



SUDAN DIVESTMENT

TASK FORCE

A project of the Genocide Intervention Network

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Sudan Divestment Resource Guide

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A Report by
The Sudan Divestment Task Force

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I. Introduction

Since 2003, the government of Sudan has pursued a genocidal campaign against the civilian population of Darfur. Although governmental obstruction has prevented the international community from obtaining concrete statistics on mortality, hundreds of thousands have died and over 2.5 million have been displaced as a result of the conflict.¹ The United States government first labeled the Darfur conflict as genocide in July 2004. This is the first time the U.S. has declared a situation to be genocide while atrocities are *ongoing*.²

The U.S. has maintained sanctions on Sudan since 1997, in part due to the government of Sudan's sponsorship of terrorist organizations. While these sanctions prevent the vast majority of U.S. companies from operating in Sudan, they generally do not prevent investors from investing in non-U.S. companies doing business there. To address this gap in policy, numerous individual and institutional investors from around the world have exerted shareholder pressure on problematic non-U.S. companies supporting the Sudanese regime. These efforts, which range from shareholder engagement to divestment of shares, aim to force problematic companies to address the financial and social implications of their operations in Sudan.

At the time of publication of this report (March 2008), at least twenty-four states have adopted divestment policies related to Sudan. Sixteen of these states have passed or adopted the Sudan Divestment Task Force's model of targeted Sudan divestment: Arizona, California, Colorado, Florida, Hawaii, Indiana, Iowa, Kansas, Massachusetts, Minnesota, New Mexico, New York, North Carolina, Rhode Island, Texas, and Vermont. Eight of these states have developed alternative methods of Sudan divestment: Arkansas, Connecticut, Illinois, Maine, Maryland, Missouri, New Jersey and Oregon. Additionally, at least fifty-nine universities, sixteen municipalities, and two international pension funds (Netherland's PGGM and the European Parliament members' pension fund) have adopted Sudan divestment policies. Divestment campaigns continue to gain momentum both in the U.S. and, increasingly, in Europe.

In December 2007, the U.S. government approved the Sudan Accountability and Divestment Act (Public Law No: 110-174), which authorizes and encourages state and local governments to adopt targeted Sudan divestment measures, prohibits federal contracts with companies that operate in Sudan's oil, power, mineral and military sectors, authorizes adoption of similar procurement prohibition policies at the state and local levels, and provides legal protections to asset managers that choose to divest from Sudan. A summary of the Sudan Accountability and Divestment Act can be found in *Appendix-1* of this report.

The Sudan Divestment Task Force provides more information on the status of the global Sudan divestment movement in the following resources:

Current Sudan Divestment Statistics: www.sudandivestment.org/statistics.asp

State of Sudan Divestment Report: www.sudandivestment.org/position.asp#state

¹ Reuters, "Darfur conflict." Alertnet website [online], updated October 24, 2007. Available from http://www.alertnet.org/db/crisisprofiles/SD_DAR.htm [Accessed March 6, 2008].

² Kessler, Glen and Colum Lynch, "U.S. Calls Killings in Sudan Genocide." *The Washington Post* [online], September 10, 2004. Available from: <http://www.washingtonpost.com/wp-dyn/articles/A8364-2004Sep9.html> [Accessed March 6, 2008].

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Sudan Divestment Legislative Charts: www.sudandivestment.org/legislative_chart_2008.asp (2008)
www.sudandivestment.org/legislative_chart.asp (2007)

Interactive U.S. Divestment Map: www.sudandivestment.org/home.asp#map

The Sudan Divestment Task Force

The Sudan Divestment Task Force (SDTF) was formed in late 2005 to coordinate and help provide resources for the burgeoning Sudan divestment campaign. In October 2006, SDTF was incorporated as a project of the Genocide Intervention Network (www.genocideintervention.net), a 501(c)3 non-profit organization based in Washington D.C. With staff in Washington, Boston, and London, SDTF provides free research, policy, and advocacy support to individuals and institutions dealing with Sudan divestment. SDTF supplements its research with ongoing communication with fiduciaries and asset management firms, foreign policy experts, think tanks, international non-governmental organizations (NGOs), contacts on the ground in Sudan or linked to Sudan, and executives of problematic companies targeted by the Sudan divestment movement.

This resource guide outlines the targeted Sudan divestment model developed by SDTF. It then introduces resources to identify problematic companies in Sudan, tools for shareholder engagement, and existing options for Sudan-free investing. The guide also addresses concerns regarding fiduciary duty, U.S. constitutional requirements, and the potential for Sudan divestment to set a precedent other divestment requests.

II. Models for Sudan Divestment

The Sudan Divestment Task Force's Targeted Sudan Divestment Model

The government of Sudan has a well-documented history of susceptibility to economic pressure.³ Possessing neither the capital nor the expertise to fully exploit its own natural resources, the government of Sudan is highly reliant on foreign direct investment (FDI) not only to pay its debts and subsidize government expenditures, but also to fund its military and finance the war in Darfur. In fact, a former Sudanese finance minister estimated that 70% of the government's share of oil profits is spent on the military.⁴ These strong links between FDI and conflict in Sudan, discussed in greater depth in SDTF's *Efficacy of Targeted Sudan Divestment* report, have raised social concerns among many investors about portfolio companies operating in Sudan.

Efficacy of Targeted Sudan Divestment Report: <http://www.sudandivestment.org/position.asp#efficacy>

Furthermore, recent events in Sudan have prompted investors to also question the *financial* prudence of investing in problematic companies in Sudan. These firms, which support the

³ See *Efficacy of Targeted Divestment*: www.sudandivestment.org/position.asp#efficacy

⁴ Gettleman, Jeffrey, 2006. "War in Sudan? Not Where the Oil Flows." *New York Times*, October 24, 2006. Available online: <http://www.nytimes.com/2006/10/24/world/africa/24sudan.html?ex=1319342400&en=9fa37c1bffd09db2&ei=5088&partner=rssnyt&emc=rss> [Accessed February 1, 2008].

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government of Sudan at the expense of the country's marginalized populations, carry significant financial, operational, and reputational risk. A summary of these risks can be found in *Appendix-2* of this report.

SDTF developed the targeted Sudan divestment model to provide investors with an effective means to exert shareholder pressure on problematic companies operating in Sudan. The model seeks to create a positive change that helps bring about comprehensive peace in Sudan, minimize negative impacts on innocent civilians, protect long term investment returns, and conform to relevant constitutional limitations and federal law (such as the Sudan Accountability and Divestment Act). The SDTF model was developed with input from Sudan experts, institutional fiduciaries, and constitutional law experts, and is currently available in two formats: a legislative model and a sample investment policy statement.

Legislative Model: www.sudandivestment.org/docs/task_force_targeted_divestment_model.pdf

Investment Policy Statement: www.sudandivestment.org/docs/SDTF_Investment_Policy_Statement.pdf

Additionally, full-time consultants are available to work directly with investors seeking to implement SDTF's targeted Sudan divestment model.

The targeted Sudan divestment model addresses the following four general questions that investors must consider when deciding how to deal with problematic companies in Sudan:

1) *Which companies in Sudan are problematic and should be targets for shareholder pressure?*

In contrast to other models of Sudan divestment that advocate targeting all non-humanitarian business connections to Sudan, the targeted Sudan divestment model focuses shareholder pressure on problematic companies that fit *all* of the following general criteria:

- The company has a business relationship with the government of Sudan, a government-created project, or companies affiliated with a government-created project; AND
- The company provides little benefit to the disadvantaged populations of Sudan; AND
- The company has not developed a substantial business-practice policy addressing the fact that the company may be (sometimes inadvertently) contributing to the government of Sudan's genocidal capacity.

