

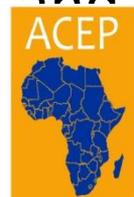
# A Decade of Transparency Initiatives - the Oil and Gas Industry still lags behind

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# Introduction

- One of the reasons why most resource rich countries have not translated their extractive industries wealth into development for their people is poor governance – transparency and accountability.
- Contract transparency is key in the transparency and accountability chain:
  - Many countries have been unable to negotiate good deals due to lack of negotiation capacity arising from lack of the urgency to acquire capacity
  - Some countries have often negotiated private interests in contracts at the expense of the public interest
  - Benefits from extractive resources are determined by contractual arrangements negotiated in non-transparent environment
- Poor governance has therefore led to disproportionate share of risks and benefits between resource owners and resource industries



Disproportionate share of benefits illustrated

- “The business of mining] is perhaps the most disadvantageous lottery in the world, or the one in which the gain of those who draw the prizes bears the least proportion to the loss of those who draw the blanks”.
- Adam Smith, The Wealth of Nations (1776)

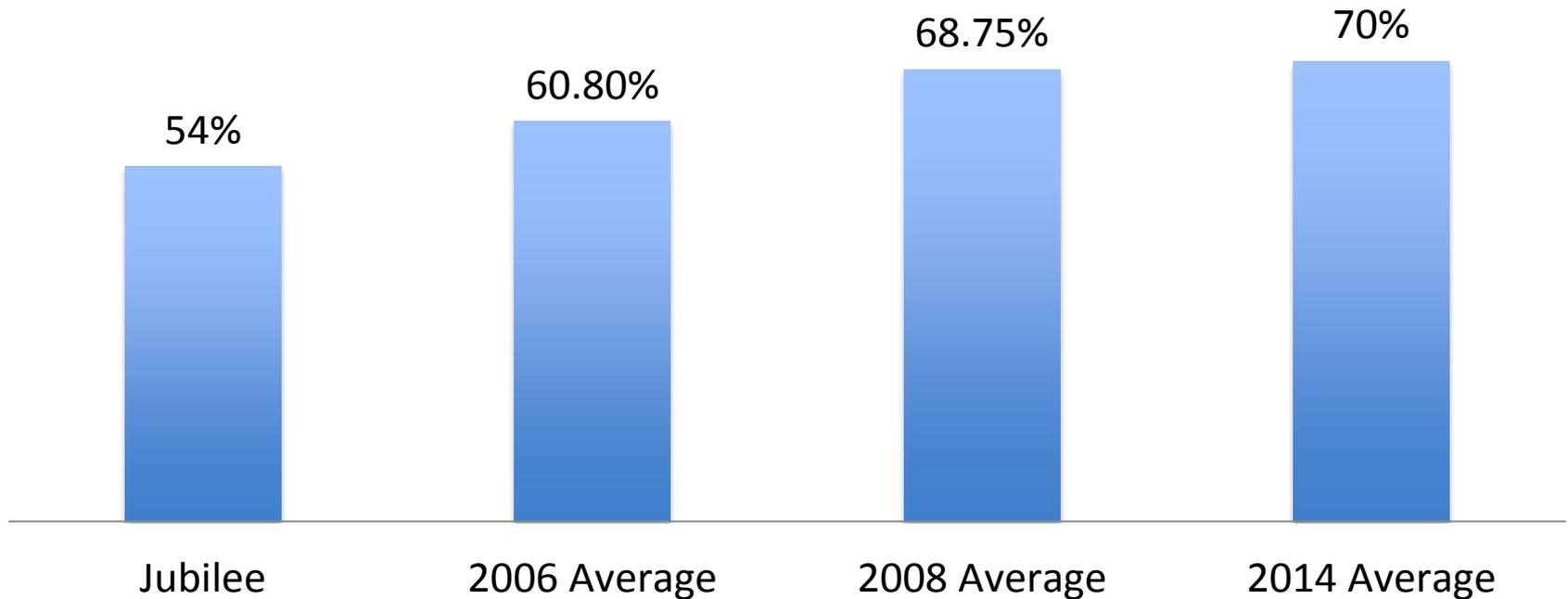
# Why Transparency is important in the oil and gas industry

- Improving trust and managing expectations - Awareness of the terms within contracts helps lay the foundations of trust between society, government and companies, and helps avoid misperceptions around agreements
- Management of local tensions - Failure to release contracts has led to national and local tensions providing risks to the investments of oil companies
- Lack of transparency facilitates corruption and investments that do not pursue what is in the public's best interest
- Transparency in contracting process would send a signal that attracts quality investors
- Transparency in tax systems adds pressure for fairer fiscal terms

