio, 21 June 2016: *Ecuador comprometió ventas de crudo con China hasta el 2024*, <https://www.elcomercio.com/actualidad/ecuador-petroleo-china-exportaciones-venta.html>; Medium, 21 March 2018: *PetroChina: La ruta del dinero*, <https://medium.com/focus-news-ecuador/petrochina-la-ruta-del-dinero-a8a49d8f870f>.

⁴ El Universo, 18 September 2017: *Colegio de Abogados de Pichincha y Fernando Villavicencio denuncian 'atracó' en intermediación petrolera*, <https://www.eluniverso.com/noticias/2017/09/18/nota/6388342/colegio-abogados-pichincha-fernando-villavicencio-denuncian-atracó>; Medium, 21 March 2018.

⁵ Fiscalía General de Estado, Ecuador, 26 January 2018: *En la Fiscalía se receptaron dos versiones privadas en caso Petrochina*, <https://www.fiscalia.gob.ec/la-fiscalia-se-receptaron-dos-versiones-privadas-caso-petrochina/>.

⁶ El Comercio, 19 July 2018: *Fiscal pide más diligencias sobre el caso Petrochina*, <https://www.elcomercio.com/actualidad/fiscal-diligencias-casopetrochina-investigacion-petroecuador.html>.

such positions when the corrupt practices took place continue to serve in the group managements and/or boards of both companies.

With respect to new structural initiatives at board level, the company itself points to the Anti-Corruption Leading Team at the parent company CNPC (China National Petroleum Corporation) as one of the most tangible expressions of the companies' stronger efforts to combat corruption in the past few years. A team of this kind was originally created at PetroChina in January 2014. However, it was re-established at CNPC in 2018 following personnel changes and to better meet the needs of the companies' anti-corruption efforts. The team is led by the chair of the two companies, while three members of CNPC's senior management (the President (CEO), Vice President and Chief of Discipline & Inspection Group) act as deputy leaders. The team's main task is to implement key government regulations and guidelines on integrity and anti-corruption, draw up an overarching anti-corruption plan and system, and coordinate and monitor these activities at CNPC and PetroChina.⁷ PetroChina has not answered the Council's question about how often the team meets.

Compliance:

PetroChina asserts that the company's recent anti-corruption efforts have, in general terms, been prompted by the importance the Chinese government attaches to combating corruption. This policy can be seen, not least, in the official anti-corruption campaign that has been underway since 2012. With reference to the fact that the Chinese state owns around 84 per cent of the company through CNPC, PetroChina underlines that it must comply with the government's requirements in all areas. Furthermore, PetroChina emphasises that the company's entire management attaches great importance to the anti-corruption effort and points to the establishment of the Anti-Corruption Leading Team as one of the clearest examples of the "tone from the top" within CNPC and PetroChina.⁸

PetroChina maintains that it takes a holistic approach to anti-corruption in its operations, with the involvement of several departments, including the Audit Department, Internal Controls Department and Supervision Department. Of these three departments, the latter has day-to-day responsibility for leading the company's anti-corruption efforts. According to PetroChina, the Supervision Department carries out regular inspections of all the company's business areas / regional departments in China, which includes a specific focus on corruption risk. The department has staff at the company's headquarters and regional offices, in addition to its own monitoring teams. The department has also set up its own monitoring units inside regional subsidiaries, partly in collaboration with other company departments.⁹

PetroChina says that the Supervision Department currently has a staff of 23 at head office and 78 at regional centres. It currently has 22 employees divided between six monitoring teams that are deployed on temporary assignments in departments at head office, in the divisions and in selected departments and subsidiaries with limited monitoring capacity. A total of 272 monitoring units, staffed by 2,141 people, have been created in the regional subsidiaries.¹⁰ According to PetroChina, it has established the practice of informing the other employees of the consequences that have befallen those involved, once a corruption case has been concluded.¹¹

⁷ Meeting with PetroChina, 4 May 2018; Letter from PetroChina dated 13 July 2018.

⁸ Meeting with PetroChina, 4 May 2018.

⁹ Meeting with PetroChina, 4 May 2018; Letter from PetroChina dated 13 July 2018.