These criteria exclude companies that contract exclusively with the regional government of South Sudan, that primarily provide goods or services that principally and directly benefit Sudan's marginalized populations, that are involved in business related to general downstream consumer goods and services in Sudan, that contribute to most types of infrastructure development, or whose primary purpose in Sudan is humanitarian, medical, journalistic, educational, or otherwise associated with "social goods." Companies whose activities in Sudan are currently dormant are also excluded from divestment. In fact, out of the hundreds of multinational companies operating in Sudan that SDTF has reviewed, only a few dozen potentially meet the general criteria above.

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Nearly all of the problematic companies that fit SDTF's targeted criteria operate in Sudan's oil, mineral extraction, large-scale power, and defense sectors. Accordingly, these are the four sectors designated in the legislative version of the SDTF model and authorized for divestment in the U.S. Sudan Accountability and Divestment Act. A summary of the Sudan Accountability and Divestment Act can be found in *Appendix-1* of this report.

2) *What is the best mechanism for influencing these problematic companies?*

After problematic companies are identified according to the criteria described above (the *identification* phase), the targeted Sudan divestment model requires investors to conduct a three month period of shareholder engagement (the *engagement* phase). During this time, investors send letters to problematic companies requesting that each company either take "substantial action" (see below) or cease its problematic business operations in Sudan within one year. Problematic companies that fail to commit to either of these actions must then be excluded from the portfolio. The investor is required to sell the securities it holds in these problematic companies (excluding investments held in certain "hard-to-divest" asset classes) over the course of a reasonable sell-off period (the *divestment* phase).

SDTF recognizes that shareholder engagement is almost always a more effective means of reforming problematic company behavior than shareholder divestment. However, SDTF argues that Sudan represents a unique situation where it is necessary to utilize the "stick" of divestment as a tool of last resort. Extended shareholder engagement through traditional mechanisms such as proxy voting and coalition building often takes years. This timeframe is wholly unsuited to the urgency of ongoing genocide. Not only does the threat of shareholder divestment provide a clear endpoint to the engagement process, but the threat of divestment itself has increased the willingness of many problematic companies in Sudan to engage with shareholders.

3) *How can these problematic companies best address the social and financial concerns that investors have related to their operations in Sudan?*

It is imperative to note that SDTF, through the targeted Sudan divestment model, does not seek to force all companies to leave Sudan.

When possible, SDTF encourages companies that operate in Sudan to use their leverage to push for peace and sustainable development in the country. The government of Sudan's dependence on foreign investment gives companies operating in Sudan considerable leverage and a unique ability to influence the government's harmful policies. It therefore is necessary to first encourage problematic companies willing to negotiate, engage, and change their behavior to stay, in order to avoid their replacement by firms that are less responsible, less responsive to human rights concerns, and unwilling to improve their behavior.

Problematic companies that choose to remain in Sudan and wish to avoid divestment are expected to implement robust corporate policies in the country that address all relevant issues. SDTF has defined these expectations for problematic companies as "substantial action"⁵ in the targeted Sudan divestment model.

⁵ According to the targeted divestment legislative model, "substantial action" is defined as "adopting, publicizing, and implementing a formal plan to cease scrutinized business operations within one year and to refrain from any such new business operations; undertaking significant humanitarian efforts in conjunction with an international organization, the government of Sudan, the regional government of southern Sudan, or a non-profit entity and evaluated and certified by an independent third party to be substantial in relationship to the company's Sudan business operations and of benefit to one or more marginalized populations of Sudan; or through engagement with the government of Sudan, materially improving conditions for the genocidally victimized population in Darfur."

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Montreal-based mining firm La Mancha Resources provides an excellent example of a company taking “substantial action”. Previously targeted for divestment because of its gold mining operations in Sudan, La Mancha has taken extraordinary steps to ensure that it is a responsible corporate actor in Sudan, specifically addressing its provision of revenue to the government of Sudan. The company met with government of Sudan officials to express concern about Darfur and agreed to refrain from new investment in Sudan until the government of Sudan facilitates full implementation of the United Nations/African Union hybrid peacekeeping force in Darfur. La Mancha Resources also is donating a substantial amount of money to a humanitarian project in Darfur, which has been approved of by an independent and reputable third party. Finally, La Mancha Resources submitted to a full evaluation of their business operations, including labor, environmental, and company security detail practices. If La Mancha Resources had simply left Sudan, their mining operations would likely have been sold back to the government of Sudan, as stipulated in the company’s contract. Instead, La Mancha Resources opted to use its leverage to effectively respond to the situation in Darfur and ensure that it is a positive force in Sudan.

SDTF offers further elaboration on “substantial action” through its general engagement principles for problematic companies in Sudan.

General Engagement Principles: www.sudandivestment.org/engagement_principles.asp

- 4) *How can institutional investors implement a Sudan divestment policy and maintain their responsibility as fiduciaries?*

While investors may be interested in dissociating from genocide on moral grounds, fiduciaries have an important obligation to manage retirement assets in a financially prudent manner exclusively in the interest of their beneficiaries. SDTF, in recognition of these constraints, designed the targeted Sudan divestment model in consultation with fiduciaries, asset managers and legal counsel to comport with fiduciary responsibility. The last section of this report, entitled *Legal and Policy Considerations*, explores this issue in greater detail. Additionally, the fourth section of this report, entitled *Sudan-Free Investments: Options & Costs*, and *Appendix-2*, entitled *Financial, Operational and Reputational Risks Summary*, address the various financial risks associated with problematic companies in Sudan.

Other Models for Sudan Divestment

SDTF’s targeted Sudan divestment model is the only existing coordinated approach to, or model for, Sudan divestment. Sixteen of the twenty-four states that have adopted Sudan divestment policies for their pension funds strictly follow the SDTF model. However, a small number of U.S. states have used alternative approaches, most of which were instituted prior to the creation of the targeted Sudan divestment model.

In 2005, the states of Illinois and New Jersey adopted “blanket” divestment policies that target all companies with non-humanitarian ties to Sudan, which differs greatly from the targeted Sudan divestment model. SDTF strongly believes that the “blanket divestment” approach may have unintended negative consequences both for Sudan’s underprivileged, who may benefit from responsible FDI, and for investor portfolio returns. Furthermore, since the signing of the Sudan Accountability and Divestment Act in December 2007, only divestment policies which limit their focus to companies operating in Sudan’s oil, mineral extraction, large-scale power, or defense sectors are afforded federal constitutional protection. A summary of the Sudan Accountability and Divestment Act can be found in *Appendix-1* of this report.

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Several other state pension funds, including those of Maryland, Arkansas, and Maine, adopted variants of the targeted Sudan divestment model. The state of Connecticut adopted a policy that gives the state treasurer discretion to engage with and possibly divest from companies tied to Sudan. The state of Oregon adopted a policy that led its pension funds to divest from four companies operating in Sudan, two of which are no longer operating in Sudan. Finally, Missouri's treasurer pushed the state's largest pension fund to adopt a "terror-free" investment policy that bars it from holding stakes in companies operating in Sudan, Iran, North Korea, Syria or Cuba.

