Governor Terry E. Branstad
Lt. Governor Kim Reynolds

IPERS
Donna M. Mueller
CHIEF EXECUTIVE OFFICER

September 28, 2012

Honorable Mike Marshall,
Secretary of the Senate
Honorable W. Charles Smithson,
Chief Clerk of the House
General Assembly of the State of Iowa
Des Moines, IA 50319

Dear Messrs. Marshall and Smithson:

Enclosed is the Iowa Public Employees' Retirement System's report for the fiscal year ended June 30, 2012, on divestment activities related to companies doing business in the Sudan. This annual report is required by section 12F.5 of the Code of Iowa.

The report describes IPERS' implementation of the Sudan divestment program and provides information on IPERS divestment activities and costs as well as an update on the current situation in Sudan. The report also includes a list of prohibited companies as of June 30, 2012.

Sincerely,

Donna M. Mueller
Chief Executive Officer

Enclosure

IOWA PUBLIC EMPLOYEES' RETIREMENT SYSTEM
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IOWA PUBLIC EMPLOYEES' RETIREMENT SYSTEM
ANNUAL REPORT
ON SUDAN DIVESTMENT
For the Fiscal Year Ended June 30, 2012

Iowa Code chapter 12F requires the Iowa Public Employees' Retirement System (IPERS) to scrutinize companies with business operations in the Sudan, and under certain circumstances, to restrict its purchases of, and/or divest of, holdings of any company determined to have active business operations in the Sudan. Chapter 12F specifies certain procedures to be followed in engaging companies doing business in the Sudan, and requires IPERS to annually report to the General Assembly on its activities concerning the Sudan divestment law.

Implementation

IPERS develops a list of scrutinized companies using the research and findings of the Conflict Resolution Network (CRN). The CRN, which was formerly known as the Sudan Divestment Task Force, is an organization that helped develop the legislation and is considered to be an authoritative source of information in this area. IPERS considers companies characterized by the CRN as "Scrutinized" to be companies with active business operations in the Sudan.

IPERS sends a letter to each company with active business operations asking them to discontinue their operations in the Sudan. Companies are given the opportunity to provide evidence that contradicts the CRN's findings. The letter also notifies the company that IPERS will prohibit further investment and divest of its holdings in the company's securities if the company does not meet the requirements of the law. If the company does not respond, or fails to provide convincing evidence within the time period established by law, then IPERS places the company on its prohibited companies list. The prohibited companies list is updated quarterly, and is provided to the public on IPERS' Web site at www.ipers.org.

IPERS' investment managers are prohibited from purchasing securities issued by companies on the prohibited companies list. Investment managers that have any existing direct holdings[1] of a prohibited company must sell (divest) the position within 18 months of the date the company was first notified. An investment manager has the discretion to decide when to sell its holdings within the 18 month period.

[1] It is important to note that chapter 12F makes a distinction between direct holdings and indirect holdings. *Direct holdings* are securities directly owned and held in IPERS' name. *Indirect holdings* refer to situations where IPERS may indirectly own an interest in a security because of its ownership of shares in a commingled investment vehicle, such as a mutual fund. The General Assembly recognized that it may not be possible to efficiently divest of prohibited companies held in a commingled fund, and exempted indirect holdings from many provisions of chapter 12F. IPERS is required to analyze the prudence of moving its indirect holdings to Sudan-free commingled funds if such an option exists. See section on Indirect Holdings.

Chapter 12F requires IPERS to engage only those scrutinized companies in which it has direct holdings. However, IPERS has opted to send letters to all scrutinized companies, and will place a scrutinized company on the prohibited companies list if warranted, regardless of whether or not IPERS has any direct holdings in the company. This is done because IPERS prefers to engage a company and determine whether it is a prohibited company before an investment manager purchases any securities of such company. The investment manager wants to know if a company is prohibited before buying it, not afterwards.

Chapter 12F also requires IPERS to contact companies that have inactive business operations in the Sudan. However, the purpose of such letter is to encourage them to keep their business activities inactive until the genocide stops in the Sudan. IPERS uses information from CRN to determine which companies have inactive business operations in the Sudan.

Fiscal Year 2012 Engagement Activity

The following chart summarizes the numbers of companies contacted by IPERS in fiscal year 2012 pursuant to chapter 12F.

Time Period	Number
Sept. 30, 2011	7
Dec. 31, 2011	4
Mar. 31, 2012	6
June 30, 2012	2

In total, letters were sent to 19 companies under scrutiny for active business operations. Caterpillar, Inc., a company that CRN raised concerns about in the first quarter of 2012, was the only company that responded to IPERS letter. Caterpillar argued that it did deserve to be classified as a scrutinized company under Iowa law because the activities in question were performed by dealers that should not be considered as affiliates of the company. Furthermore, Caterpillar argued that IPERS could not prove that the 10% revenue test in chapter 12F had been met. IPERS conceded the second point, and in a follow-up letter requested Caterpillar to assist IPERS and other investors in collecting the information needed to determine if the revenue test has been met. To date, IPERS has received no response from Caterpillar. Since IPERS does not have the information necessary to determine if the firm meets the requirements of the law, Caterpillar has not been added to the prohibited companies list

IPERS updates and publishes its prohibited companies list on a quarterly basis. During fiscal year 2012, 25 companies were added to the prohibited companies list, and 6 companies were removed. The companies were removed because the CRN no longer considered them to be Highest Offenders. IPERS' prohibited companies list as of June

30, 2012 is included as Appendix A to this report. In addition, IPERS staff sent annual reminder letters to the 93 companies that are on the list in Appendix A, encouraging them to transform their active Sudan operations into inactive operations. Chapter 12F requires this annual communication with each company on the prohibited companies list.

