



Ministry of Trade, Industry and Fisheries  
Attn.: Director General Ms Mette Wikborg  
P.O.Box 8090 Dep  
0032 Oslo

Our date: 2016-03-02  
Our ref.:  
Our contact:  
T:  
Your date: 2016-02-16  
Your ref.: 16/1181  
Page 1 of 17

**[TRANSLATION FROM THE ORIGINAL LETTER WRITTEN IN THE NORWEGIAN LANGUAGE]**

**Report regarding Hydro's trade in Tajikistan**

**Table of Contents**

1	Introduction.....	2
2	1993-2004: Initial cooperation and contracts.....	3
2.1	Background – demand for 'cold metal' .....	3
2.2	Tajikistan .....	4
2.3	Agreements .....	4
2.4	Steering Documents .....	5
2.5	Board of Directors' involvement .....	6
2.6	Involvement of various technical environments in key contracts .....	7
3	2005-2007: Dispute and new contracts.....	7
3.1	Arbitration and Settlement Agreement .....	7
3.2	Tripartite Agreement .....	10
3.3	HSE and Social Responsibility.....	11
3.4	Steering Documents .....	12
3.5	Board of Director's involvement .....	12
4	2007-2016: Management of the Settlement and Tripartite Agreements.....	12
4.1	Agreement management .....	12
4.2	HSE and Social Responsibility.....	13
4.3	Status of Settlement and Tripartite Agreements.....	14
4.4	Guidelines - Code of Conduct .....	15
4.5	Board involvement .....	15
5	Compliance in Hydro.....	16
6	Conclusion.....	17

## 1 Introduction

Reference is made to the letter of 22 February 2016 from the Ministry of Trade, Industry and Fisheries (NFD) to Norsk Hydro ASA (Hydro), for the attention of the Chairman of the Board. The letter requests a further account of Hydro's involvement in Tajikistan, more specifically:

1. What corporate directives have underpinned the company's involvement;
2. What investigations the company undertook before and during its involvement in Tajikistan, and
3. How the Board was involved in the matter at various points in time.

In this report, Hydro will expand on the memorandum submitted to NFD in the meeting of 12 February 2016 which memo was later updated and forwarded by email of 19 February 2016. The final version is also published on Hydro's website [www.hydro.com](http://www.hydro.com).

Hydro's business activities in Tajikistan extend over 20 years and first and foremost concern the purchase of aluminium and sale of the raw material alumina. The facts are extensive, and have previously been the subject of thorough reviews both internally and externally. In autumn 2007, this matter was featured in the Norwegian media. In 2007-08 a thorough review was made of Hydro's business activities in Tajikistan. The conclusion was that there was no evidence that Hydro had breached any laws or any of its steering documents. This report builds on documents from archives and electronic correspondence as well as discussions with several Hydro employees who have worked on the Tajikistan matter since 1993. Hydro's review has helped to systematically organise the information in this case. This report has been prepared over a relatively short time-period and there may be further relevant information. Hydro will therefore continue working on the case internally in order to determine if such further information exists.

In the following account, certain commercial matters are being disclosed that could not normally be made public without breaching confidentiality obligations. Such obligations have previously constrained Hydro's ability to share certain information regarding contracts and judicial processes in which the company has been involved. We are now disclosing such matters in order to fully respond to the Ministry's inquiries, and to provide a correct presentation of how Hydro has managed its business activities in Tajikistan.

It is imperative for Hydro to emphasise that the company has zero tolerance of corruption. The message from management is clear: Hydro must every day do its best to ensure that the company conducts its business in compliance with Norwegian and international anti-corruption legislation.

In Tajikistan, Hydro has solely bought and sold goods at market prices. Hydro has not engaged any agents or intermediaries.

The ethical question is how far a company should be expected to go to determine whether corruption is taking place within its suppliers and customers.

Expectations in this area have increased in recent years. Hydro has followed this development closely. Hydro has worked systematically throughout with the ethical dilemmas in this area, particularly when trading in countries that score low on the corruption index.

To the extent Hydro can contribute positively to the creation of value and to social and economic development, this can represent a good way of combining business with corporate social responsibility.

As will be apparent from the following account, Hydro has repeatedly sought to bring about improvements in transparency, health, safety and environment in TadAZ<sup>1</sup>. Lack of progress in this area was a major reason why Hydro, in November 2009, decided not to enter into further metal purchase agreements.

The Board of Directors was briefed on the Tajikistan matter as an ordinary matter of high value, based on the challenging situation in the country, and whenever the financial exposure or specific issues made briefing appropriate. The Board was briefed in 2003, 2004, 2005, 2007, 2008 and 2016, in some years in several meetings.

The President and CEO adopted Hydro's first ethical guidelines (Code of Conduct) in 1995 which states that all employees shall comply with laws and regulations and conduct business in an ethically responsible way (appendix 1). The Board of Directors adopted a new version in 2003. In the period from 1993-2012 there has been a significant increase in laws and regulations and expectations regarding social responsibility and ethical conduct. The Board's involvement has grown in step with these increased legislative standards and expectations as well as the Hydro Group's own development.

This report is broken down into three periods:

- i) 1993-2004: the period before deliveries of metal from Tajikistan ceased at year-end 2004/2005;
- ii) 2005-2007: the years when Hydro did not trade with Tajikistan and arbitration was pursued followed by a Settlement Agreement; and
- iii) 2007-2016: management of the Settlement Agreement and Tripartite Agreement.

Furthermore, for each period, the ethical guidelines applicable in the company and the involvement of the Board are set out.