The majority of the municipalities, universities, and financial institutions that have explored or adopted Sudan divestment policies have coordinated with SDTF and employed the targeted Sudan divestment model.

Sending a consistent message to problematic companies operating in Sudan is necessary to effectively change company behavior and, in turn, to change the behavior of the government of Sudan. Therefore, SDTF strongly recommends that concerned investors and policymakers utilize the targeted Sudan divestment model. Additionally, while investors may choose to implement individual phases of the targeted model, SDTF has found the full model to be the most effective in achieving the desired outcome.

III. Screening/Identification of Problematic Companies

The first step in implementing a targeted Sudan divestment policy is to identify a list of problematic companies that should be subject to shareholder pressure. Several organizations or firms produce research on this subject. SDTF publishes the quarterly *Sudan Company Report*, a comprehensive listing of companies with problematic business operations linked to Sudan that includes a detailed description of each company's history and current involvement in the country. This report is free of charge and available to the public. Several independent for-profit firms also produce proprietary Sudan-related company lists.

The Sudan Divestment Task Force's *Sudan Company Report*

The *Sudan Company Report* is intended to serve as a listing and comprehensive profile of all problematic companies that SDTF has determined warrant scrutiny by investors because of their business operations linked to Sudan. Over the past two years, SDTF's research team has examined more than 800 companies with Sudan-linked operations to determine whether these operations negatively impact the situation in Darfur while offering minimal benefit to Sudan's disadvantaged populations. Only a small fraction of the examined companies make it onto the *Sudan Company Report* since the vast majority of companies operating in Sudan are not problematic according to the targeted Sudan divestment model. The report is compiled with input from a variety of sources, including direct communications with problematic companies. SDTF has reached out repeatedly to all companies listed in the *Sudan Company Report*. Those that do respond and hold meetings with SDTF are given the opportunity to review their entry in the report to ensure factual accuracy.

The *Sudan Company Report* contains three categories of companies:

- *Category One ("Highest Offenders")*: In general, these companies have proven to be largely unresponsive to engagement by shareholders and/or have not yet formalized a business plan to reform their problematic business operations in Sudan. While SDTF strongly recommends engagement with all companies before any divestment decision is made, SDTF considers companies in this category to be likely candidates for

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divestment at present time. Many fiduciaries and public funds currently use Category One of the *Sudan Company Report* as a divestment list or screen.

- *Category Two (“Ongoing Engagement”)*: In general, these companies do not fully meet the criteria for shareholder divestment according to the targeted Sudan divestment model. This is either because the company has engaged shareholders and is in the process of remedying past problematic actions or because further clarification is needed regarding the exact nature of the company’s current operations in Sudan. SDTF therefore considers companies in this category to be targets for continued shareholder engagement and emphasizes the importance of this engagement.
- *Category Three (“No Publicly Traded Equity”)*: The majority of the companies in this category currently demonstrate problematic “highest offender” activity in Sudan, but all are either private firms or wholly-owned by a government. While these companies do not have any publicly-traded equity of which SDTF is aware at present time, fiduciaries may be exposed to these companies through private placements, corporate bonds, or private equity funds.

The *Sudan Company Report* contains significant background information on each company and ranks companies from most problematic to least problematic within each category. Both the analytical criteria used to identify problematic companies operating in Sudan and the *Sudan Company Report* itself are certified by the Calvert Group, the world’s largest socially-responsible mutual fund family.

A subscription to the *Sudan Company Report* is available at no charge through the SDTF website:

Free subscription to the *Sudan Company Report*: www.sudandivestment.org/reportrequest.asp

Along with the *Sudan Company Report*, SDTF also offers spreadsheets based on data from Bloomberg LP, which contain security identifier information for the companies contained in the report, including CUSIP, SEDOL, and other identifiers. SDTF also provides a comprehensive list of company contact information to facilitate shareholder communication with companies. Both spreadsheets are provided at no charge. To receive these documents, please contact SDTF at info@sudandivestment.org.

Additionally, SDTF tracks the rankings of companies in the *Sudan Company Report*, allowing investors to see changes in company behavior over time, and to give a sense of the list’s stability. The rank chart is provided for download with a *Sudan Company Report* subscription.

Finally, SDTF has developed, in conjunction with *InvestedInterests.com*, an online screening tool that allows individuals to screen U.S.-based mutual funds for exposure to the “Highest Offenders” in Sudan that appear on our report.⁶

Mutual Fund Screening Tool: <http://www.sudandivestment.org/screener.asp>

⁶ The Sudan Mutual Fund Tool only includes information on U.S. based mutual funds. If you would like to screen a non-U.S. based mutual fund, please contact SDTF (info@sudandivestment.org) to obtain data on problematic companies.

Other Research Providers and Sudan Company Lists

Two third-party research providers, *RiskMetrics* (www.riskmetrics.com) and *KLD Research & Analytics* (www.kld.com), currently sell screens/lists that are intended for compliance with the targeted Sudan divestment Legislative Model. SDTF provides free research and consultation to both providers in an effort to ensure that all Sudan company information available to investors, both free and proprietary, is of the highest possible quality. Information on both the *RiskMetrics* and *KLD Research & Analytics* products, including pricing and proprietary restrictions, is available through each third party.

Numerous parties have called on the U.S. federal government to provide a list of foreign companies operating in Sudan. Unfortunately, the federal government consistently has failed to provide investors with accurate information for this purpose. In 2007, the U.S. Securities and Exchange Commission (SEC) created a web tool intended to list companies connected to countries considered state sponsors of terror by the U.S. government, including Sudan. However, the tool was criticized widely by companies, investors, and activists as inaccurate and unhelpful and the SEC elected to take down the tool in June 2007.^{7 8} Furthermore, when considering the Sudan Accountability and Divestment Act in October 2007, the U.S. Senate Committee on Banking, Housing, and Urban Affairs concluded that the federal government was not logistically situated to produce a public list of foreign companies operating in Sudan. The committee's chairman, Senator Christopher Dodd, noted this in an October 17, 2007 committee report:

"In testimony before the Committee, the Department of the Treasury seemed to sanction lists developed by non-government organizations (NGOs) produced for purposes of divestment from Sudan, suggesting that the federal government would not be able to add much value given current efforts already underway by NGOs. The Committee therefore discerns that in accordance with sections 3 and 4 of [the Sudan Accountability and Divestment Act], States, local governments, and fund managers may rely on resources provided by internationally-recognized NGOs, and other appropriate sources, to target companies for divestment."⁹

As an additional note, SDTF strongly urges investors against relying exclusively on divestment screens/lists published by other investors or institutions after they adopt a divestment policy. These lists usually reflect a fixed moment in time and are updated rarely. For example, a number of investors and institutions have relied on certain university divestment lists published in June 2005, even though many of the companies on those lists no longer operate in Sudan and other problematic companies that do not appear on those lists have since been discovered or commenced operations in Sudan.

⁷ On July 5, 2007, SDTF director Adam Sterling and Todd Malan, the president and CEO of the Organization for International Investment (OFII) published an opinion piece in the *Wall Street Journal* criticizing the SEC's "terror watch list." This is available on OFII's website: <http://www.ofii.org/newsroom/news/070507wsj.htm> [Accessed March 7, 2008].

⁸ Norris, Floyd, "S.E.C. Rethinks List Linking Companies and Terrorist States." *The New York Times* [online], July 21, 2007. Available from: <http://www.nytimes.com/2007/07/21/business/21sec.html> [Accessed March 7, 2008].