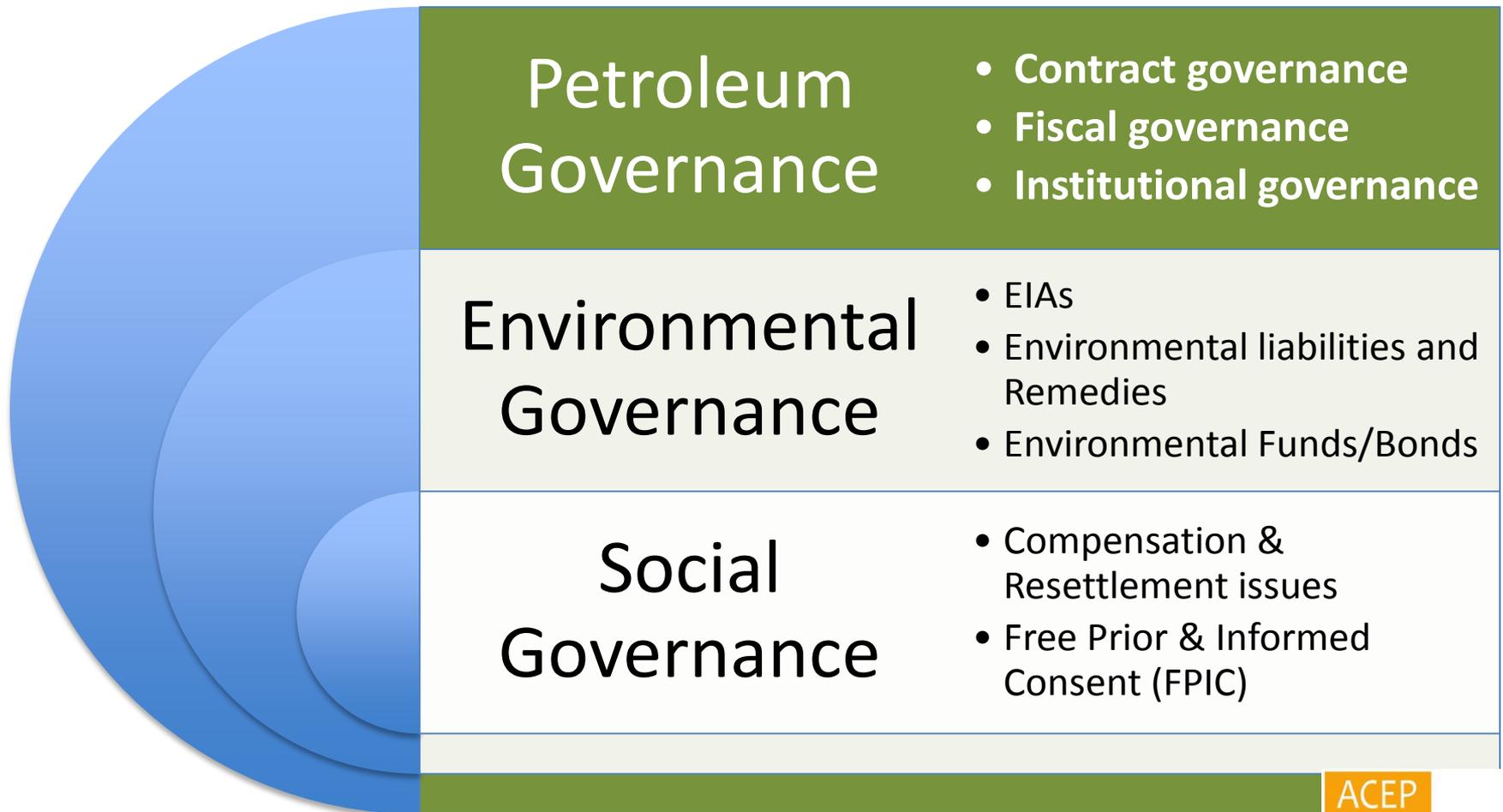
# Transparency and Fiscal Graduation in Ghana