¹⁰ Letter from PetroChina dated 13 July 2018.

¹¹ Meeting with PetroChina, 4 May 2018.

With respect to the company's operations abroad, PetroChina explains that these are often joint ventures, which leads to other kinds of risk and control measures.¹² The company says that its monitoring also encompasses its business operations abroad, but it is unclear how and to what extent this occurs. PetroChina's annual reports and website contain very little information about its international operations.

According to PetroChina, the individual business areas used to perform their own risk assessments of their respective areas. However, an overarching risk assessment of the entire company was carried out for the first time in 2016 under the leadership of the Supervision Department, but with support from the individual business areas. The risk assessment resulted in a total of 14,000 different risks being identified. However, this figure included all kinds of risk: operational, strategic, commercial, compliance in its broad sense, occupational health and safety, environment, etc.¹³

With respect to corruption risk in particular, the company says that it focuses primarily on its five key business areas: the development and operation of oil and gas fields, processing and chemicals, sales, pipelines and engineering services. Within these areas, the company has chosen to prioritise recruitment, investment decisions, procurement, tenders and bidding, as well as key positions at all levels with decision-making, administrative and spending authority as the most important processes and/or roles with a view to corruption risk. In relation to all these processes and roles, an assessment is also made of the extent to which key internal control requirements have been met.¹⁴

According to PetroChina, it undertakes extensive training of all employees in China with respect to all laws, regulations and guidelines. The different business areas also have their own programmes related, among other things, to technical, operational and management issues. With respect to corruption more specifically, the company says that it has relatively recently developed an app-based test containing questions relating to ethics and anti-corruption. All employees, including company management, are required to take the test on a regular basis. This tool gives the company a constantly updated overview of who has taken the test and what score they achieved. In addition to training programmes and the app, the company also points out that a lot of learning takes place in connection with the Supervision Department's inspections. The purpose of these inspections is not only to uncover, follow up and, if appropriate, punish non-compliance, but also to provide guidance and training with a view to preventing errors and unintended infringements of the rules.¹⁵

PetroChina claims to have a "whistleblower" system in place, through which people can report wrongdoing via letter, email or phone. The Supervision Department is responsible for ensuring that reports received are dealt with in a uniform manner and, according to the company, the department has dedicated employees who work specifically with the handling of such reports. Depending on the content of the report and who it concerns, its subsequent follow-up will be handled by the responsible inspectors at headquarters, the regional offices or the monitoring units in the regional subsidiaries.¹⁶

The inspections and investigations carried out on the basis of reports received are in addition to the company's more "proactive" control system, which comprises digital screening and a more detailed examination/verification of identified risks/irregularities. This work is divided between the Supervision Department and other departments/business areas in PetroChina, or

¹² Meeting with PetroChina, 4 May 2018.

¹³ Meeting with PetroChina, 4 May 2018.

¹⁴ Letter from PetroChina dated 13 July 2018.

¹⁵ Meeting with PetroChina, 4 May 2018.

¹⁶ Letter from PetroChina dated 13 July 2018.

associated companies if relevant. The Supervision Department is responsible for the subsequent handling of reports relating to verified irregularities.¹⁷

PetroChina also claims to have wide-ranging due diligence procedures in place that encompass all kinds of risk, not merely corruption. Because of the complexity related to this kind of research, it is considered most expedient that the individual departments at head office carry out due diligence within their own areas of responsibility, including an assessment of corruption risk. Examples given for this are the Engineering & Construction, Sales and Procurement departments.¹⁸ It is unclear to the Council on Ethics how and to what extent the Supervision Department assists in such inquiries.

Many questions remain unanswered by the company. The Council on Ethics has received no information about how many of the company's inspectors work specifically with anti-corruption, how many inspections are carried out with respect to corruption risk or how many violations of the anti-corruption regulations have been uncovered. Nor has the company provided details of what sanctions – including criminal charges – it has imposed in cases of corruption, what it considers to be its most important corruption risks or what are the most important measures to address these risks.