⁹ U.S. Senate. Committee on Banking, Housing and Urban Affairs Committee, "Sudan Accountability and Divestment Act of 2007" (to accompany S.2271). Senate Report 110-213. Government Printing Office, 2007. Available from: http://frwebgate.access.gpo.gov/cgi-bin/getdoc.cgi?dbname=110_cong_reports&docid=f:sr213.110.pdf [Accessed March 6, 2008].

IV. Engagement

As discussed above, engagement is a critical and required component of the targeted Sudan divestment model. SDTF recommends that investors engage with all companies, including “Highest Offenders” in Sudan, before any divestment takes place. SDTF engages, directly and on behalf of various investors, with many of the companies in the *Sudan Company Report*. SDTF summarizes the history of its engagement with each company in the company profiles section of the *Sudan Company Report*.

SDTF provides specifically tailored template letters, complete with company contacts and addresses, to facilitate company engagement for two types of investors: public fund managers that are under a legislative mandate for targeted Sudan divestment and investors or institutions that are not. Letters are available for companies in the “Highest Offenders” and “Ongoing Engagement” categories. The letters are based generally on the “Substantial Action” exemption for divestment and SDTF’s General Engagement Principles (as mentioned above) but also contain recommendations specific to each company.

Template engagement letters: please contact info@sudandivestment.org

General Engagement Principles: http://www.sudandivestment.org/engagement_principles.asp

Coordinated engagement ensures that stakeholders send companies a consistent and productive message. Therefore, SDTF strongly encourages investors to consult the organization before initiating or continuing shareholder engagement with companies operating in Sudan. To learn more about the possibility of joining with other investors to collectively engage problematic companies, please contact SDTF at info@sudandivestment.org.

V. Sudan-Free Investments: Options, Costs and Benefits

In the final phase of the targeted Sudan divestment model, investors sell the securities they hold in problematic companies that fit the targeted identification criteria and have proven insufficiently responsive to engagement. This section discusses the resources available to investors to facilitate this process, including Sudan-free investment products, and will explore the potential costs of divestment.

Sudan-Free Investment Products

MSCI Barra Indices

In January 2008, SDTF chose MSCI Barra (NYSE:MXB) to calculate a series of custom indices that exclude the “Highest Offenders” in Sudan from several standard MSCI Indices, including the MSCI EAFE, MSCI Emerging Markets, and MSCI All Country World ex-US Indices. MSCI Barra is a leading provider of investment decision support tools worldwide, including indices and risk and return portfolio analytics.

The custom indices include reweighting strategies that minimize any potential tracking error from the standard indices. For more information on the indices, the reweighting strategy and funds based off the customized MSCI indices, please contact SDTF at info@sudandivestment.org.

Sudan-Free Funds

As mentioned above, in 2005, the state of Illinois passed legislation that required Illinois pension funds to divest from all companies with non-humanitarian connections to Sudan. In response, a number of asset managers, including Northern Trust and Barclay's Global Investors, began to offer Sudan-free investment vehicles. Both the legislation and the resulting investment vehicles take a blanket approach to divestment and exclude many more companies than the targeted Sudan divestment model requires. As a result, the tracking error for investment vehicles that utilize this blanket screen is much greater than it would be for investment vehicles tailored to the targeted approach.

SDTF currently is in talks with several asset managers about developing Sudan-free funds that are based on a targeted Sudan screen and/or customized indices like the MSCI indices mentioned above. SDTF strongly urges investors interested in targeted Sudan-free products to contact the organization at info@sudandivestment.org. Investors also should contact their existing fund managers directly to request that they develop *targeted* Sudan-free products. In addition, Northern Trust, Barclays Global Investors, and certain other asset managers have stated that they are already able to customize their blanket divestment investment vehicles to meet targeted Sudan divestment requests for separately managed accounts.

In addition to the Sudan-free options offered by large asset management companies, numerous money managers that specialize in socially responsible investing (SRI) offer certified Sudan-free funds. For more information on these funds, please contact SDTF at info@sudandivestment.org.

Hundreds of institutional investors have adopted the targeted Sudan divestment model and many more currently are considering the model. In response, asset managers have become increasingly familiar and comfortable with implementing customized Sudan-free mandates, especially with the advent of customized MSCI indices mentioned above. As the targeted Sudan divestment movement continues to gain momentum, it is likely that such options will become even more widely available and the potential costs associated with moving to Sudan-free investment vehicles will decrease even further.

Divestment Costs and Benefits

A major consideration for investors and fiduciaries considering adoption of the targeted Sudan divestment model is the potential for both short and long term costs associated with divestment. While private pension plans regulated under the Employee Retirement Income Security Act (ERISA) are generally allowed to take social issues into account when making investment decisions, it is widely accepted that those decisions can only happen when financially equivalent alternatives that otherwise have similar costs, risks, and return potential exist.

Although they are not directly subject to ERISA, public pension funds generally follow this principle of fiduciary duty. As the scope of a divestment policy broadens, it becomes increasingly difficult to find financially equivalent alternative investments for each and every blacklisted investment, making it more difficult to uphold fiduciary duty. Because of the limited breadth of the targeted Sudan divestment model, the abundance of free implementation resources provided by organizations like SDTF to minimize implementation costs, and the material risk and underperformance associated with "Highest Offenders" in Sudan, investors can confidently implement the targeted Sudan divestment model without violating their fiduciary responsibility. This conclusion is supported by section five (*Legal and Policy Considerations: Fiduciary Duty*), *Appendix-2 (Financial, Operational and Reputational Risks Summary)* of this report and this section's analysis on short and long term costs. It is also consistent with a statement made by the Teacher's Retirement System of Texas to *Global Pensions* in January 2008 that the

implementation of the state's targeted Sudan divestment law would have “no material impact” on the performance of the fund.¹⁰

Short-Term Costs

The potential short-term costs associated with the targeted Sudan divestment model generally relate to the research, administrative, and transactional costs of implementing the policy. SDTF offers its company research and engagement materials free of charge and notes that this research, in and of itself, is adequate for fiduciaries to comply with legislative mandates for targeted Sudan divestment. The majority of states that have passed Sudan divestment legislation subscribe to the free *Sudan Company Report*, and more than a dozen states rely on SDTF research and materials to implement targeted Sudan divestment legislation. For those fiduciaries or investors that prefer to purchase research from third-party firms, both *RiskMetrics* (www.riskmetrics.com) and *KLD Research & Analytics* (www.kld.com) have their own payment scheme for providing information on companies operating in Sudan.

The major phases of the targeted Sudan divestment model—identifying problematic companies, conducting shareholder engagement, finding replacement investments, and complying with reporting requirements—all require staff resources. In order to minimize administrative costs associated with these phases, SDTF provides free company research, security identifier information for problematic companies (including CUSIP, SEDOL, and other security identifier numbers), template letters and contact information for corporate engagement, current information on Sudan-free investment vehicles, and assistance from full-time corporate engagement and legislative compliance specialists. As a result, any administrative costs should fall well within the normal course of operations associated with performing due diligence in the management of an investment portfolio. Nearly all fiduciaries implementing the targeted Sudan divestment model have been able to do so without hiring additional staff for this purpose, especially if the fiduciaries consult with SDTF specialists.

The short-term transaction costs associated with the targeted Sudan divestment model will vary depending on the fiduciary's portfolio structure and mode of management. However, the targeted Sudan divestment model contains several provisions intended to generally minimize transaction costs. Those provisions are expanded upon in section five of this report (*Legal and Policy Considerations: Fiduciary Duty*).