## **2 1993-2004: Initial cooperation and contracts**

### **2.1 Background – demand for 'cold metal'**

The production of primary aluminium in Norway entails the remelting of primary cold metal ("cold metal") whereby a small amount of raw aluminium of low quality, or aluminium cast in a shape not suitable for industrial use, is added into the liquid metal. After adding alloy metal, the aluminium is cast into finished products for industrial use. This saves both costs, time, energy and environment by exploiting the 'excess heat' of the liquid aluminium to melt the cold metal. Liquid metal from electrolysis is too hot for direct casting. Either you must wait until it has cooled, or you can accelerate cooling by adding cold metal. Depending on demand and total production volume of liquid primary aluminium in Norway, variable quantities of cold metal are added at Hydro's plants.

With a large production of primary aluminium in Norway, and with a commercial strategy to produce larger volumes of aluminium products than Hydro's own electrolysis-based production would allow, Hydro from the early 90s adopted a strategy to purchase cold metal from other aluminium producers.

As a result of the dissolution of the Soviet Union in 1991, many new sovereign states were established. At the same time, the political turmoil meant an end to the 'Comecon Agreement', the

---

<sup>1</sup> TadAZ was renamed Tajik Aluminium Company (Talco) in 2007. For simplicity's sake Hydro uses TadAZ throughout this briefing.

economic cooperation on which the countries behind the Iron Curtain had based much of their foreign trade. All this meant many new challenges and opportunities for the countries affected.

The aluminium industries in the former East Block countries found that they were no longer subject to central control. On the other hand, the industry could no longer reap benefits from established systems, institutions and legislation. The institutions that had previously organised central procurement, for example of raw materials, and sale of finished products, no longer existed. In Russia, the reduced consumption of aluminium for military purposes together with a privatisation process in the aluminium industry, led to the export of large volumes of aluminium. This created negative price reactions in the aluminium market, and prices fell to a historical low (period 1991-94). A natural market for this aluminium was Western Europe where sellers could settle accounts in convertible currency, which was highly attractive to the exporters.

During this period, Hydro was interested in purchasing cold metal in line with its strategy. This was desirable both for remelting in Hydro's own plants, and to develop its own trade in cold metal on a global basis. The many independent smelters in Russia were among Hydro's suppliers. The same was also true of other aluminium producers in the former East Block countries.

## 2.2 Tajikistan

Tajikistan achieved independence in 1991 following the collapse of the Soviet Union, but was destabilized by civil war in the years 1992-97 with significant loss of life. Tajikistan currently has a population of roughly eight million and is one of the poorest countries in the world. Tajikistan's economy is dominated by mining, aluminium production and agriculture. The economy is also greatly boosted by remittances from Tajik expats in Russia, who send their pay checks home. The country is landlocked.

The situation in Tajikistan after leaving the Soviet Union was significantly different than, for instance, in Russia. Tajikistan did not privatise its major metal plant, TadAZ, but chose to let it remain in state hands. There was an acute lack of liquidity in convertible currency. The bank sector was virtually non-performing, both at the national and the international level, and was seldom able to assist with payments in foreign currency. Neither the money market (short-term financing market) nor the capital market (long-term financing market) functioned in any comparable way with what exists in the western world. Telecommunication was virtually non-existent. Nobody had managed to replace the former centralised procurement and sales organisation with an equivalent competent organisation at the metal plants. Everything needed to be built entirely from scratch, and the process took time. There were few local suppliers of necessary raw materials to feed the aluminium plant, and operations were therefore dependent on imports, including alumina.

## 2.3 Agreements

Hydro's first contract with Tajikistan and the aluminium plant TadAZ took the form of a barter agreement in 1993. Barter agreements involve the exchange of goods as an alternative to payment in money (convertible currency). In practice, the parties agree on the values of the goods to be exchanged, and exchange shipments reflecting these value ratios. For example, if Hydro supplied anodes valued USD 1 million, and the metal price was USD 2000 per tonne, that would result in an exchange of 500 tonnes of aluminium. The contracts worked for a while, but due to the civil war (1992-97), the aluminium plant was eventually unable to deliver the agreed quantity of metal to Hydro in exchange for anodes delivered by Hydro for use in aluminium production. Hydro therefore stopped the anode deliveries, but maintained contact with the aluminium plant. Hydro hoped that TadAZ, once the civil war had ended, would again be able to settle its debts. After hostilities ended, it turned out that Hydro was not alone in having outstanding accounts with TadAZ. Several

aluminium customers had supplied various goods and services to TadAZ without receiving any settlement.

The Guernsey-registered trading company Ansol, owned by Tajik businessman, Avaz Nazarov, was interested in 1998 in selling metal to Hydro that Ansol had purchased from TadAZ. It gradually emerged that Ansol had signed a major contract with TadAZ (both for deliveries of raw materials to, and sale of metal from, TadAZ). Hydro and Ansol signed contracts based on 'settlement upon delivery'. Hydro was not Ansol's only customer for purchase of TadAZ metal.

In spring 2000, discussions commenced with Ansol to consider the opportunities to help finance the aluminium operation in Tajikistan. Since Hydro did not consider Ansol credit-worthy for the desired financing, various financing arrangements and alternative methods to reduce political and commercial risks associated with a possible arrangement were discussed.

Before Hydro was even willing to consider making any new agreement with TadAZ, there was a precondition on Hydro's part that the debt from the nineties must be settled in full. This was accomplished through a three-way agreement between TadAZ, Ansol and Hydro. With this Tripartite Agreement in place, both the Barter and Aluminium Agreements could be signed in summer 2000.

The contract structure that was chosen was a combination of a Barter Agreement between TadAZ and Hydro (where Ansol was nominated as TadAZ's and not Hydro's agent), and a metal contract between Ansol and Hydro (the Aluminium Agreement). Under the Barter Agreement, Hydro would supply raw materials, essentially alumina, to TadAZ, and receive metal in settlement later. Under the Aluminium Agreement, Hydro would purchase a given volume of aluminium tonnage per month from Ansol. Ansol undertook under this contract to settle with Hydro for the various commercial and financial elements that were not a part of the Barter Agreement.