Fiscal Year 2012 Divestment Activity

The only divestment activity in fiscal year 2012 concerned one company. Reliance Industries Limited was added to IPERS' prohibited companies list effective January 1, 2012. At that time, IPERS had direct holdings in Reliance Industries Limited of 123,039 shares with a market value of $1,605,496.22. The investment manager that held these shares had completely divested of the position by the close of business on February 22, 2012, incurring a commission cost of $5,143.00 to trade the shares.

We also note that PTT Chemical PCL was added to IPERS' prohibited companies list effective October 1, 2011. Our direct holdings of PTT Chemical PCL at that time were 509,000 shares with a market value of $1,621,071.27. However, during the course of the fourth quarter of 2011, the ownership structure of PTT Chemical PCL changed, such that it was no longer considered to be majority-controlled by PTT Public Company Ltd. (PTT). As a result, CRN removed the company from scrutinized status and IPERS likewise removed the firm from the prohibited companies list effective January 1, 2012. No divestment activity occurred during the one quarter that PTT Chemical PCL was on IPERS prohibited companies list, so no costs were incurred.

Indirect Holdings

As noted earlier, chapter 12F makes a distinction between direct and indirect holdings. IPERS' had indirect holdings in three companies listed on the prohibited companies list on June 30, 2012 that were valued at $1,396,341.72, which was less than one one-hundredths of the total IPERS Fund value. While indirect holdings are generally exempt from most of the provisions of the law, IPERS is required to evaluate the potential costs associated with moving its indirect investments to funds that will comply with chapter 12F, if it is prudent to do so.

IPERS investment staff collected information concerning the potential cost of moving its indirect holdings to Sudan-free alternatives and presented such information to the IPERS Investment Board at its June 21, 2012 meeting. The Investment Board agreed with staff that it was not prudent to incur the trading costs to eliminate such small indirect exposures to prohibited companies.

Fiscal Year 2012 Program Costs

The cost to implement the Sudan monitoring and divestment program have been very low so far. IPERS has been able to avoid payment of any staff overtime costs during the implementation phase of the program, and IPERS has not incurred any third party costs for research or other services by using the free information made available by CRN. IPERS did incur commission costs of $5,143.00 in fiscal year 2012 due to the divestment of our holdings of Reliance Industries Limited.

Conclusion

The impact of the law on the situation in the Sudan is unknown. However, significant political changes have occurred in the Sudan. Following the creation of the independent country of South Sudan on July 9, 2011, border skirmishes with Sudan persisted. These intensified when South Sudan decided to cease all oil production, until a more equitable arrangement could be made on pipeline transit fees. South Sudan controls 75% of the oil production of the two countries combined, but has no viable means of bringing it to market, except through the pipelines of Sudan. Pressure from the African Union and United Nations resulted in a tentative agreement on August 4, 2012 that should lead to a resumption of oil production activity in December. However, several potential roadblocks remain to be negotiated. Please see the attached report from CRN describing the current situation in the Sudan.

For More Information

See IPERS' Web site at www.ipers.org/investments/restrictions.html for quarterly updates throughout the year. We can be reached by e-mail at investments@ipers.org or by telephone at 515-281-0030.

Appendix A

Iowa Public Employees' Retirement System's
Prohibited Companies List

July 1, 2012

	Divestment Date *
» AKM Industrial Co. Ltd.	
» Alstom	
» Alstom Projects India	
» AREF Energy Holding Company	
» Areva T&D India Ltd	June 30, 2013
» AviChina Industry & Technology Ltd.	
» Biopetrol Industries AG	December 31, 2012
» Chemoil Energy Limited	June 30, 2012
» Chennai Petroleum Corporation Limited (CPCL)	
» China Gezhouba Group Limited	December 31, 2012
» China Hydraulic and Hydroelectric Construction Group Corporation (Sinohydro)	
» China National Petroleum Corporation (CNPC)	
» China North Industries Corporation (NORINCO)	
» China North Industries Group Corporation (CNGC/NORINCO)	
» China Petroleum Finance Co. Ltd.	
» CNPC Golden Autumn Ltd	June 30, 2013
» CNPC HK Overseas Capital Ltd.	December 31, 2012
» Daqing Huake Group Co. Ltd.	
» Dongfeng Motor Group Co. Ltd. (DFL)	
» Egyptian Kuwaiti Holding Company	
» Electricity Generating Company (EGCO)	
» Eneos Globe Company	June 30, 2013
» Gas District Cooling PutraJaya Sdn Bhd	
» Glencore FDG LLC	December 31, 2012
» Glencore Finance	December 31, 2012
» Glencore Finance (Europe)	December 31, 2012
» Glencore International PLC	
» Hafei Aviation Industry Co.	
» Harbin Dongan Auto Engine Co.	
» Indian Oil Corporation Ltd. (IOCL)	
» Infotel Broadband Services Ltd.	March 31, 2013
» Jiangxi Hongdu Aviation (Hongdu Aviation)	
» Jinan Diesel Engine Co. Ltd	
» JX Holdings Inc.	
» JX Nippon Oil & Energy Corporation	
» KEPCO Plant Service & Engineering Co., Ltd.	December 31, 2012
» Kingdream PLC	
» KLCC Property Holdings Bhd	
» KMCOB Capital Berhad	
» Kunlun Energy Co. Ltd.	September 30, 2012
» Lanka IOC Limited	
» Liaoning Huajin Tongda Chemical Co. Ltd.	
» LS Industrial Systems	December 31, 2012
» Managem	
» Mangalore Refinery and Petrochemicals Ltd. (MRPL)	
» Mercator Lines Singapore	June 30, 2012
» Mercator Ltd.	
» Midciti Resources Sdn Berhad	
» MISC Berhad (Malaysia International Shipping Company)	
» MISC Capital Ltd.	
» Nippo Corporation	March 31, 2013
» Nippon Mining Holdings	
» Nippon Oil Corporation	
» Nippon Oil Finance	December 31, 2012