Long-Term Costs and Benefits

Concerns about long-term costs associated with the targeted Sudan divestment model typically relate to opportunity, management, and reputational costs. With regard to opportunity costs, fiduciaries and investors have questioned whether excluding certain companies operating in Sudan from an investment portfolio will preclude the investor from important investment opportunities, such as emerging markets or energy sector industries.

Although stock market theory posits that any limitation of the “investable universe” creates an opportunity cost for investors, the reality of the targeted Sudan divestment model does not bear this out. Financially equivalent alternatives exist for each of the small number of problematic companies singled out by targeted Sudan divestment. Restricting investment in “Highest Offenders” in Sudan does not categorically bar investors from any single global sector, asset class, geographic location, or market capitalization category. Even within certain sectors that operate in Sudan, such as oil and power, only the most problematic companies are targeted for divestment, leaving investors with the opportunity to invest in a more responsible company

¹⁰ Sheen, Andrew, 2008. “TRS reveals Sudanese investments.” *Global Pensions*, January 11, 2008. Available online: http://globalpensions.com/showPage.html?page=gp_display_news&tempPageId=665818 [Accessed February 1, 2008].

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within the same industry sector in Sudan. Additionally, since the U.S. government already forbids U.S. persons from conducting business related to Sudan, targeted Sudan divestment does not affect portfolio exposure to U.S. domestic securities.

Evidence from states that have already adopted targeted Sudan divestment policies suggests that only minimal percentages of an investment portfolio will be affected. None of the U.S. public pension plans that have adopted the model held over 0.3% of their assets in problematic companies. Most have held less than 0.1%.

In addition, some public fiduciaries have opted to find alternative investments to problematic companies operating in Sudan because these problematic companies expose the fund to an unacceptable level of financial risk. New York State Comptroller Thomas DiNapoli, sole fiduciary for the \$144 billion New York State Common Retirement Fund stated in June 2007 that:

“The pension fund must be managed for the benefit of the members, beneficiaries and retirees, but I’m confident the members of the Retirement System do not want the pension fund to support governments that engage in genocide. And investing in companies that lend aid to these regimes is not conducive to long-term investment strategies.”¹¹

Similarly, Matthew Potter, chairman of the Investment Committee of the Wyoming Retirement System, stated in November 2007 that:

“One would have to question the business acumen of a company that makes the decision to do business with such a regime [as the one in power in Sudan] in light of all the opposition to that regime...It seems to me that continuing to hold these shares, with the knowledge that that pressure is forthcoming, truly is a violation of one's fiduciary duty.”¹²

Research supports the hypothesis that targeted Sudan divestment may be a sound financial decision. SDTF has tracked the financial, operational, and reputational risks associated with certain problematic business operations in Sudan. A summary of these risks can be found in *Appendix-2* of this report. In the aggregate, these risks are sizable and often underappreciated by fiduciaries.

Besides opportunity costs, fiduciaries may be concerned about management and reputational costs associated with targeted Sudan divestment. While it is true that there may be some minimal change in management fees associated with removing “Highest Offenders” in Sudan from fiduciary portfolios, the impending introduction of Sudan-free investment vehicles tailored for targeted Sudan divestment by mainstream asset managers will significantly decrease management costs (especially as commingled fund solutions come online). Fiduciaries may also be concerned about the reputational risks the targeted Sudan divestment model may pose to their funds and that placing restrictions on an investment portfolio might hurt their future ability to attract competitive bids by external money managers. However, the growing international Sudan divestment movement, which is now active in eighteen countries, clearly has brought the demand for Sudan-free investment mandates into the mainstream investment community.

¹¹ DiNapoli, Thomas. Office of the New York State Comptroller, “DiNapoli Announces Program for Sudan Investments”. *New York State Office of the State Comptroller*, June 11, 2007. Available Online: <http://www.osc.state.ny.us/press/releases/june07/061107.htm> [Accessed February 1, 2007]

¹² Potter, Matthew, “Fiduciary duty calls for divesting”. *Pensions & Investments*, November 26, 2007. Available Online: <http://www.pionline.com/apps/pbcs.dll/article?AID=/20071126/PRINTSUB/71121014/1026/TOC> [Accessed February 1, 2007]

Furthermore, the narrow list of problematic companies targeted does not affect core portfolio holdings for most Western fiduciaries. The targeted Sudan divestment model also makes special adjustments for divestment from certain investment vehicles that are relatively small parts of most fiduciary portfolios but where reputational risk may be high because the investment vehicle or its manager are highly sought after.¹³ To date there is no evidence that fiduciaries have had difficulty attracting top talent to manage Sudan-free portfolios.

VI. Legal and Policy Considerations

Federal Constitutionality

In February 2007, U.S. District Judge Matthew F. Kennelly ruled the state of Illinois' broad Sudan divestment statute to be unconstitutional and in violation of federal preemption, the constitutional principle that gives the federal government the exclusive power to dictate foreign policy and commerce. However, instead of striking down divestment *per se* as unconstitutional, Judge Kennelly defined certain limits to Sudan divestment statutes and ruled that Illinois had overstepped those limits. SDTF's targeted Sudan divestment model was developed with *pro bono* legal counsel from Cooley Godward Kronish LLP to preemptively address each of Judge Kennelly's concerns. As such, the targeted Sudan divestment model falls well within the constitutional limits for Sudan divestment statutes outlined by Judge Kennelly.

Additionally, and as noted elsewhere in this report, U.S. President George W. Bush signed into law the Sudan Accountability and Divestment Act in December 2007. The act is an explicit authorization by the U.S. federal government of state and municipal targeted Sudan divestment. It therefore effectively addresses concerns relating to the constitutionality of these policies by states and municipalities. A summary of the Sudan Accountability and Divestment Act can be found in *Appendix-1* of this report.

Fiduciary Duty

As mentioned above, the concept of fiduciary duty is applied to private pension plans through the federal Employee Retirement Income Security Act (ERISA). ERISA requires fiduciaries to "act solely in the interests of participants and beneficiaries." This principle of fiduciary duty has been applied to public pension funds largely through the Uniform Principal and Income Act (UPAIA) and the Uniform Management of Public Employee Retirement Systems Act (UMPERSA). A similar concept of fiduciary duty is included in nearly all state code dealing with public funds.

Analysis of ERISA by the U.S. Department of Labor has found that fiduciaries may take social issues into account as long as the alternative investments are not expected "to provide a plan with a lower rate of return than available alternative investments with commensurate degrees of risk or [to be] riskier than alternative available investments with commensurate rates of return."¹⁴ In other words, fiduciaries do not breach their duty of loyalty if incidental benefits flow to a third

¹³ For example, the targeted Sudan divestment model legislation mentions private equity but does not require immediate divestment from private equity funds or accounts. For the purposes of the targeted Sudan divestment model legislation, private equity funds are considered to be "actively managed commingled funds." Fiduciaries therefore are not required to eliminate exposure to targeted companies through their private equity investments unless a comparable "Sudan-free" version of that investment becomes available (though they must request asset managers create such alternatives). If this happens, fiduciaries may transfer investments into such a vehicle if they deem it to be financially equivalent.

¹⁴ U.S. Department of Labor, "Interpretive bulletin relating to the fiduciary standard under ERISA in considering economically targeted investments," 29 CFR 2509.94-1 (1994). Available from: http://www.dol.gov/dol/allcfr/title_29/Part_2509/29CFR2509.94-1.htm [Accessed March 12, 2008].