Even with the final settlement of old debt from TadAZ, it was not an alternative for Hydro to take on a large credit risk on TadAZ under a new Barter Agreement. TadAZ was incapable of obtaining any financing from foreign banks, and local banks had nothing to offer.

This exposure was mitigated by an insurance policy that would cover most of Hydro's loss if the aluminium deliveries under the new Barter Agreement came to a halt. The Barter Agreement originally had a financing limit of USD 25 million. In 2002 this was expanded to USD 33 million, then to USD 100 million in 2003, and to USD 125 million in 2004. In addition, the credit term was increased from the original 120 days to 180 days. The credit risk linked to TadAZ's financing limit was insured throughout the entire period with a large number of insurance companies. Hydro had a deductible (self-assurance amount) written into these insurance contracts.

As a result of Hydro's increasing financing of TadAZ through the Barter Agreement, it was possible for the aluminium plant to expand its metal production significantly. Tajikistan's foreign exchange revenues increased and Hydro became the aluminium plants' largest customer. In autumn 2004 it was agreed that Hydro in 2005 would purchase 336 000 tonnes of TadAZ's total annual production, estimated at something over 400 000 tonnes.

## 2.4 Steering Documents

The President and CEO adopted Hydro's first ethical guidelines – the Code of Conduct – in 1995, which stipulates that all employees shall comply with applicable laws and regulations when acting on behalf of the company and operate the business in an ethically sound manner, see Annex 1. The Board adopted a new version in 2003.

Hydro's steering documents at corporate level since 1999 have explicitly stated that the company has zero tolerance of corruption, see Annex 2. In one steering document (Industrial Development

and Social Responsibility), Hydro established a group-wide regulation in respect of social responsibility. While the Code of Conduct is aimed at individual employees, the group-wide steering document is linked to the social responsibility of the various business units of the corporate organisation and management. The latter determines that it is a management responsibility at all levels to ensure that bribes and other forms of corruption do not occur. In 2003, in part due to the corruption concept being expanded in the Norwegian Penal Code, Hydro's ethical guidelines were again revised, see Annex 3. In addition to the formally approved steering documents, Hydro also published practical guidelines and handbooks which included, among other things "Invitation to dialogue" (2002), Annex 4, "Invitation to action" (2004), Annex 5, and "You and Hydro" (2004), Annex 6. The last-mentioned was distributed to all employees in the beginning of 2005. The purpose of "You and Hydro" was – in an easily comprehensible way – to teach all employees what they needed to know about the Code of Conduct in particular, and other steering documents in general. It was published in 15 languages, including Russian. They were all meant to help employees in their daily work to comply with the standard that was set.

In the nineties, and upon entering into the Barter and Aluminium Agreements in 2000, the primary focus was on managing Hydro's exposure related to credit risk resulting from commercial and political risk, in addition to compliance with current laws and regulations. The focus on ethical issues, social responsibility, and on health, safety and environment (HSE) grew in scope as the scope of the contracts expanded in 2003. In that connection, Hydro was interested in possibilities of contributing to positive development at the aluminium plant. A series of evaluations were done internally regarding how Hydro could assist in the best possible way, see also 2.6.

## **2.5 Board of Directors' involvement**

In the nineties and early 2000, Hydro was a large industrial conglomerate with activities in agriculture, oil and gas, energy, fish-farming, petrochemicals, magnesium and aluminium. Hydro's business in Tajikistan consisted of exchanging raw materials for aluminium. The contracts related to this business did not require consideration by the Board under Hydro's delegation of authority matrix in light of the financial exposure or other factors related to this trade.

The Board's involvement in ongoing operations is determined in part by the financial value or exposure of a contract, and whether the matter is significant or unusual in nature, or of major importance in relation to the company's situation as a whole.

Hydro's Board Instructions from 2001 set out the division of responsibility between the Board and the President and CEO. The Board is required, among other things, to decide on matters of major financial significance, supervise daily operations and ensure that adequate internal steering documents, processes and systems are in place, including those related to ethical conduct and compliance.

Starting in 2002, the Internal Audit function reported every six months to the Board Audit Committee. In the wake of Statoil's Horton case in Iran, Internal Audit made a high level ethical survey of many of Hydro's foreign activities, including relations with TadAZ. In 2004, Internal Audit presented a semi-annual report to the Board Audit Committee. Internal Audit concluded that their general impression was that there was great attention in the management regarding ethical conduct, but that the company should work further to see how Hydro could influence its business associates to adhere to the same standards as Hydro.

At the President and CEO's briefing in October 2003, the Board and Corporate Assembly were advised that Hydro had entered into a Barter Agreement with the TadAZ smelter for a three year term and an Aluminium Agreement for further purchases of TadAZ-produced metal from Ansol. This was in connection with the increase in barter-financing to USD 100 million (see Chapter 2.3).

In September 2004, the Board was informed in writing, in the President and CEO's briefing, of negotiations between the parties for a further expansion of the agreements. The Board was also informed that Tajikistan was challenging politically, environmentally and financially, and that there was a strong focus on handling the issues relating to social responsibility and HSE in the cooperation with TadAZ in a good way.

## **2.6 Involvement of various technical environments in key contracts**

In decision processes related to, for example, acquisition transactions, investments and long-term supply deals, various specialists in Hydro have over many years been involved to secure that the basis for the decision-making process is as thorough and objective as possible. This includes involving – among others – financial control organised under the Group CFO, who also ensures that the recommendations to the Corporate Management Board and Board for large financial decisions contain relevant assessments of risks and mitigating factors regarding CSR, HSE and other matters of a non-financial nature. In addition, the Legal, CSR and HSE departments are regularly involved in the development of these matters. This broad involvement contributed to ensuring relevant facts were analysed from different perspectives and the level of involvement increased in proportion with the development of Hydro's trade in Tajikistan. The larger the portion of the aluminium plants' total production capacity that was purchased by Hydro, the more thorough reviews and assessments were made.