Iowa Public Employees' Retirement System's
Prohibited Companies List

July 1, 2012

	Divestment Date *
» NORINCO International Cooperation Ltd.	
» North Navigation Control Technology Co. Ltd.	
» Oil and Natural Gas Corp. Ltd. (ONGC)	
» Oil India Limited	
» ONA S.A.	
» ONGC Videsh Limited (OVL)	June 30, 2012
» Optimal Chemicals (Malaysia) Sdn Bhd	September 30, 2012
» PetroChina Co. Ltd.	
» Petroliam Nasional Berhad (Petronas)	
» Petronas Capital Limited	
» Petronas Chemicals Glycols Sdn Bhd	September 30, 2012
» Petronas Chemicals Group Berhad	September 30, 2012
» Petronas Dagangan Bhd	
» Petronas Gas Bhd	
» PT Pertamina Persero	March 31, 2013
» PTT Exploration & Production PCL	
» PTT Public Company Ltd. (PTT)	
» PTTEP Australia International Finance Proprietary Ltd.	June 30, 2012
» PTTEP Canada International Finance Ltd.	December 31, 2012
» Putrajaya Holdings Sdn Bhd	December 31, 2012
» Ranhill Berhad	
» Ranhill Power Sdn Bhd	March 31, 2013
» Ranhill Powertron Sdn	
» Reliance Holdings USA Inc.	March 31, 2013
» Reliance Industries Limited	March 31, 2013
» Scomi Engineering Berhad	
» Scomi Group Berhad	
» Sichuan Nitrocell Co. Ltd.	
» Sinohydro Group Ltd.	December 31, 2012
» Sinopec Corporation (China Petroleum and Chemical Corporation)	
» Sinopec Finance Co. Ltd.	
» Sinopec Group (China Petrochemical Corporation)	
» Sinopec Kanton Holdings Ltd.	
» Sinopec Shanghai Petrochemicals Ltd.	
» Sinopec Yizheng Chemical Fibre Co. Ltd.	
» Societe Metallurgique D'imiter	
» Space Energy Corporation	June 30, 2013
» Trafigura Beheer	
» Wuhan Boiler Company	

» Denotes wholly- or majority-owned subsidiaries, parent companies, or affiliates of companies that have the most problematic operations in Sudan according to the Sudan Divestment Task Force model of targeted divestment.

* Denotes deadline for divesting of security.

CONFLICT RISK NETWORK

2012

/ THE SUDAN - SOUTH SUDAN OIL DEAL & IMPLICATIONS FOR DIVESTMENT

ABOUT CONFLICT RISK NETWORK

Conflict Risk Network is made up of institutional investors, financial service providers and related stakeholders calling upon corporate actors to fulfill their responsibility to respect human rights and to take steps that support peace and stability in areas affected by genocide and mass atrocities. Our goal is to increase such behavior by corporate actors and thereby reduce conflict risk.

The Network has a respected voice in the institutional investment field. It produces unparalleled research on companies operating in Sudan, makes recommendations on how corporations can fulfill their responsibility to respect human rights in areas affected by mass atrocities and genocide, and harnesses the collective weight of over U.S. $3 trillion in assets when leading focused corporate engagement.

Since 2006, Conflict Risk Network's research and engagement have persuaded more than 12 major corporations to adopt recommendations for appropriate conduct in Sudan. Our work has been featured in thousands of news articles in outlets such as CNN, *The Wall Street Journal*, *Financial Times*, *The New York Times*, *Forbes*, *Responsible Investor* and Bloomberg.

The Network's 100 members include pension funds, some of the world's largest asset management firms, government entities, university endowments, foundations, financial service providers, and socially responsible investment firms.

ABOUT UNITED TO END GENOCIDE

Conflict Risk Network is a project of United to End Genocide, the largest activist organization in America dedicated to preventing and ending genocide and mass atrocities worldwide. The United to End Genocide community includes faith leaders, students, artists, investors and genocide survivors, and all those who believe we must fulfill the promise the world made following the Holocaust – "Never Again!"

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ACRONYMS AND TERMS

AU	African Union
CNPC	China National Petroleum Corporation
CPA	Comprehensive Peace Agreement
GNPOC	Greater Nile Petroleum Operating Company
IMF	International Monetary Fund
MOU	Memorandum of Understanding
SADA	Sudan Accountability and Divestment Act
SPLA	Sudan People's Liberation Army
SPLM-N	Sudan People's Liberation Movement - North
SSTL	State Sponsors of Terrorism List
UN	United Nations

THE SUDAN - SOUTH SUDAN OIL DEAL
& IMPLICATIONS FOR DIVESTMENT

EXECUTIVE SUMMARY

On August 4, African Union officials announced that Sudan and South Sudan had reached an agreement on oil pipeline fees. The proposed deal, coming two days after a United Nations deadline for the resolution of all outstanding issues between the two countries, could pave the way to the resumption of oil production. This deal is a potentially significant step toward the peaceful resolution of many unresolved issues between the two countries.