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party (in this case, Sudan's marginalized populations) as a result of shifting to financially equivalent alternative investments that are expected to have equal risk/return profiles.

The question of whether divestment violates fiduciary duty has only been tested on a few occasions in the U.S. federal courts. The highest court to rule on the matter was the Maryland Court of Appeals in 1989. The court found that divestment legislation based at least in part on moral considerations did not violate the principle of fiduciary duty if its cost is *de minimis* "when viewed in relation to the systems' total assets." Although the court did not quantify *de minimis*, it found both the initial and annual costs related to the South Africa divestment statute at hand to be *de minimis*. Importantly, South Africa divestment was markedly more expansive and intrusive for investors than the targeted Sudan divestment model is today. South Africa divestment targeted a broad range of companies, including roughly 1/3 of the companies on the S&P 500 (with the S&P 500 representing a major portion of investor portfolios at the time). In contrast, the targeted Sudan divestment model entails less than thirty problematic companies, none of which are on the S&P 500 (or any other US-predominant index). Therefore, a simple comparison between South Africa and Sudan divestment using the Maryland Court standard suggests that the limited scope of targeted Sudan divestment would almost assuredly also meet the Court's *de minimus* standard and therefore fulfill financial prudence requirements.

Recognizing the principle of fiduciary duty and the limited legal precedents on fiduciary duty vis-à-vis divestment, the targeted Sudan divestment model was designed in consultation with fiduciaries, asset managers, and legal counsel to be consistent with this principle.¹⁵ The following aspects of the targeted Sudan divestment model specifically contribute to its financial prudence:

- **Limited scale of divestment:** The SDTF list of "Highest Offenders" in Sudan represents a minute fraction of total holdings (under one-third of one percent of total assets) in every state implementing the targeted Sudan divestment model. Furthermore, no state or investor implementing targeted Sudan divestment has reported that divestment has affected portfolio performance adversely.
- **Minimal implementation costs:** All resources and pertinent information needed to carry out the research, engagement, and reporting provisions of the targeted Sudan divestment model are available free of charge from SDTF or for a reasonable price from third-party research firms, thereby minimizing administrative burdens.
- **Potential to change company behavior through engagement first:** The targeted Sudan divestment model requires that fiduciaries try to change company behavior through a brief engagement process before divesting. This creates the potential to avoid divestment altogether if the company is responsive. Several companies previously classified as "Highest Offenders" in Sudan have already been removed from divestment consideration because shareholder engagement through the targeted Sudan divestment model led to a change in company behavior.
- **Special treatment for certain "hard-to-divest" asset classes:** The targeted Sudan divestment model precludes from immediate divestment certain types of investments that are difficult to divest from, such as mutual funds and private equity funds. Fiduciaries are required only to ask asset managers to provide Sudan-free versions of

¹⁵ The analysis in this section is based on U.S. federal and state law. While the concept of fiduciary duty is similar in countries outside the US, certain country-by-country differences do exist. For a more complete analysis of how Sudan divestment and other environmental, social, or governance concerns mesh with fiduciary duty in other countries, please see the following report by the United Nations Environmental Program's Finance Initiative: www.unepfi.org/fileadmin/documents/freshfields_legal_resp_20051123.pdf

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such funds and to move into them once they become available, provided that such a transition is deemed to be financially prudent.

- Long sell-off period to allow strategic planning: The targeted Sudan divestment model provides fiduciaries with a fifteen month period to complete the sell-off of problematic companies unresponsive to engagement, thereby allowing fiduciaries to be strategic about the sale, as well as the purchase of replacement investments.
- Built-in safeguards to protect against unforeseen circumstances: If the accumulated costs of divestment, including opportunity costs and transaction costs, exceed an agreed-upon objective *de minimus* cost standard, fiduciaries are allowed to relax the targeted Sudan model's divestment requirements. No fund implementing the targeted Sudan divestment model has ever needed to employ this provision.
- Recent federal legislation affirming targeted Sudan divestment falls within ERISA standards: Section five of the Sudan Accountability and Divestment Act affirms the right of ERISA plans to divest from Sudan without violating ERISA as long as the investment policy change is executed in accordance with ERISA and Department of Labor guidelines. This also provides helpful guidance to vast majority of public pension plans, which are bound by some derivative of ERISA principles. A summary of the Sudan Accountability and Divestment Act can be found in *Appendix-1* of this report.

In addition to the evidence presented above, SDTF notes that several public pension plans have independently supported or adopted targeted Sudan divestment without a legislative mandate, having made the determination that targeted Sudan divestment is consistent with fiduciary duty. These plans include the Arkansas Teachers Retirement System, Colorado Public Employees' Retirement Association, New Mexico Educational Retirement Fund, New Mexico State Investment Council, New York State Common Retirement Fund, Pennsylvania State Treasury, and the Vermont Public Investment Committee.

Slippery Slope

SDTF stresses that divestment is an option that should be considered only in the most extreme of circumstances. It is impractical and imprudent to heed every call for divestment. The overwhelmingly heinous nature of genocide—validated by official, non-biased, and highly trustworthy sources—and the need for urgent responses when genocide occurs requires immediate international consideration. In the case of Sudan, the perpetuation of genocide by the government of Sudan, the government's susceptibility to economic pressure, the establishment of nuanced criteria that allows investors to distinguish between beneficial companies and problematic companies in Sudan, explicit authorization for a financially sound targeted Sudan divestment model by the U.S. federal government, and the fact that diplomatic and political efforts to solve the crisis have been exhausted combine to make targeted Sudan divestment truly singular and warranted.

There must be a rigorous threshold set for divestment, and while the situation in Sudan clearly meets such a threshold, many other calls for shareholder divestment do not. Before divestment is even considered for a particular concern, SDTF argues that certain basic questions should be addressed, including:

1. Has shareholder engagement been seriously tried?
2. Does the issue rise to the level of being a grave concern?

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3. Is the situation so urgent that extended shareholder engagement can not be employed?
4. Can divestment criteria separate problematic from non-problematic companies no matter what industry a company may operate in?
5. Is there strong evidence that divestment would be efficacious? For example, would the perpetrators of the concern be responsive to this type of pressure?
6. Can a divestment program addressing the concern comport with fiduciary duty requirements?

As of early 2008, other divestment campaigns have yet to provide sufficient evidence to fully answer these questions. They lack detailed engagement phases, comprehensive benchmarks for corporate behavior, proof of efficacy, or safeguards to protect fiduciary responsibility. In contrast, the targeted Sudan divestment model was explicitly developed with these questions in mind. This resource guide provides answers to most of the questions above. Further answers to the above questions can be found in SDTF's report on the *Efficacy of Targeted Sudan Divestment*.¹⁶

Appendix-1: Sudan Accountability and Divestment Act Summary

The Sudan Accountability and Divestment Act (Public Law No: 110-174)

The Sudan Accountability and Divestment Act authorizes, but does not mandate, state and local governments to adopt targeted Sudan divestment policies. It also prohibits companies operating in Sudan's military, mineral extraction, oil and power sectors from receiving U.S. federal government contracts, and authorizes state and local government to prohibit these contracts as well. Finally, the legislation provides legal protection to asset managers seeking to make the investment vehicles they offer free from certain problematic companies in Sudan. While the Sudan Accountability and Divestment Act contains other provisions, those listed above are the ones directly relevant to fiduciaries. The Sudan Accountability and Divestment Act was signed into law by President George W. Bush on December 31, 2007.