**Contract Disclosure Phase**

**Ghana Oil Contracts - Average Net Fiscal Contribution**



# Governance in the Oil and Gas Sector



# Contract Governance

## Mineral Right Allocation

- **Geological Information; Open and Competitive Bidding Process**

## Ownership of Mineral Rights

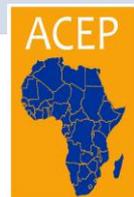
- **Beneficial Ownership Information, Technical Competence, Financial Capacity**

## Mineral Agreements/Contracts

- **Mandatory Disclosure of primary contracts, appendices, permits, and marketing contracts**

## Anti-corruption in Contracts

- **Conflict of Interest of public officials in contracting**



# Growing adoption of contract transparency

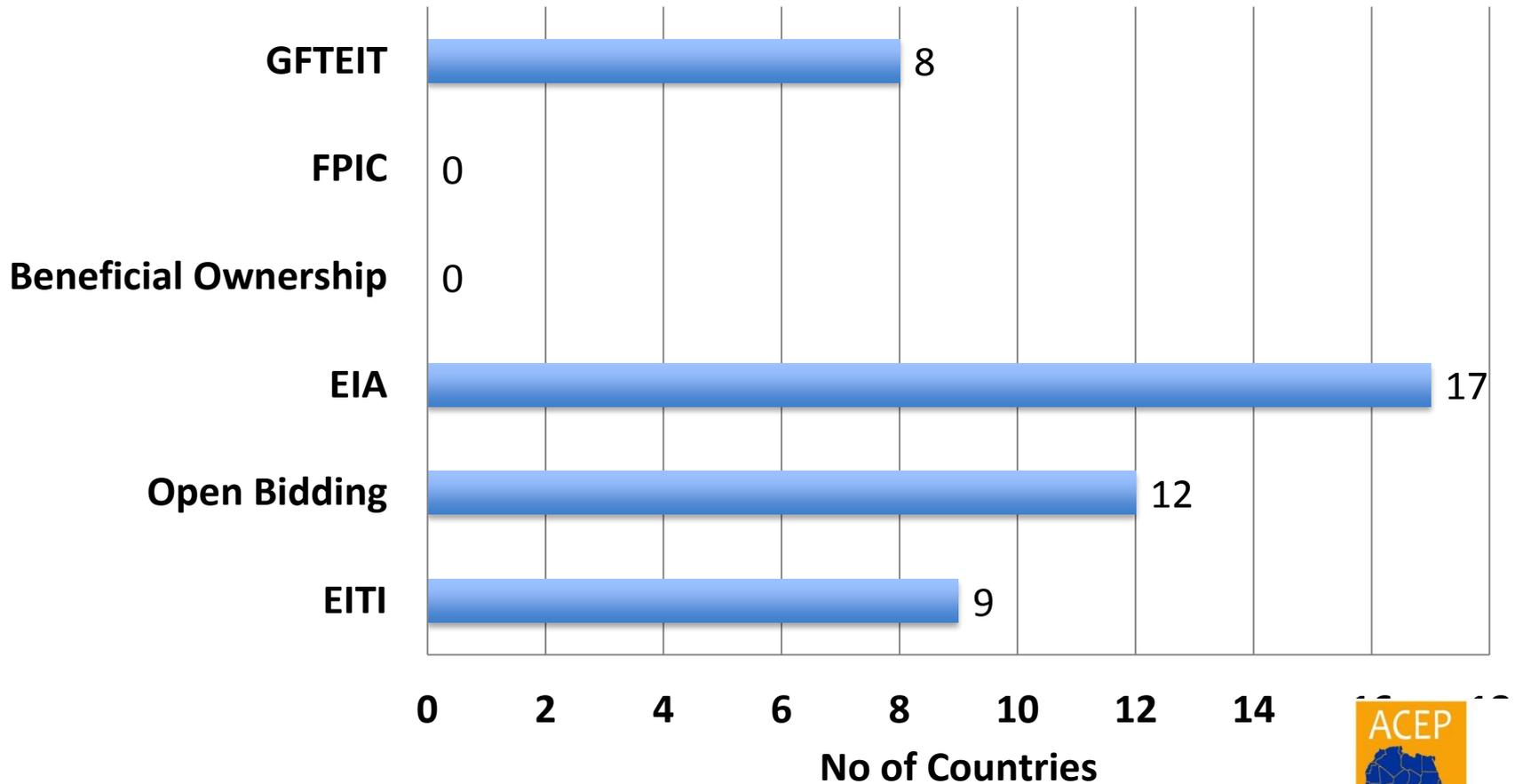
- An increasing number of host governments are encouraging contract publication.
- There are now more than 25 countries that have published contracts and more are coming on board as time passes.
- In Africa, more countries are adopting contract transparency in the extractive industries.