Before the expansion of the Barter and Aluminium Agreements in September 2003, an internal legal opinion was made addressing various legal issues. The conclusion was that there was no indication of any breach of applicable corruption legislation, nor any breach of Hydro's Code of Conduct.

Representatives from CSR and HSE and technical personnel visited Tajikistan in 2004 to assess the situation, identify improvement opportunities and recommend measures. This was deemed vital because Hydro had become TadAZ's largest customer.

In the period 2003-04, the cooperation with TadAZ was discussed seven times in the Corporate Management Board, including a review of the dilemmas associated with doing business in Tajikistan.

## **3 2005-2007: Dispute and new contracts**

### **3.1 Arbitration and Settlement Agreement**

The deliveries under the Barter Agreement came to an abrupt halt at the end of December 2004, when TadAZ ceased all its business with Ansol and with Hydro. TadAZ replaced Ansol with CDH Investment Corp (CDH) as their new tolling partner<sup>2</sup>. At that time, Hydro was owed deliveries of 71 000 tonnes of aluminium that had been pre-paid with alumina shipped under the Barter Agreement. The metal was valued at around USD 125 million. Additionally some 8 580 tonnes of aluminium, to which title had passed to Hydro, was detained in Tajikistan by the State Prosecutor.

In the beginning of 2005, Hydro engaged in dialogue and meetings with TadAZ and Tajik authorities in an effort to get TadAZ to fulfil its obligations under the Barter Agreement, but without

---

<sup>2</sup> Tolling (*verksleie*) is a term used to describe when an entity (lessee) provides a processor with raw materials and receives in return the finished good and pays a processing fee (tolling-fee) for the use of the processing facility.

success Hydro was informed that metal from the smelter would have to be purchased from CDH. This was consistently rejected by Hydro due to its lack of transparency.

In February 2005, Hydro initiated arbitration proceedings against TadAZ in London pursuant to the Rules of the London Court of International Arbitration. The action was brought to pursue Hydro's rights under the Barter Agreement regarding both the undelivered aluminium and the detained aluminium. TadAZ made a number of allegations during the proceedings, including that Hydro knew, or ought to have known, about the alleged corruption and overpricing of raw material deliveries by Ansol.

Almost a year after TadAZ's breach of its delivery obligations, an award was handed down by the arbitration tribunal in November 2005, allowing Hydro's claim in full. Hydro was awarded approximately USD 150 million in compensation plus interest and costs.

TadAZ contested the decision by appealing to the High Court. The appeal was withdrawn however when the court, as a condition to hearing the appeal, demanded security from TadAZ of the entire sum in accordance with the arbitration award and TadAZ refused to deposit USD 150 million. Accordingly the decision of the tribunal became final and legally binding. Even though the decision is confidential, some of the tribunal's reasoning and conclusions were made public when the High Court published its judgement.

For example, it was repeated in the judgement that TadAZ had alleged, among other things, that the Barter Agreement was used as a tool by Ansol to defraud the smelter by overpricing raw materials. It was also alleged that Ansol had made improper payments to the plant manager at TadAZ. Hydro was not accused of receiving, or being in a position to obtain, any undue proceeds through the Barter Agreement. Nor was it alleged that Hydro had acted fraudulently, or given or received any bribes. Rather, the argument put forward by TadAZ was that Hydro knew, or ought to have known, about Ansol's alleged fraud.

Even though the tribunal did not make any positive finding regarding the alleged fraud, it held that Hydro had not known about any fraud. Furthermore, it was stated in the Award that Hydro was "*entirely innocent of any bribery or fraud*", and that there was "*absolutely no evidence of lack of probity on the part of Hydro or Hydro's employees involved in the transactions with Ansol and TadAZ.*" It was further concluded that "*since Hydro is entirely innocent of any bribery or fraud, the Tribunal considers that the equitable course would be to enforce the Barter Agreement*".

Hydro's insurance companies covered Hydro's losses, less the deductible. However, Hydro was obliged under the respective policies to make every reasonable effort to assist the insurance companies with recovery of the loss.

Hydro examined various options to enforce the claim of USD 150 million, which the company had been awarded by the arbitration tribunal. However, since Tajikistan at the time had not ratified the New York Convention on the Recognition and Enforcement of Foreign Arbitration Awards, it was not possible to enforce the arbitration award in Tajikistan. Moreover it was assumed that TadAZ did not own any assets of significance outside Tajikistan. Therefore Hydro had to consider other mechanisms to collect the award.

Hydro entered into dialogue with TadAZ, but up to summer 2006 this produced no results. In June 2006 Hydro and the Norwegian Ministry of Foreign Affairs (UD) were invited to Dushanbe to discuss possible solutions. Ambassador Øyvind Nordsletten describes the meeting as follows in his letter to the Foreign Ministry:

*"Hydro explained the background and the binding award, and made it clear that they now expected the Tajikistan counterpart to present a proposal to resolve the issue without delay which would satisfy the amounts owing to Hydro. TadAZ's spokesmen explained their views and proposed an outline for a solution. This was clearly inadequate and could not be accepted by Hydro."*



In this connection, Hydro also established contact with World Bank and EBRD (European Bank for Reconstruction and Development) representatives in Dushanbe in an effort to persuade Tajikistan to recognise and fulfil international arbitration awards.

It soon became clear that TadAZ was unwilling to repay any significant portion of the outstanding USD 150 million, unless Hydro was willing to enter into new commercial contracts. Hydro was informed that the Tajik government had decided that TadAZ would be run on a 'tolling basis'. TadAZ therefore insisted that they had to have the opportunity to transfer any commercial agreements to a tolling partner. Hydro's dilemma was therefore whether the company should abandon all, or a substantial part, of the claim, or accept further engagement with TadAZ and a tolling partner in order to ensure an acceptable recovery. In this assessment, it was also important to take account of Hydro's obligations towards its insurers.