The Council on Ethics has, moreover, not received any information about how many people are employed to handle reports of corruption in the company, how many reports about possible corruption have been received or how many reports have been confirmed. Nor has the company responded to the Council's questions regarding the number of due diligence inquiries that have been performed with respect to corruption risk, including the number of potential contract partners that have been rejected as a result, or provided more detailed information on the most important checkpoints used in connection with such inquiries.

The Council on Ethics has also requested access to detailed information or copies of relevant documents, including those relating to PetroChina's anti-corruption training programmes and the company's handling of corruption in its international operations. However, PetroChina has failed to comply with the Council's requests.

The Council on Ethics' assessment

The Council on Ethics notes that PetroChina has shared more information in 2018 – through the meeting in Beijing in May 2018 and its letter of July 2018 – than the Council received during its investigations prior to its original recommendation.

The Council now knows more about how PetroChina has organised its anti-corruption efforts through the Supervision Department and about the size of the company's control organisation. The Council has also received further information about how the company organises its risk assessments and what are the most important focus areas and checkpoints for these assessments. The information the company has provided about the development of an in-house app containing questions relating to ethics and anti-corruption also indicates that the company has recently strengthened its anti-corruption training efforts. The Council knows more about how PetroChina deals with reports of wrongdoing and what role the Supervision Department has in this area. PetroChina has also shared slightly more information about how the company carries out third-party due diligence. News of the re-establishment of the Anti-Corruption Leading Team at CNPC in February 2018 can also be taken as a sign that the company wishes to strengthen the "tone from the top".

All in all, this has reinforced the Council on Ethics' impression that the company has some corruption-prevention systems in place and that these seem in some respects to have been

¹⁷ Letter from PetroChina dated 13 July 2018.

¹⁸ Meeting with PetroChina, 4 May 2018; Letter from PetroChina dated 13 July 2018.

strengthened since the Council sent its recommendation to Norges Bank. At the same time, the Council would like to point out that there is still a lot we do not know about PetroChina's anti-corruption efforts.

For example, the Council on Ethics does not know how many PetroChina employees engage specifically in anti-corruption activities, how many inspections specifically focusing on corruption risk are carried out, or how many violations of the anti-corruption regulations have been uncovered in recent years. Nor has the Council received more detailed information about the company's most highly prioritised corruption risks and associated countermeasures. This makes it difficult to assess the extent to which the company has an analytical and targeted approach to corruption risk. It is, moreover, difficult for the Council to assess what kind of organisation PetroChina has to deal with reports of corruption, since it has not been given any details of how many people in the company are engaged in handling such reports, the number of reports received or how these have been handled.

PetroChina claims to have wide-ranging due diligence procedures in place, but has given no further details about the performance of such inquiries. The Council notes that PetroChina has developed new anti-corruption training programmes for all its employees, but when the company declines to share any further details about what these programmes contain, it is difficult to assess the extent to which this training complies with best practice.

Overall, this means that the Council still knows little about what PetroChina *actually* does to prevent, uncover and deal with corruption in the company. Given the sector and the countries in which PetroChina operates, as well as the company's history of widespread corruption, the Council considers that this does not provide sufficient assurance that the company's anti-corruption efforts are adequate. The situation seems to be most serious with respect to the company's international operations. While it has come to light that PetroChina may be involved in a corruption case in Ecuador, the Council on Ethics knows even less about the company's operations and anti-corruption activities in this country and elsewhere around the world than it does about similar operations and initiatives inside China.

The Council on Ethics further notes that certain members of group management and/or the board of directors of PetroChina and its parent company continue to hold the same positions as they did when the alleged corruption took place. The Council considers that this also signals that the company still does not take the risk of corruption seriously enough.

The Council on Ethics is therefore of the opinion that there is still a considerable risk that PetroChina may once again become involved in corruption. However, because the Council places greater emphasis on the fact that the company has shown a willingness to share more information than before, and that a relatively short period of time has elapsed since its observation of the company commenced, the Council has decided not to recommend that PetroChina be excluded from the GPF. Observation should therefore be continued for the time being.

The Council on Ethics will continue to observe PetroChina's anti-corruption efforts through dialogue with the company. The Council will also monitor whether new information emerges from other sources regarding the case in Ecuador or any other serious cases of corruption.

Yours sincerely,

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