At independence South Sudan came into control of 75% of the almost 500,000 barrels per day of oil production that had previously belonged to a unified Sudan. However, the landlocked South still has to export its oil through Sudan, and negotiations over fees for usage of the North's pipelines grew increasingly contentious last fall. In January, South Sudan suspended production—cutting off its 350,000 barrels per day output—after accusing Sudan of stealing oil. The shutdown, which was strongly criticized by international actors, has caused severe economic problems for both countries. It also contributed to an outbreak of fighting around the Heglig oil field located on the contentious border between the two countries in April. At times the situation threatened to reignite war between Sudan and South Sudan.

The need for an oil agreement, a necessary precondition for the resumption of production, reached a critical point this summer. The economies of both countries are overwhelmingly dependent on oil revenue. Sudan began experiencing protests in response to fuel subsidy cuts enacted as part of austerity measures. These measures were imposed to deal with the budget crisis caused by loss of oil revenue. Meanwhile, South Sudan is believed to have almost entirely depleted its foreign-exchange reserves during the shutdown.

The oil deal is not a cure-all. Sudan has said that it will not sign the agreement until a final resolution is reached on security. This means that issues around border demarcation, accusations of both countries supporting cross-border rebel groups, and determination of the status of the disputed Abyei region could all still potentially derail the oil agreement. Even once the deal is signed, production is not expected to begin until December or reach pre-shutdown levels until at least June 2013.

BACKGROUND ON SUDAN AND SOUTH SUDAN

On January 9, 2011, the people of South Sudan voted to secede from the North and form a new nation. This referendum on whether or not to secede was part of the Comprehensive Peace Agreement (CPA) signed in 2005, which ended a brutal 22-year civil war between the Sudanese government and groups in South Sudan. The result of the January referendum was a landslide vote for secession, with nearly 100% of voters in the South voting in favor of separation.

Six months later, on July 9, 2011, the Republic of South Sudan officially became the world's newest nation. Prior to independence, oil revenue provided the government of Sudan and the regional government of South Sudan with 63% and 98% of their revenue, respectively.[1] With an estimated 75% of that oil located in South Sudan, this means a potential fiscal gap of $7.77 billion for Sudan without some sort of agreement on a transitional financial assistance package and oil transit fees.[2]

South Sudan took with it the majority of Sudan's oil, but it still requires use of pipelines running through Sudan to reach Port Sudan for export. An agreement on the fees for South Sudan's use of those pipelines was not reached before independence, but oil initially continued to flow during negotiations. These negotiations extended beyond oil to a host of other issues—including border demarcation, citizenship, security and the contested Abyei region—and grew increasingly contentious during late 2011.

SOUTH SUDAN OIL SHUTDOWN

On January 20, 2012, the government of South Sudan in Juba made the drastic decision to shut down all oil production indefinitely.[3] Juba claimed this extreme measure was in response to Sudan's illegal confiscation of more than six million barrels of southern oil, valued at over $800 million. The government of Sudan in Khartoum denied that it stole oil from South Sudan. It claimed the oil was confiscated to offset unpaid fees. Negotiations continued during the shutdown and a summit between the two heads of state was scheduled for April 3. However, before the meeting Sudan's President Omar al-Bashir canceled the summit and cut off talks when fighting first broke out around Heglig at the end of March. Both Khartoum and Juba refused to allow South Sudanese oil to be transported through Sudanese pipelines ever again, placing stress on both nations. For the North, the challenge is finding alternative means of revenue and for the South to find a means of transport. Despite resistance from the Sudans, the African Union (AU) made strong demands for both countries to return to the negotiating table. Both the AU and the United Nations (UN) issued resolutions demanding significant progress by August 2.

FIGHTING OVER HEGLIG

Tensions over the standoff escalated dramatically at the end of March when the worst fighting between the two countries since the South's independence in July 2011 erupted. South Sudan's military, the Sudan People's Liberation Army (SPLA) attacked oil-producing region of Heglig, situated on the contentious North-South border in Sudan's South Kordofan state. SPLA claimed to be responding to a Sudanese attack on South Sudan's Unity State and a bombing campaign of southern oil fields.[4] On April 10, 2012, the SPLA seized control of Heglig. The occupation was condemned by the international community, while Sudan called the move an act of war and mounted an offensive to retake the area.[5] SPLA forces withdrew from Heglig on April 20. South Sudan claimed that it withdrew voluntarily to avoid all-out war, while Sudan claimed the counterattack by its armed forces drove the South out.[6] Despite South Sudan's retreat from Heglig, Sudan has continued to bomb border areas and there have been claims of Sudanese troops crossing the border.[7]

While there had been ongoing negotiations over several of the disputed areas on the border, Heglig had not previously been a major point of contention. In 2009, the Permanent Court of Arbitration ruled that it was not a part of Abyei and instead belonged to the North, despite the South's claim that it culturally belongs with them. Prior to the fighting, the oil fields in Heglig—operated by the Greater Nile Petroleum Operating Company (GNPOC) consortium led by China National Petroleum Corporation (CNPC)—accounted for almost half of Sudan's oil production. The South shut down oil production while in control of the field and the fighting reportedly resulted in significant damage to oil facilities. The loss, even temporarily, of 70,000 barrels of oil per day is a significant blow to Sudan's economy—which was already reeling from the loss of the oil-rich South.[8] Despite Sudanese claims that oil production has been restored, it is believed that output as of August 2012 is still well below pre-April levels.