In the negotiations with TadAZ, Hydro expressed concern that the involvement of a tolling partner might reduce the transparency of the agreement structure, and it would therefore be preferable if TadAZ was maintained as the counterparty to the commercial agreements. Hydro made it clear that TadAZ's then tolling partner, CDH, would in any case be unacceptable as a counterparty for Hydro. This was due to the lack of transparency surrounding CDH, including CDH's refusal to disclose the identity of its shareholders. The World Bank and EBRD, who for several years had been working to increase transparency in Tajikistan, had also stated that CDH was unacceptable. TadAZ eventually agreed to replace CDH with a new tolling partner.

After thorough legal and ethical evaluations internally, Hydro accepted that TadAZ could assign its rights and obligations under the contemplated new commercial arrangements, but only on the condition that the new tolling partner was acceptable to Hydro and that there was transparency regarding its ownership. In this assessment, Hydro had the right to focus, among other things, on the ownership constellation, and whether the relevant third-party would be acceptable to the World Bank and EBRD.

Additionally Hydro demanded that the tolling partner was owned at least 70 % by the State of Tajikistan, and that the residual ownership was *"beneficially owned by parties at arm's length from the Tajik government (provided that those parties are otherwise acceptable to Hydro)"*. From Hydro's perspective, this would represent a significant improvement compared to CDH, the first partner proposed by TadAZ.

This resulted in an agreement for the settlement of outstanding claims signed with TadAZ in December 2006 (Settlement Agreement), which was a combination of cash repayments, alumina deliveries, and metal purchases over several years. That was how Hydro would recover a significant portion of the award handed down in the arbitration award in London. The Settlement Agreement was signed during an open ceremony at the Tajik National Bank, with representatives of the Tajik Government, the Norwegian Foreign Ministry, the World Bank and EBRD present.

The main points in the Settlement Agreement were as follows:

- USD 94 million to be paid in cash over a period of roughly 4 years;
- Purchase of 120 000 tonnes of aluminium per year over a 4-year period;
- Sale of 150 000 tonnes of alumina per year over a 3-year period based on annual price negotiations; and
- Technical support and HSE assistance to TadAZ from Hydro.

According to the Settlement Agreement, the metal and alumina deliveries should have been completed in 2010 and 2009, respectively.

The commercial contracts were based on market prices<sup>3</sup> and approved by the insurance companies. For TadAZ, Hydro and the insurance companies, the Settlement Agreement represented a total package which was acceptable to all.

### 3.2 Tripartite Agreement

Hydro was advised that TadAZ was planning a tender competition to select a new tolling partner. Hydro understands that this bidding round was performed over a period of three weeks. Hydro had no insight into the bidding process, but the World Bank was present when the bids were opened. In the first quarter of 2007, Hydro was informed that Talco Management Ltd (TML), registered in the British Virgin Islands (BVI), had been appointed as the new tolling partner. TML was indirectly 70 % owned by the State, with the remaining 30 % owned by three individuals. Through the work on this report, Hydro has learned that the information about the ownership in TML is available on the internet, and considers therefore that it can be disclosed without breaching any confidentiality obligations. The owners at the time in TML were the state-owned companies Vostokredmet<sup>4</sup> (35 %) and BarkiTojik<sup>5</sup> (35 %), and the three individuals were Ismatullo Hayoev (10 %), Jamshed Abdulov (10 %) and Maruf Orifov<sup>6</sup> (10 %).

TadAZ asked for Hydro's consent to assign its rights and obligations under the Settlement Agreement (regarding purchase of alumina and sale of aluminium) to TML. Hydro then performed a vetting process to determine whether TML would be an acceptable counterparty.

Regarding the ethical aspects, the following circumstances were identified, among others, and considered prior to Hydro's consent to the assignment to TML:

- Several reasons were given to explain why TML was registered in BVI. The most prominent was a desire to isolate the cash flows and metal from legal claims by third parties. Hydro understood that establishing an enterprise in a so-called tax haven generally is associated with a greater risk of corruption and concealment of funds, as a result of lack of transparency. With Hydro's experience from attempts to enforce the arbitration award against a Tajiki company in Tajikistan, there could also be some upside with a company registered in a country with a well-functioning justice system.
- Hydro gained insight into the tolling agreement between TadAZ and TML, which agreement was shared with EBRD and the World Bank. In this agreement, the tolling fee was a fixed amount per tonne of produced aluminium for a two-year period. The fee was considered reasonable in light of a historical LME price. This would be advantageous to TadAZ at a lower LME price, and disadvantageous at a higher-than-historical LME price. Hydro expressed

---

<sup>3</sup> For aluminium contracts, the market reference price is the daily rate quoted at the London Metal Exchange (LME). The same rate was used as a benchmark in the contract with TadAZ (and subsequently continued on identical terms with the new tolling partner). In addition to the basic price set for aluminium products, there can also be an additional amount (premium) or a discount, depending on the form, metallurgical qualities, delivery location and the like. Benchmark prices reported on LME, are in the simplest case aluminium I products that are acceptable for delivery to an LME-authorized warehouse for cash settlement which meet certain tolerances regarding aspects such as metal content. Such metal is known as LME registered. The metal from TadAZ was not certified for delivery to a LME warehouse due to impurities – including silicon and iron – in the product. It therefore traded at a discount to an LME registered brand.

<sup>4</sup> State-owned conglomerate

<sup>5</sup> State-controlled energy corporation

<sup>6</sup> Maruf Orifov was convicted of corruption in Tajikistan in 2008, according to internet sources

concern about the tolling structure, indicating that Hydro would prefer a floating tolling fee based on a percentage of the LME price.

- In addition to Hydro's own investigations, Hydro obtained a "Reputational Due Diligence – Open Source Research" of TML and its owners from an independent third party. The due diligence revealed nothing that was considered harmful for the reputation of the owners of TML. It was revealed that the private owners were Tajiki businessmen with extensive networks. No information was found to indicate that any of them had been involved in – or investigated for – any improper or unlawful business. However, environmental pollution was reported for Vostokredmet's businesses. The report pointed out that the substandard internet in Tajikistan put constraints on the access to information.