Full Text: www.govtrack.us/congress/billtext.xpd?bill=s110-2271

Section 1: Title

Section 2: Definitions

Provides definitions for material involvement of a company in Sudan's military, mineral extraction, oil and power sectors.

Section 3: Authorization for state and local governments to divest from certain companies in certain sectors in Sudan

¹⁶ See the *Efficacy of Targeted Sudan Divestment Report*:
www.sudandivestment.org/docs/effectiveness_of_divestment.pdf

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Authorizes state and local entities to adopt *targeted* Sudan divestment measures, limiting the scope of companies targeted to four sectors (military, mineral extraction, oil and power) and requiring engagement of companies before divestment occurs. Also authorizes state and local governments to prohibit contracts with companies in targeted sectors. Additionally, the authorization requires notification of divestment and/or contract prohibition to the Department of Justice for policies enacted after December 31, 2007.

Section 3 establishes that state or local governments adopting targeted Sudan divestment measures and/or contract prohibition, as authorized in this section, are not preempted by any federal law or regulation.

Section 4: Safe harbor for asset managers

Provides legal protection to asset managers that divest within the parameters set forth by Section 3. Also requires that asset managers disclose applicable divestment of equity and fixed income securities to the SEC. At the time of publication of this report, the SEC was in the process of creating regulations and amending disclosure forms to allow for compliance under this section.

Section 5: Sense of Congress regarding ERISA plans

Affirms the right of plans governed under the Employee Retirement Income Security Act (ERISA) to divest from Sudan without violating ERISA as long as the investment policy change is executed in accordance with ERISA and Department of Labor guidelines.

Section 6: Prohibition on United States government contracts

Requires all companies registering to receive or renew U.S. government contracts to certify that they do not conduct business related to Sudan's military, mineral extraction, oil and power sectors (as defined by Section 2). Companies unable to certify non-involvement will lose eligibility for contracts. The President is provided with a "national interest" waiver for this section.

Section 7, 8, and 9: Senses of Congress regarding peace in Sudan

Encourages other countries to adopt measures similar to the Sudan Accountability and Divestment Act.

Section 10: Report on sanctions

Requires the Secretary of Treasury to submit various reports regarding the effectiveness of U.S. sanctions on Sudan.

Section 11: Repeal of non-related reporting requirement

Section 12: Termination

Terminates the provisions of Section 3, 4, 5, 6, and 10 thirty days after the President has certified to Congress that the government of Sudan has honored its commitments to:

- Abide by United Nations Security Council Resolution 1769 (which authorizes a robust peacekeeping force for Darfur);
- Cease attacks on civilians;

- Demobilize and demilitarize the Janjaweed and associated militias;
- Grant free and unfettered access for delivery of humanitarian assistance; and
- Allow for the safe and voluntary return of refugees and internally displaced persons

Appendix-2: Financial, Operational and Reputational Risks Summary

The current geopolitical situation and developments on the ground in Sudan have created significant risks for companies operating there, particularly for problematic companies associated with the oil, large-scale power, mineral, and military sectors. Not only are these sectors disproportionately dominated by the unstable government of Sudan, but unlike certain sectors in Sudan, such as agriculture, they are the primary targets of the Sudan divestment movement and affiliated sanctions efforts.

This appendix summarizes the financial, operational, and reputational risks facing problematic companies (“Highest Offenders”) operating in Sudan’s oil, large-scale power, mineral, and military sectors. These are problematic companies that haven’t taken sufficient steps to mitigate these risks by reforming their behavior in Sudan (“Substantial Action”).

Financial Risk

The Sudan Accountability and Divestment Act and Contract Prohibition

Following unanimous approval by the U.S. Congress, President George W. Bush signed the Sudan Accountability and Divestment Act (SADA) into law on December 31, 2007. SADA prohibits companies operating in Sudan’s oil, power, mineral and military sectors from receiving federal contracts and authorizes state and local governments (and private pension plans and asset managers) to divest from and prohibit contracts with these companies. In March 2008, Arizona became the first state to follow the U.S. federal government’s lead and legislatively implement state procurement restrictions (contract prohibition) for companies with problematic operations in Sudan. These contract prohibition efforts clearly increase the financial risk for “Highest Offenders” in Sudan, which are automatically locked out of lucrative business opportunities.

The Divestment Movement

From 2005 to the time of publication of this report (March 2008), at least twenty-four states have adopted divestment policies related to Sudan. Sixteen of these states have adopted the Sudan Divestment Task Force’s targeted Sudan divestment model and focus exclusively on companies operating in Sudan’s oil, large-scale power, mineral, and military sectors. At least, sixteen additional U.S. states will consider targeted divestment policies in 2008. Dozens of cities, universities, and private foundations are also implementing targeted divestment policies. Beyond the U.S., at least eighteen countries have initiated targeted Sudan divestment campaigns including Australia, Belgium, Brazil, Canada, Denmark, Germany, India, Ireland, Italy, Japan, the Netherlands, New Zealand, Norway, South Africa, Sweden, Switzerland, the U.S., and the U.K. Already, one of Europe’s largest public pension funds, the Dutch PGM fund, and the pension fund for members of the European Parliament have implemented targeted Sudan divestment policies.

The divestment movement has also spread rapidly to the private sector. In 2007, Fidelity Investments reduced its U.S. holdings of PetroChina, the listed arm of Sudan’s largest oil

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partner, China National Petroleum Corporation, by 91%. Berkshire Hathaway, the holding company for Warren Buffett, sold over two billion shares in the company.

The extent of the divestment movement is impressive, on a scale not seen since the days of divestment from Apartheid South Africa. As the number of market participants willing to purchase the securities of “Highest Offenders” in Sudan declines, so does share price.

Japan Oil Ban

In November 2007, two major Japanese electricity firms halted oil imports from Sudan in response to the Darfur crisis. Recently, Japan's Trade Ministry has considered implementing a country-wide ban of Sudanese oil imports.¹⁷ Japan, the world's third largest oil importer and a top importer of Sudanese oil, is one of the few countries with the ability to refine Sudan's Dar blend crude oil, which already sells at steep discounts relative to the world oil price. Japan's statements demonstrate that companies with considerable investments in Sudan's oil industry face serious consequences if Sudanese oil exports are jeopardized by international concern over the situation in Darfur.

Further Sanctions

After signing the Sudan Accountability and Divestment Act, President Bush stated, “My Administration will continue its efforts to bring about significant improvements in the conditions in Sudan through sanctions against the Government of Sudan.” These sanctions could include an addition of companies to the Department of Treasury's *List of Specially Designated Nationals (SDN) and Blocked Persons*. A number of European leaders, including French President Nicholas Sarkozy and British Prime Minister Gordon Brown, have also publicly discussed economic sanctions against Sudan, both unilaterally and at the European Union (EU) and United Nations levels. The EU, unlike the U.S., has thus far refrained from sanctioning Sudan. As a result, businesses in Sudan have become dependent on the European financial system. Given the recent tightening of U.S. sanctions, Sudan has begun a new push to shift currency reserves and transactions from the dollar to the euro. Therefore, the threat of European Union sanctions, and restrictions on the use of the euro in Sudan, poses an especially significant risk to companies operating in Sudan. In fact, in July 2007, the European Parliament passed a resolution that “calls on the [EU] Member States to encourage divestment of European companies and funds from Sudan.”¹⁸

Operational Risk

CPA implementation and overall instability

The Comprehensive Peace Agreement (CPA), signed in January 2005 between the government of Sudan and the Sudan People's Liberation Movement (SPLM), ended the 21-year civil war between the two parties. It formally recognized the regional government of South Sudan and created the Government of National Unity. Business activity in southern Sudan (where much of the country's natural resources are) began to return and flourish after years of inactivity due to the war. However, ongoing tension between the government of Sudan and the government of South Sudan jeopardizes the region's newly realized peace.