LOCAL ECONOMIC IMPACT

The shutdown of oil production was a bold move with significant risks given both countries' dependence on oil revenues. In order to cope with the loss, the government of South Sudan intended to cut non-salary spending by 50%.[9] However, according to a scathing leaked World Bank report from March 2012, even if South Sudan decreased monthly spending by 77%, reserves would only last until December 2013 without restarting oil production.[10] In the report a World Bank official noted that if South Sudan managed to triple non-oil revenue it would have only a "negligible" impact on the economy. The months without production have reportedly left South Sudan running low on dollars, weakening the South Sudanese pound, driving up the cost of imports and straining the economy.[11] The poverty level in South Sudan is predicted to jump from 51% to 83% in 2013.[12] Most worrisome, South Sudan is believed to have almost entirely depleted its foreign-exchange reserves during the shutdown.

South Sudan isn't alone in facing severe economic challenges, including rampant inflation and skyrocketing food and fuel prices.[13] A recent International Monetary Fund (IMF) mission to Sudan found a 2.7% slump in its economic growth, a 4% deficit in the GDP in 2011, and projected 19% inflation by the end of 2012.[14] In June, as part of austerity measures to help compensate for lost oil revenues, the Sudanese government announced plans for the gradual removal of fuel subsidies along with an increase in taxes and customs duties on luxury products. The announcement provoked public protests in Khartoum, Omdurman and other cities.[15] The protests have at times been met with violent response by the government, including the deaths of eight protestors who were shot by police in Nyala, Darfur, in August.[16]

GLOBAL ECONOMIC IMPACT

The decrease in the supply of oil as a result of the South's shutdown has had a global impact. China and Japan have relied on the Dar and Nile blend crudes from the country, and have had no choice but to procure the oil elsewhere. This has contributed to the current strains on the world market and increased oil prices.[17] China, historically an ally of Sudan,[18] has attempted to approach the countries equally, balancing its support to ensure the best possible position with both countries without appearing to take sides. Zhong Jianhua, China's envoy for Africa, traveled to Sudan in mid-May 2012 to work with the Sudans on negotiations for a peaceful agreement over outstanding issues plaguing the two countries.[19]

The alleged oil confiscations provoked South Sudan to threaten legal action to prevent the unauthorized sale of its oil, to warn that it may expel Chinese oil companies if found complicit in the theft of its oil, and to hold up delivery of oil for at least one company, Trafigura.[20] Petrodar, a joint venture between CNPC and Petronas, claimed that its contracts with the government in Khartoum required it to purchase the oil regardless of its origin.[21] Other corporations maintain that they were unaware of where the oil came from.[22] In February, the government expelled the head of Petrodar from South Sudan for the company's alleged complicity in the theft of the country's oil.[23]

AU AND UN RESOLUTIONS

On May 2, 2012, the UN Security Council adopted UN Resolution 2046 in response to heightened tensions between Sudan and South Sudan. The resolution threatened additional measures such as sanctions if they failed to make substantial progress on the outstanding issues by the resolution's August 2 deadline.

Both countries had offered proposals and counter proposals to resolve the oil impasse. South Sudan was clear that they simply wanted to pay transit fees for use of the North's pipeline. However, Sudan wanted a deal that would maintain its income at a level similar to the pre-independence 50-50 revenue sharing agreement. South Sudan's initial offer was less than $1 per barrel; Sudan's demand was $36. The two sides seemed stuck at these numbers for much of the last year. Adding further complications, Sudan said it would not consider an oil transit fee proposal from South Sudan until security issues are settled.

There seemed to be little real progress towards a deal in the lead up to the August 2 deadline until July 22 when South Sudan proposed *The Agreement on Friendly Relations and Cooperation (AFRC) between The Republic of South Sudan and The Republic of Sudan.* The proposal attempted to address all outstanding issues between the two sides and included $7.26 and $9.10 per barrel transit fees for use of the main Petrodar and GNPOC pipelines, respectively, and $8 billion in transitional financial assistance. Sudan rejected the deal while lowering its demand to $32 per barrel. Despite the rejection, the proposal was the first indication of real movement by either side since a failed effort to sign an interim oil deal in January shortly after the shutdown.

THE TENTATIVE OIL DEAL

Transit Fees

The August 2 deadline for an agreement came and went. However, on August 4, AU officials announced that Sudan and South Sudan had reached an agreement on oil pipeline fees potentially paving the way for the resumption of oil production. Pressure from U.S. Secretary of State Hillary Clinton, who visited the South Sudan capital the day before the deal, and pressure from China are believed to have been large factors in reaching an agreement.[24]

Unlike South Sudan's July proposal, this deal is limited to oil issues. The agreement establishes transit fees of $9.48 and $11 per barrel for the Petrodar and GNPOC pipelines as well as $3.028 billion in transitional financial assistance for Sudan to make up for the loss of revenue as the result of South Sudan's secession. The agreement will last for 3.5 years at which point the transit fees can be renegotiated, but not increased.