# Growing adoption of contract transparency in Africa



# Challenges remain

## APPA and Governance Trend (Total Members 18 )



# Local content increasing added value or added corruption

- International Investment Contracts provides for local requirements such as equity participation, employment and sourcing of materials and services.
- Such targets have laudable goals of ensuring positive spill-overs in the local economy.
- However, when the processes for meeting this laudable objective is not transparent, it creates significant governance risks.
  - It affects equitable development by concentrating benefits in a few elite group at the expense of all citizens especially where the local firms are “carried over” by their international partners.
  - The elites could leverage political connections to land big contracts at below-market prices which they can sell at a premium.
  - It also promotes “fronting” for local or foreign masters

# Local Content, contracts and conflict of interest

- To correct the practice of quick flips to foreign companies, there are some examples:
  - In Liberia’s local content requirements, it is included that transfers of Liberian participation is restricted until after commerciality is declared.
  - Transfers can only be made to other Liberian Entities.
  - In Ghana. LI2204 provides in Regulation 4(5) “The interest of an indigenous Ghanaian company arising from a petroleum agreement or a petroleum license is not transferable to a non-indigenous Ghanaian company”.
  - However, this is not subject to commerciality.

# Need for Contract transparency requirements

1.

- **Publish their contracts in an accessible, digestible manner, including summaries of the key contract terms.**

2.

- **Adopt open contracting principles throughout whole process of concession award and management of contracts**

4.

- **Fully implement contract transparency laws**

5.

- **Analyze and use information to negotiate better, more balanced deals, backed up by robust modelling**

# Requirement: Open contracting principles

- This must be expressed across the entire contract value chain. Open contracting in the oil industry requires that:
  - The process for contracting/licensing of oil blocks must be open and competitive,
  - Justification for award of contracts must be published
  - Contract disclosure must be mandatory, and
  - The products of Contracts (oil production data, sales price, revenues, costs) must not be held confidential.
  - Information on beneficial ownership must be disclosed to prevent conflict of interest situations
  - The National Oil Company must be regulated and have financial transparency
  - Citizens must be allowed to make public comments on contracts (citizens participation)

## Requirement: Mandatory Contract Disclosure forms

- Online registers - online searchable databases for their contracts and/or licenses and payments data
  - Guinea
  - Liberia
  - Republic of Congo
  - Philippines
  
- Online – website of responsible agencies
  - Ghana

# Requirement: Confidentiality clauses

- In some cases, confidentiality covers the contract itself, reports, data, studies or any information of proprietary nature
- Some confidentiality may be necessary where the the purpose for keeping it is necessary and well defined
- There are conditions under which confidential information may be disclosed:
  - If disclosure is required by the law of the investor's home country, or the host government's country
  - If disclosure is required by a stock exchange
  - If it is to be used to raise capital from financial institutions
  - If it is to be used by the state or its representatives
- However, if confidentiality clauses are broad, strict, and not well defined, they turn to undermine public ability to scrutinize investment contracts