¹⁷ Bloomberg, “Japan Studies Effect of Possible Sudan Crude Oil Ban.” Bloomberg, reposted on *Sudan Tribune* [online], November 17, 2007. Available from: <http://www.sudantribune.com/spip.php?article24778> [Accessed March 20, 2008]

¹⁸ European Parliament, “European Parliament Resolution of 12 July 2007 on the Situation in Darfur,” Text P6_TA(2007)0342. European Parliament [online], July 12, 2007. Available from: <http://www.europarl.europa.eu/sides/getDoc.do?pubRef=-//EP//TEXT+TA+P6-TA-2007-0342+0+DOC+XML+V0//EN&language=EN> [Accessed March 20, 2008].

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In late 2007, government of South Sudan representatives withdrew temporarily from the Government of National Unity to protest the government of Sudan's failure to implement key aspects of the CPA.¹⁹ They registered three main grievances against the government of Sudan, including its failure to equitably share oil revenue from southern oil fields and its initial failure to redeploy northern forces to the north. Although the government of Sudan conceded on these points following intense negotiations, South Sudan's third grievance regarding the Abyei region remains unresolved. Abyei, with its vast oil reserves, lies along the contentious north-south border and is claimed by both governments. Several violent skirmishes have occurred in Abyei since December 2007, and the threat of renewed fighting is ever-present. In 2011, as stipulated by the CPA, South Sudan will vote on whether to secede from Sudan; tensions like these increase the likelihood that its citizens will choose autonomy. This occurrence will pose operational risks to many "Highest Offender" companies that will be caught between the two rival countries; for example, both their contracts and pipeline access will be jeopardized.

Nor are Darfur, Abyei, and the southern oil fields the only areas of Sudan where unrest threatens the stability of the region and the operations of multinational corporations there. For example, following the oppression by government forces of peaceful protests at the Merowe Dam site, armed groups have organized in Sudan's northern region ahead of construction on other hydropower projects. In late 2007 and early 2008, sites of oil exploration and power production continued to be the areas of greatest instability in Sudan outside of Darfur, which increases the risks to companies operating in these sectors.

A February 2008 article published in *BusinessWeek* further describes the operational risk faced by companies operating in Sudan, with specific reference to Chinese oil-giant Petrochina:

In a politically unstable country such as Sudan there is always the possibility of an abrupt change in government and the seizure of foreign oil assets. PetroChina, like other global oil companies, faces risks such as "nationalization, rising taxation, and changing contract structures," says Xu Xiaojie, director of the Institute of Overseas Investment at CNPC's Research Academy of Economics & Technology.

As Xiaojie puts it, "Our projects in Sudan cross both regions [i.e. the North and the South] where there is the potential for a war. So this is a major, major potential impact on our company."²⁰

Analyses of operational risks by others paint an even more worrisome picture. For example, Japan stated in February 2008 that Sudan is at present too dangerous to justify any investment by Japanese companies, even after such investment was explicitly solicited by one of Sudan's top political officials.²¹

Rebel attacks and kidnappings

In November 2007, a Darfurian rebel group, the Justice and Equality Movement (JEM), kidnapped five employees of a foreign oil-related firm from Sudan's Defra oilfield, specifically citing the oil industry's connections to the Sudanese government and the conflict in Darfur. JEM threatened further attacks on Sudan's oil fields and allegedly followed through with an attack on the Rahaw field and another attack on the Defra field in December 2007. Given increased tensions between the Sudanese government and Darfur rebels, the lack of progress on a Darfur

¹⁹ Sudan Tribune/Reuters, "Sudan's SPLM to Rejoin National Government." *Sudan Tribune* [online], December 12, 2007. Available from: <http://www.sudantribune.com/spip.php?article25130> [Accessed March 20, 2008].

²⁰ Roberts, Dexter, "The Squeeze on PetroChina." *BusinessWeek* [online], February 28, 2008. Available from: http://www.businessweek.com/magazine/content/08_10/b4074028093921.htm?chan=globalbiz_asia+index+page_compaines [Accessed March 20, 2008].

²¹ AFP, "Japan Says Sudan Not Right for Investment." AFP, reposted on *Sudan Tribune* [online], March 6, 2008. Available from: www.sudantribune.com/spip.php?article26247 [Accessed March 20, 2008].

peace process, and problems with deploying a United Nations-African Union hybrid peacekeeping force to Darfur, it seems likely that such attacks will continue. Companies that continue their operations in these areas risk the safety of their employees. In addition, they may be forced to suspend exploration and production should their facilities be destroyed in the attacks. There is clear precedent for this possibility. Many major companies were forced to halt or abandon their capital intensive projects during Sudan's North-South civil war, including Chevron, Total, OMV, Lundin Petroleum, and Talisman Oil.

Departure of other companies

As material risks increase, companies will continue to withdraw from Sudan. Those that remain will have fewer reputable companies with whom to partner and contract. In some cases, the diminished range of potential contract partners could be operationally devastating. For example, when Rolls Royce recently departed Sudan on account of the Sudan divestment movement, the parts they supplied to Sudan's oil consortiums were quite difficult to replace.²² Given the past relationship between the oil and large-scale power industries and conflict in Sudan, companies operating in these industries are also likely to be situated in areas of greatest tensions and possible violence.

Reputational Risk

Listing as a "Highest Offender"

SDTF's "Highest Offender" list and *Sudan Company Report*, both publicly available through the SDTF website, are utilized by numerous governmental officials and over two thousand U.S. and foreign fiduciaries and investors with combined assets that top \$3 trillion. As a result, a company determined to be a "Highest Offender" in Sudan by SDTF faces significant negative attention among a very large investor pool. Presence on the "Highest Offender" list has also brought other reputational risks to companies, including negative public comments from U.S. Presidential candidates, numerous press reports on the problematic companies, public protests, and criticism from wide-spread grassroots campaigns that utilize SDTF's *Sudan Company Report*.

Negative Media Attention

In 2007, the Save Darfur Coalition launched a multi-million dollar advertising campaign in support of the Sudan divestment movement. The advertising campaign, which targeted companies operating in Sudan and their largest foreign investors, included national television commercials, newspaper advertisements, and billboards. In fact, the divestment of holdings in PetroChina by both Fidelity and Berkshire Hathaway came in the midst of this advertising campaign.

In addition to paid advertising, the Sudan divestment movement has been covered extensively in the press, including features in CNN, FOX News, MSNBC, Forbes, Bloomberg, Reuters, the Associated Press, the New York Times, the International Herald Tribune, Fortune, the London Times, the Financial Times, the Wall Street Journal, and Xinhua.

²² Cohen, Roberta, "Will Security Council Resolution 1769 Make a Difference in Darfur?" The Brookings Institution [online], August 9, 2007. Available from: http://www.brookings.edu/papers/2007/0809humanrights_cohen.aspx [Accessed March 19, 2008].