Transit Fee Agreement	
Pipeline	Transit fee (per barrel)
GNPOC	$11.00
Petrodar	$9.48

In an effort to sever its dependence on Sudan, South Sudan has spoken of working with Kenya and Ethiopia to construct a pipeline to transport oil. The concept, which has been discussed for years, would involve exporting South Sudan's oil through Kenya to the port of Lamu.[25] The 3.5 year term for the transit fee agreement appears to be the result of the belief on the part of South Sudan that it can have that pipeline completed in this timeframe. But with bids on the project just being submitted, this seems an extremely optimistic estimation both logistically and financially.[26] Sudan will also have to be assured that it won't be completely cut off from the revenue from South Sudan's oil following completion of this pipeline.

Transitional Financial Assistance

Sudan and South Sudan have made commitments to ensure the mutual economic viability of both countries following the independence of South Sudan. These commitments include an agreement around oil transit fees and a transitional financial assistance package for Sudan. The IMF estimated that Sudan faces a fiscal gap of $7.77 billion as a result of South Sudan's independence; Sudan itself claims $10.4 billion.[27] The leading proposal for addressing this gap was a plan in which one-third would be filled by South Sudan, Sudan would save one-third through austerity measures, and the final third would come from international donors through debt forgiveness, grants and the removal of sanctions.[28] This was the proposal that was ultimately incorporated into the proposed agreement. South Sudan has agreed to pay $3.028 billion to Sudan over the 3.5 years of the deal.

As part of the CPA, the United States committed to lifting sanctions if Sudan allowed the referendum on the South's independence. Sudan's attacks on South Kordofan, Blue Nile and Abyei along with the ongoing violence in Darfur have made this impossible. However, while those sanctions mean the U.S. cannot contribute directly to reduce the gap, it is lobbying other donors—especially China and the gulf countries—and waiving sanctions to allow dollar transfers. The waiver of sanctions on dollar transfers is critical, as most global financial transactions are in dollars. A waiver would make it significantly easier for countries to contribute to filling the remaining third of Sudan's budget deficit.

Arrears Forgiveness

In addition to the cash transfer, by all accounts the proposed agreement includes South Sudan forgiving the arrears and outstanding debts owed by Sudan. Officials in Juba claim this will amount to almost $5.5 billion; half a billion dollars in commercial arrears owed to South Sudan dating back to independence and $4.97 billion in pardoned debt relief also owed by Sudan.[29] According to South Sudanese Vice President Riek Machar—combined with the transitional financial assistance and oil transit fees—this is the equivalent of $40 per barrel of oil and would make South

Sudan, "the biggest donor on earth to a single country, Sudan."[30]

"Promise Ring"

While this deal is incredibly promising, at this point it is still just an agreement to agree. The signing of the oil agreement is contingent on a deal being reached on security. This means that issues around border demarcation, accusations that both countries have been supporting cross-border rebel groups, and determination of the status of the disputed Abyei region could all potentially derail the oil agreement. Given the interconnected nature of these challenges, there is real concern that if they are not resolved in conjunction with the oil agreement, they will not be resolved. Security talks were set to resume in Addis Ababa at the end of Ramadan, but they were postponed until the beginning of September as a result of the death of Ethiopian Prime Minister Meles Zenawi. The African Union meets on September 22 to hear a report on the status of talks from the African Union High-Level Implementation Panel on Sudan (AUHIP). There is pressure on both countries to show further progress by then.

REMAINING ISSUES

Security

The oil shutdown, coupled with the acrimonious history between Sudan and South Sudan, prompted the signing of a non-aggression and cooperation memorandum of understanding in February 2012.[31] However, the pact did nothing to stop the fighting. The conflict around Heglig was just an extension of the violence in other border areas. Both sides have long accused each other of recruiting and funding armed militias to attack within each other's territory.[32] Sudan continues to block aid from reaching civilians in South Kordofan and Blue Nile, claiming that the assistance would be used to fortify rebel groups.[33] The U.S. has warned that Sudan's blockade on aid risks a full-scale famine.[34] On August 5, the Sudanese government and Sudan People's Liberation Movement—North (SPLM-N) each signed a Memorandum of Understanding (MOU) for humanitarian access to South Kordofan and Blue Nile as part of an agreement brokered by the UN, AU and League of Arab States. Despite the MOU, by the end of August, humanitarian assessments have not begun and aid has yet to enter SPLM-N controlled areas in South Kordofan and Blue Nile.

Since May 2011, violence has escalated in contentious regions along Sudan's border with the South. The government of Sudan has utilized its military forces to launch attacks in civilian areas of South Kordofan and Blue Nile, as detailed in United to End Genocide's report, *Sudan's Man-Made Catastrophe: A War on Civilians in South Kordofan and Blue Nile.*[35] There are widespread reports from South Kordofan that churches and schools have been targeted. There are further reports that civilians have been arrested and even executed on the basis of their ethnic and political identity.

The Sudanese army has also bombed refugee areas in South Sudan where civilians from Blue Nile and South Kordofan fled to avoid government attacks.[36] The UN estimates that more than 655,000 people have been displaced or severely affected since the fighting began in South Kordofan and Blue Nile,[37] with 167,000 fleeing to South Sudan and 370,000 to Ethiopia.[38] Attacks on civilians disrupted the crucial cultivation season, and currently 200,000-250,000 civilians are facing crisis to emergency levels of food insecurity in South Kordofan alone.[39]

Border Demarcation

Border demarcation and demilitarization is another contentious issue. At least 20% of the border has yet to be demarcated with major disagreements on at least five contentious areas across the border.[40] A Technical Border Committee was established soon after the signing of the CPA. However, the Committee has been ineffective, and has yet to resolve any of the outstanding border disputes. A demilitarized border zone was agreed upon in June 2011, but it has yet to be implemented as a result of disagreement over where the border actually lies. The AU proposed a map in 2011, which would serve solely as a reference for the demilitarized zone, while negotiations continued on final resolution of the border. The location of the demilitarized zone has been a focal point of negotiations throughout the spring and summer. South Sudan has accepted the proposal, but Sudan has not.