In April 2007, TadAZ – with Hydro's consent – assigned certain of its rights and obligations under the Settlement Agreement to TML. This was effectuated by a three-way agreement between Hydro, TadAZ and TML (Tripartite Agreement), where the contractual rights and obligations in connection with deliveries of aluminium and alumina were assigned to TML.

Hydro demanded, and succeeded in inserting a clause in the Tripartite Agreement whereby Hydro, EBRD and the World Bank would have access to TML's annual accounts, audited by an internationally recognised firm of accountants. Even though Hydro would have preferred to enter into an agreement directly with the smelter, Hydro accepted TML on the basis of its ability to follow-up and implement risk-mitigating measures which were intended to further openness and transparency in TadAZ. Such measures included, the possibility of setting up an office in Dushanbe, obtaining audited accounts and continuous assessment of factory visits, etc. TML also appeared to be a better alternative than CDH given that the ownership was known.

In Hydro's correspondence with the World Bank's representative in Dushanbe in March 2007, the following statement was made by the World Bank: *“Overall, we think that the letter that was sent by Talco (TML) to you is progress and their commitment to get themselves audited and to work with WB/ IFC/ EBRD is an opportunity to introduce more transparency into TadAZ.”*

This underscores the dilemma that Hydro, and Western institutions, faced in Tajikistan. Hydro considered that greater transparency had been achieved through the Settlement Agreement and Tripartite Agreement and that civil society, through the World Bank, would have an opportunity to scrutinise the money flows between Hydro and TML, and between TML and TadAZ.

### **3.3 HSE and Social Responsibility**

Hydro had support from institutions with a good knowledge of Tajikistan, including EBRD, the World Bank and the Norwegian Foreign Ministry, to help bring about greater transparency.

In Hydro's assessment, the Ministry of Trade's ownership policy in 2006-07 did not put any constraints on which countries Norwegian companies could trade with. Later the Norwegian Parliament (Stortinget) has supported industrial involvement in developing countries in the white paper, Storting Report no. 200 for 2008-09, page 2, where it states, inter alia:

*“This Report finds that Norwegian companies shall be among the foremost in pursuing social responsibility and in that way help strengthen the position of human rights, create decent working conditions, safeguard the environment and counteract corruption. The Government believes that active involvement by companies in these areas will have a positive effect both on the companies and society in general.*

[...]

*The Government believes that economic involvement in developing countries is positive as it contributes to value creation and can promote political and social development.”*

Hydro understood the Foreign Ministry to mean that Hydro's commercial involvement in Tajikistan would contribute towards stability and positive development in the country. Hydro refused to cooperate with companies whose ownerships and relationships were not transparent (see Chapter 3.1 and 3.2). TLM was accepted only after a thorough and concrete assessment, on the condition of improved transparency and a minimum 70 % State ownership.

In meetings with representatives from TadAZ and the authorities, Hydro discussed opportunities to help improve the situation at the smelter. Hydro raised CSR issues and proposed improvements in respect of HSE. TadAZ visited Hydro smelters in Norway and Slovakia. Hydro visited TadAZ and presented proposals for improvements thereafter. Through a special project "Retrofit", an initiative was taken to upgrade two production lines at the plant which would result in significantly better performance and lower environmental emissions (see Chapter 4.3). Together with the World Bank, Hydro actively encouraged Tajikistan to ratify the Kyoto Protocol which it did in 2008.

### 3.4 Steering Documents

No substantial changes were made to Hydro's relevant formal steering documents (Code of Conduct and Hydro's Social Responsibility) in the period 2005-07. In 2005, Hydro published a central document regarding anti-corruption work: "Hydro Integrity Program Handbook on corruption and human rights", see Annex 7. The Handbook focuses on how employees can avoid corruption, respect human rights and how Hydro shall act in relation to business partners in the value chain. The President and CEO's preface states as follows: *"Ethical dilemmas are here to stay; how to deal with them is what counts"*. Extensive training was conducted throughout the entire organisation in connection with the launch. The handbook was translated to all of Hydro's key languages and additionally an e-learning course was developed that all employees were required to take as part of the program "The Hydro Way". This launch coincided with Hydro's anniversary celebrations of 100 years as a company. In March 2007 the Russian version of the Handbook was distributed at a meeting with Tajik authorities. The conversation at the meeting was about integrity and anti-corruption, among other things.

### 3.5 Board of Director's involvement

In connection with the termination of deliveries from TadAZ in December 2004, there was a major focus on whether Hydro ought to account for a loss in its financial accounts. This was the subject of consideration in at least four of the meetings in the Board Audit Committee in 2005.

The termination of deliveries and the accounting effects were described in the Annual Report for 2004, and also described in our 20-F reporting, in connection with Hydro being then listed on the New York Stock Exchange in the US<sup>7</sup>.

In February 2005 the President and CEO briefed the Board of Directors in writing and orally about the situation, including the arbitration case in London.

## 4 2007-2016: Management of the Settlement and Tripartite Agreements

### 4.1 Agreement management

In order to manage the risks associated with the Settlement Agreement, and TML in particular, a range of measures were put in place. Hydro carried out regular visits and meetings in Tajikistan, where personnel from Commercial, CSR, HSE and technical functions took part. Hydro also

---

<sup>7</sup> Hydro shares were removed from NYSE listing in autumn 2007.

considered setting up a permanent presence in Tajikistan, but decided against this as the Settlement Agreement did not generate sufficient activity to justify posting of Hydro personnel to Tajikistan.

There had been increasing concern linked to TML. In the negotiations for the "Retrofit" project (see Chapter 4.3), Hydro imposed the requirement that the tolling partner had to be fully state-owned. This requirement was rejected by TadAZ, which defended its position by saying it could have a negative effect on the protection of the TadAZ cash flow against legal claims from third parties.