Abyei

Adjacent to the oil-rich town of Heglig, Abyei has political and economic significance for the North and South. Both countries have tried to claim it. Sudan seized Abyei in May 2011, displacing 110,000 civilians. The entire Ngok Dinka population fled to South Sudan. One month later, in June 2011, Sudan and South Sudan reached an agreement to withdraw all armed troops from Abyei.[41] In May 2012—11 months after the agreement—South Sudan completely removed its police forces from Abyei. Sudan did not completely remove its military forces from the region until May 29, the day negotiations resumed between the Khartoum and Juba. However, armed police forces from Sudan remain in the region in violation of the agreement.[42] In advance of the resumption of talks South Sudan accused Sudan of keeping those forces in the region to provoke a return to hostilities.[43] Only an estimated 10,000 of the Ngok Dinka who fled from Abyei in May 2011 have returned, while 100,000 remain displaced.[44]

NEXT STEPS

The oil agreement is an incredibly positive sign. It is the first real progress toward peacefully resolving the host of issues between Sudan and South Sudan. It offers hope that the inevitable economic crisis that will occur should the shutdown continue can be avoided. The Sudanese pound rebounded 8% upon announcement of the deal, and much-needed foreign financial assistance can be expected with the return of oil production.

The next step is for the two countries to make sufficient progress on the remaining issues, particularly security, so that the oil agreement can be signed and the taps turned back on. Despite aggressive predictions of when production would resume in the heady aftermath of the oil deal, South Sudan now expects production won't begin until December with a full return to production by June 2013. The pipelines—filled with water to prevent damage during the shutdown—will have to be flushed and refilled with oil. The equipment that was damaged after being improperly shut down will have to be repaired, and oil companies will have to re-hire and return staff. Nevertheless, once production resumes, the significant internal and external pressure to keep the oil flowing should hopefully ensure it is not shut down again.

Obstacles remain that could derail the deal or delay the resumption of oil exports. This would not be the first time a deal between Sudan and South Sudan has fallen apart at the last moment or was ignored once signed. An oil deal, or even an agreement over security, border demarcation and Abyei, will not mean a fundamental reapproachment between Sudan and South Sudan. Antagonism between the two countries is likely to continue in the forseeable future.

FAQ: IMPLICATIONS FOR U.S. DIVESTMENT LEGISLATION

What are the existing U.S. policies relating to Sudan and investment?

The United States has listed Sudan on its State Sponsors of Terrorism List (SSTL) since 1993, and maintained sanctions against Sudan since 1997. While these sanctions prohibit business activities between U.S. companies and Sudan, they do not prohibit investments in non-U.S. companies doing business there.[45]

After conflict erupted in Sudan's Darfur region in 2003, the U.S. government deemed the situation genocide. In 2007, Congress passed the Sudan Accountability and Divestment Act (SADA). The law authorized state and local governments to fill the sanctions gap by adopting a targeted model of Sudan divestment legislation, focused on restricting investments in companies with oil, power production, mineral extraction and weapons-related activities.[46] SADA also required companies seeking contracts with the U.S. government to certify that they do not have certain business activities in these same sectors. Numerous states, municipalities and other entities in the U.S. subsequently restricted their investments linked to Sudan. Currently, more than 20 U.S. states have enacted targeted Sudan divestment legislation (note that other entities have adopted non-targeted model legislation or policies, which this report does not address).

Do state and local-level policies based on the targeted divestment model apply to South Sudan?

Targeted model divestment policies remain in effect with regard to Sudan, but they do not apply to South Sudan, and therefore the South's independence did not bring any real change for investors implementing these policies. Currently, SADA and the targeted model's restrictions apply only to companies involved in certain business activities and projects (listed above) connected to the government of Sudan, which is defined as "the government in Khartoum."[47] Specifically, companies subject to the targeted model's divestment measures are those with "Business Operations that involve contracts with and/or provision of supplies or services" to:

> *(a) the Government of Sudan,*
>
> *(b) Companies in which the Government of Sudan has any direct or indirect equity share,*
>
> *(c) Government of Sudan-commissioned consortiums or projects, or*
>
> *(d) Companies involved in Government of Sudan-commissioned consortiums or projects.*[48]

SADA and the targeted model already explicitly exempt the "regional government of southern Sudan." Based on the current language, the government of South Sudan appears to be exempt as well.

WHAT IS THE LIKELIHOOD THAT U.S. SANCTIONS ON SUDAN WILL BE LIFTED SOON?

Relative to clause (b), there was speculation in the lead-up to the January 2011 referendum that U.S. sanctions against the Sudanese government might be removed. President Obama renewed sanctions against the government in November 2010, but his administration offered sanctions-related incentives in an effort to ensure a smooth referendum process. For example, the U.S. relaxed sanctions on the provision of farm equipment as well as equipment necessary to facilitate the referendum, including computers.[49] President Obama renewed the remaining sanctions on the government of Sudan in November 2011.