Hydro continued the close conversation with the World Bank and EBRD, and also engaged in dialogue with the International Monetary Fund (IMF), regarding the issues of transparency. Jointly with these bodies, Hydro repeatedly demanded that TML should be audited by internationally recognised auditors, and that the Auditor's Report be made accessible to Hydro, EBRD and the World Bank, in accordance with the Tripartite Agreement. The first audit was conducted in 2011 by an internationally recognized firm of accountants addressing the years 2007-10.

## 4.2 HSE and Social Responsibility

After the Settlement Agreement was entered into in December 2006, and deliveries of metal were recommenced, a thorough review was made of the agreement structure by Internal Audit in 2007-08. This review confirmed that payments were made through a bank in Tajikistan<sup>8</sup>. Internal Audit presented the following findings to the Board in April 2008, as set out in their Annual Report for 2007:

- *"The awareness and sensitivity towards CSR has greatly improved over time, more specifically since the Horton case in 2003. This is supported by the documentation and interviews*
- *Hydro's business practices in Tajikistan are currently compliant with our Code of Conduct, which is inspired by TRACE standards*
- *Documentation, information shared, and risk picture related to CSR are uniform from lower level of the organization to CMB*
- *Despite the efforts to improve the transparency in our business transactions with TadAZ and Talco Management (TML), Internal Audit is concerned that the TML may be controlled or highly influenced by people close to national authorities*
  - *Talco Management is registered in BVI (Tortolla) and 30 % of its ownership is through Tadjik business executives*
  - *As a mitigating risk, Hydro has a contractual right to request the audited annual accounts of Talco Management. However, such annual audit of accounts may not provide sufficient payment details in order to conclude on the funds flow"*

Both TadAZ and Hydro were interested in examining possible operational and environmental improvements at the smelter in Tajikistan. In March 2007, Hydro performed an HSE and technical review of TadAZ. Additionally there was a meeting with EBRD, the Tajik Department of the Environment, and the trade union at the smelter, TadAZ Union. The aim of that meeting was to analyse the status of HSE. In June 2007, Hydro hosted a delegation of technical personnel from TadAZ. In that connection an HSE presentation was given at Sunndalsøra and later in Oslo.

Based on the HSE analysis Hydro prepared a report addressing the HSE and technical challenges at TadAZ. Included in this analysis was a description of a potential project for modernising production line number 5 by using Hydro's point-feed technology (to reduce the occurrence of

---

<sup>8</sup> In 2011 payments were made through a bank connection in Latvia, in addition to the bank in Tajikistan. We also received payments from TML for purchase of alumina from the same Latvian bank from 2010.

environmentally harmful and unhealthy flares when adding the alumina), the so-called "Retrofit" project. The HSE standard at TadAZ was far below Hydro's standard, and significant improvements were required to attain a western standard.

Tajikistan's decision to ratify the Kyoto Protocol was announced at a renewable energy conference in Dushanbe on 22 October 2008. Hydro had advocated such a ratification. This ratification was expected to underline the viability of the "Retrofit" project, which could qualify for allocation of emissions trading certificates.

The "Retrofit" project for production line number 5 would have made a significant contribution to the total production at the smelter. It would have taken several years to complete the project, and the cost was estimated in the order of USD 70-120 million (depending, in part, on whether a gas scrubber was installed). Even though the project could have been partially funded through advance sale of emissions trading certificates, TadAZ still needed to obtain project funding through the International Finance Corporation (IFC), EBRD and/or private investors and financial institutions. Hydro's support for the project was to be of a technical nature.

Hydro was also involved in other HSE improvements at the Smelter. For instance, an HSE protocol was signed between Hydro and TadAZ in May 2009, in which both parties undertook to establish an HSE policy and strategy, and to have annual Activity Plans with TadAZ. The goal was to lift the works' HSE standard closer to an international benchmark.

In July 2009 most of TadAZ's management attended a study trip to Hydro's part-owned smelter Slovalco in Slovakia.

In January 2010, Hydro again visited TadAZ to follow up on the HSE strategy and activity plans, and to assess the improvements carried out since the previous visit. This was the final HSE related visit to Tajikistan by Hydro.

### **4.3 Status of Settlement and Tripartite Agreements**

Based on the positive elements that Hydro had negotiated into the Settlement and Tripartite Agreements, there was cautious optimism regarding the Hydro's ability to contribute to improvements at the smelter.

Although Hydro, throughout the entire period, was confident that the company was not in violation of any Norwegian or international legislation, there was very high awareness within Hydro of the many risks and dilemmas associated with the agreements. Hydro put in place all necessary measures that could reasonably be expected of a company to reduce the risk of corruption.

As already mentioned there were several attempts to encourage further improvements in transparency, HSE and increased production through Hydro's involvement in Tajikistan. There was a growing concern during the autumn of 2008 as Hydro did not see the desired developments materialize in a number of these areas. The company attempted, for example, to use the prospect of the "Retrofit" project as an incentive to encourage an increase in the State ownership in TML to 100 %. This was not successful and the "Retrofit" project was never realised. Progress with HSE was also slow. Furthermore, it took a long time before Hydro received the audited accounting reports from TML.

Towards the end of 2008, the President and CEO requested an assessment of whether Hydro could terminate the agreements. The conclusion was that the agreements could not be terminated without risking a lawsuit or compensation claim for breach of contract from the insurance companies and/or TadAZ/ TML.

Due to the lack of progress referred to above, the President and CEO decided in November 2009, that no metal purchase were to be entered into by Hydro beyond the fulfilment of Hydro's existing obligations pursuant to the Settlement and Tripartite Agreements. When Hydro communicated this, further delays occurred in the already agreed metal deliveries. Since cash payments and metal deliveries under the Settlement and Tripartite Agreements were not performed at the due time, the agreements continued to run beyond their originally agreed terms. The final delivery of alumina under the Tripartite Agreement occurred in November 2009. The final delivery of metal from TadAZ, after all the delays, was in the first quarter 2012.