In November 2010, U.S. Secretary of State Hillary Clinton stated publicly that the U.S. was prepared to lift its sanctions if the government of Sudan committed to the referendum, committed to a peaceful resolution of the conflict in Darfur, and severed links to international terrorist organizations.[50] However, following the North's seizure of Abyei on May 21, 2011, the U.S. Special Envoy for Sudan, Princeton Lyman, explained that it would "be hard" to remove Sudan from the SSTL if Khartoum continued to occupy the contested region.[51] In addition to the recent violence around Heglig, allegations of cross border aerial bombings and the ongoing fighting in South Kordofan and Blue Nile states make it increasingly unlikely the U.S. will remove Sudan from the SSTL.

It is important to note that while removing Sudan from the SSTL would result in the lifting some sanctions (primarily on dual use items), it would not remove all sanctions. Only when the government of Sudan has taken all steps outlined by Secretary Clinton would the U.S. lift all current sanctions, triggering the sunset provisions for state and local-level divestment policies based on the targeted model. Until or unless that occurs, the targeted Sudan divestment model appears to be unaffected by the secession of South Sudan or the prospective oil deal.

Even with the independent South Sudan additional action by Congress or the President of the United States would have to take place in order to terminate the application of policies based on the targeted model to Sudan. The model contains a sunset clause that provides for its expiration under any of the following circumstances:

> *(a) The Congress or President of the United States declares that the Darfur genocide has been halted for at least 12 months; or*
>
> *(b) The United States revokes all sanctions imposed against the Government of Sudan; or*
>
> *(c) The Congress or President of the United States declares that the Government of Sudan has honored its commitments to cease attacks on civilians, demobilize and demilitarize the Janjaweed and associated militias, grant free and unfettered access for deliveries of humanitarian assistance, and allow for the safe and voluntary return of refugees and internally displaced persons; or*
>
> *(d) The Congress or President of the United States, through legislation or executive order, declares that mandatory divestment of the type provided for in this Act interferes with the conduct of United States foreign policy.*[52]

Are there any changes to the targeted model Sudan screen and U.S. sanctions as a result of southern independence or the tentative oil deal?

Though South Sudan's independence in itself does not invalidate or remove targeted model divestment policies, it could mean that some companies currently implicated would no longer be targeted. South Sudan now controls the majority of the oil and numerous consortia now operate there. While most of these companies have activities in areas both above and below the north-south border, a few operate only in South Sudan. Until recently, certain activities—in particular those related to oil—would continue to trigger application of U.S. sanctions, even if they were conducted wholly within the Republic of South Sudan. In December 2011, the U.S. government amended its sanctions to authorize activities and transactions related to the petroleum or petrochemical industries, as well as the shipment of goods, technology and services, to the Republic of South Sudan through Sudan.[53]

These technical changes could narrow the application of the targeted Sudan divestment model. At the moment, with the exception of the French oil company Total SA, it appears that all oil companies operating in South Sudan also have operations in Sudan and therefore continue to be implicated by the model. The U.S. amendment to the sanctions regime opens the door for publicly traded oil companies, especially American ones, to invest in South Sudan without being implicated by the targeted Sudan divestment model.

The signing of an oil agreement and a resumption of production—as well as substantial oil discoveries this year in nearby Kenya and Uganda—seem likely to provoke intense interest in South Sudan's oil by foreign oil companies. Companies still must be approved by the government of South Sudan's Ministry of Petroleum and Mining in order to operate in the country, a process that is being developed. Additionally, even if a security agreement is reached between Juba and Khartoum, South Sudan remains an unsure environment, which might slow the entrance of foreign oil companies. So, it remains to be seen just what effect the oil deal will actually have on encouraging foreign oil companies to invest in South Sudan in the near term.

Will a comprehensive agreement on the outstanding issues between Khartoum and Juba end concerns about Sudan?

The short answer is: No. While a comprehensive agreement on oil, security, border demarcation and Abyei would be a big step towards establishing peace between Sudan and South Sudan, the conflict in Darfur continues. In 2003, as the government of Sudan was negotiating an end to the 22-year civil war between Sudan's North and South, attacks in Darfur were beginning. Between 2003 and 2005, an estimated 300,000 people lost their lives due to the Darfur conflict, which is separate and distinct from the issue with South Sudan. More than two million people remain displaced and face a dire humanitarian situation. The spring of 2012 saw a renewal of the aerial attacks and fighting between government troops and rebel groups in Darfur that have displaced at least 373,000 Darfuris since 2010.[54] Sudan Armed Forces conducted airstrikes on villages in Darfur as recently as August 2012.[55]

With the continued targeting of Darfuri civilians, the concerns that led to the passage of most Sudan-related investment policies are ongoing. While South Sudan's secession was momentous, neither independence, nor any progress on its issues with Sudan have changed conditions in Darfur. Rather, an independent South Sudan raises its own set of concerns. As Conflict Risk Network has outlined in its research and publications, both the situation in Darfur and the tension between Sudan and South Sudan create special challenges for corporate actors. Areas affected by genocide, mass atrocities or other conflict differ significantly from stable operating environments. They exhibit instability, unpredictable conditions and contexts in which rights violations are ongoing. This presents companies with greater challenges in ensuring that they do not infringe on human rights. Not only is it more difficult for companies to do no harm in such settings, but the failure to adhere to standard corporate responsibility practices carries the potential for heightened impacts on communities and on companies themselves.

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