In 2011, after the alumina obligations under the Tripartite Agreement were fulfilled, one single sales agreement was made for delivery of two ship cargoes of alumina, at ordinary commercial rates. A part-payment for this shipment was made in the form of aluminium, which was offset against the Settlement and Tripartite Agreements.

The last cash payment to Hydro was received in March 2013. Hydro continues to have a balance outstanding under the Settlement Agreement, but has not engaged in any trade in Tajikistan since the first quarter 2012.

#### **4.4 Guidelines - Code of Conduct**

The Hydro Integrity Program Handbook, described in Chapter 3.4, was revised in 2010.

The Handbook still applies and is available in eight languages, see Annex 8. The steering documents, Hydro's Social Responsibility and Code of Conduct, were revised in 2013.

#### **4.5 Board involvement**

The President and CEO advised the Board in his report in February 2007 that Hydro had entered into the Settlement Agreement, which included repayment of cash and entry into new commercial agreements with TadAZ. Most of the proceeds from the cash payments would be paid to the insurance companies as a reimbursement of what they had advanced to Hydro in connection with the insurance settlement.

The Annual Report by Internal Audit for 2006 was distributed to the Board in May 2007. Internal Audit commented that TadAZ had been asked to sign a declaration relating to transparency and corporate governance.

The President and CEO advised the Board in his report in December 2007 that Hydro was in negotiations with TadAZ for a modernisation project that would significantly reduce environmental emissions and increase production capacity by about 20 % – the "Retrofit" project. The President and CEO informed of the negative articles in online newspapers. He confirmed there was considerable emphasis placed on CSR and transparency both internally in the company, and together with the World Bank, EBRD and the Norwegian Foreign Ministry. In April 2008, Internal Audit presented their conclusion from the review of the business activities in Tajikistan (see Chapter 4.2).

In October 2008, the Board received a briefing from the President and CEO in connection with the "Retrofit" project (see Chapter 4.3) and endorsed Hydro's demand that TML should be 100 % state-owned. The Board noted, too, that the Norwegian Foreign Ministry, IMF and EBRD were informed about Hydro's position.

In connection with the then ongoing investigation into Hydro's previous oil and gas activities in Libya, Hydro worked during 2008 to describe its Compliance System (system to secure compliance with relevant laws, regulations and steering documents in the best possible way). This work resulted in a steering document that defined the roles and responsibilities within Hydro in relation

to compliance, how compliance work is organised, and the activities which jointly comprise the Compliance System (see Chapter 5 for a brief description of today's Compliance System). The Compliance System was presented and discussed in the Board of Directors, including at a meeting in October 2008.

In December 2008, the Board received an 11-page memorandum that summed up Hydro's involvement and the key assessments that had been made in that connection.

## **5 Compliance in Hydro**

Compliance with laws and regulations is a line responsibility and Hydro works systematically at all levels in the organisation to ensure compliance.

Hydro's Code of Conduct, approved by the Board of Directors and applicable to Board members and all employees in Hydro, defines compliance to embrace compliance with relevant laws and regulations, and adherence to Hydro internal steering documents.

The Board has Compliance as a fixed item on the agenda twice a year. The main focus areas have been, and remain i) HSE, ii) anti-corruption, and iii) competition law.

The responsibility for ensuring compliance and reporting any breaches of the regulations lies with the line management at all levels in the organisation.

A Corporate Compliance function has a coordinating and lead responsibility to ensure that Hydro has effective procedures and systems in place in all parts of the operations. Dedicated Compliance personnel are in place in Norway, Germany and Brazil.

The head of Corporate Compliance reports to the Executive Vice President for Legal, CSR and Compliance. The head of Corporate Compliance attends Board meetings and the Board Audit Committee twice a year and is required to report any issues that he/she finds relevant directly to the President and CEO or to the Board Audit Committee.

There is close cooperation between the various corporate staffs in terms of management and control within Compliance. This is to establish suitable procedures, routines and training throughout the organisation.

Compliance activities are structured along four main pillars: 1) Prevention, 2) Disclosure, 3) Reporting and 4) Response.

Mapping of compliance risks is an integral part of the annual risk management process in Hydro. It is intended to safeguard that adequate procedures are in place and proportional to the relevant risks.

All commercial areas define Compliance Plans that are part of the annual business plans. The President and CEO monitors the status of the compliance plans in his quarterly meetings with heads of the respective business areas.

Hydro also maintains a strong focus on follow-up of compliance in joint ventures and companies where Hydro has an ownership interest.

Hydro has maintained a "whistle-blower" channel since 2004. Since 2011 it has been named "AlertLine", and is operated by an external service provider. The channel is available in all languages applicable where Hydro has activities, and is accessible by email, internet, intranet and telephone. The person reporting may remain anonymous if desired. Internal Audit is responsible for managing the AlertLine on behalf of the Board Audit Committee. Internal Audit reports the status



each quarter. Internal Audit conducts risk-based audits throughout the entire organisation with a focus on routines and control to ensure that compliance is functioning as intended.

In autumn 2014, the Board initiated an external, independent review of Hydro's Compliance System. The conclusion from that review was that the business culture and "tone from the top" was on par with what was considered "leading practice". Proposals were made for improvement measures, which are included in management's work on continuous improvement of the Compliance System, to ensure that the compliance risks are adequately controlled and that the system is working as intended.

## **6 Conclusion**

This report builds on extensive material from a period stretching back 20 years in time. The information offered in the report builds on this material and the previous assessments made. Hydro's review has helped organise the company's information on the issue. This report has been developed over a relatively brief time-period and further relevant information may exist. Hydro will therefore continue to work on the matter in-house to determine whether more information can be found.

Yours sincerely  
for Norsk Hydro ASA

Dag Mejdell  
Board Chairman