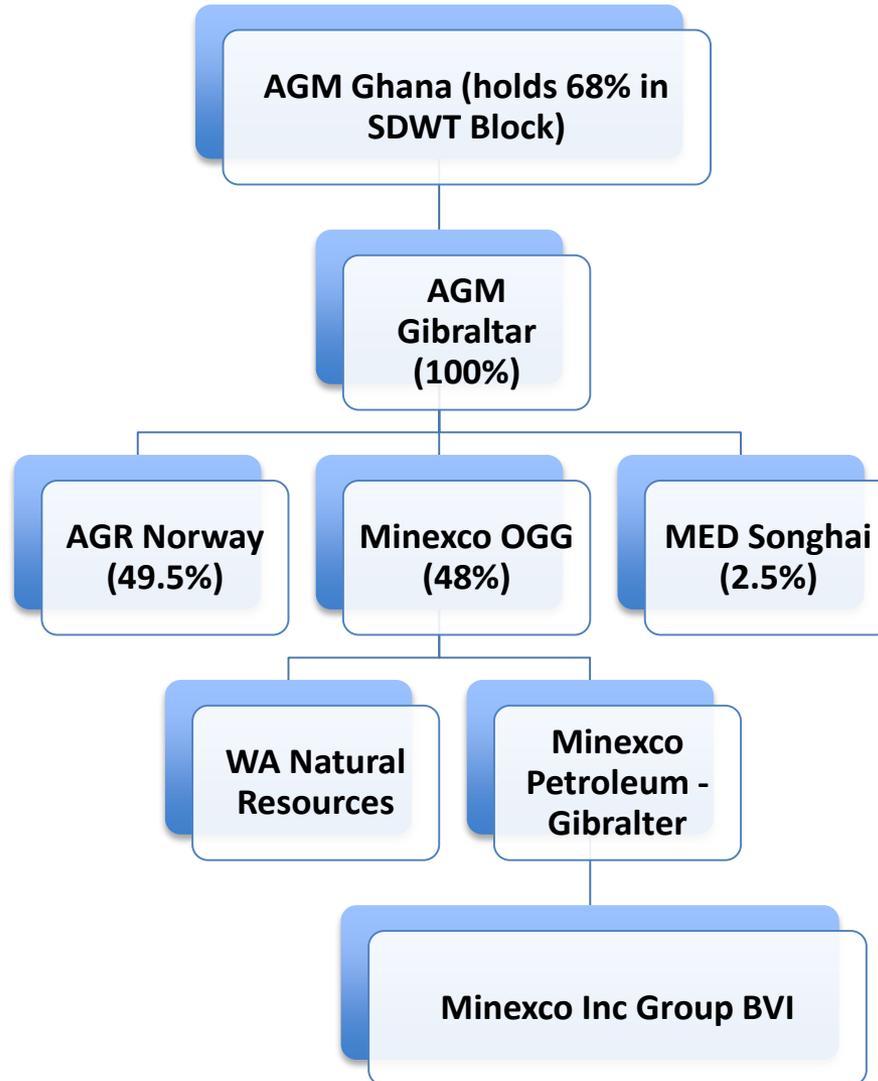
# Requirement: Scope of confidentiality clauses

- **This may require certain tests – “Test of Confidentiality”**
- **The harm test**
- The best practice in confidentiality provision is that where disclosure is prohibited, the awarding institution must show that disclosure is likely to cause substantial harm to the investor’s competitive position.
- **The public interest override test**
- Government in formulating confidentiality clauses should seek to balance commercial concerns with the public interest.
- Example - Denmark’s Model License of 2005 for Exploration and Production of Hydrocarbons:
- “Information can be disclosed if no legitimate interest of the Licensee requires the information to be kept confidential; essential public interest outweigh Licensee’s interest in maintaining confidentiality”

# The EU “Trade Secrets Directive” may clock back transparency progress

- Trade secret is defined as “Know-how and business information which is a secret and which has a commercial value because it is a secret and some one has tried to keep it a secret”
- **Problems**
- Definition of trade secret is so broad that it covers anything.
- There is no harm test for trade secrets (i.e. disclosure is encouraged where it will not be harmful)
- There is no public interest override for publication of trade secrets (i.e. disclosure is encouraged where public interest overrides non-disclosure)

# Requirement: Beneficial ownership information now critical



# Fiscal Governance

## Payment Disclosure

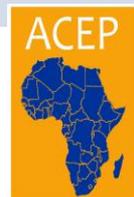
- **Mandatory disclosure of company payments to host governments – royalties, taxes, surface rentals, participation interest**

## Tax Avoidance

- **Debt loading, profit alienation**

## Illegal Financial Outflows

- **Mis-invoicing, Transfer pricing, Mandatory Disclosure of primary contracts, appendices, permits, and marketing contracts; criminality,**



# Payment Disclosure growing

- Mandatory payment disclosure is the default requirement
- Host governments must seek adopt mandatory payment disclosure
- However, most countries that have mandatory payment disclosure are mainly EITI countries
- To date, there is growing international consensus on mandatory payment disclosure

# Global initiatives on mandatory payment disclosure



**G8 Unequivocally Endorses Global Mandatory Disclosure Laws for oil, gas and mining – May, 2011.**



**EU Approves New Laws for extractive Transparency – June 2013**

- 171 EU-listed co's 419 large, non-listed co's and 26 forestry co's
- Two years to turn EU law into national law – some countries have already done this.



**Canada passed Transparency Measures Act**

- Full backing of 2 largest Canadian mining industry associations - the Mining Association of Canada ("MAC") and the Prospectors and Developers Association of Canada ("PDAC") - Jan - 2014

# Global initiatives on mandatory payment disclosure

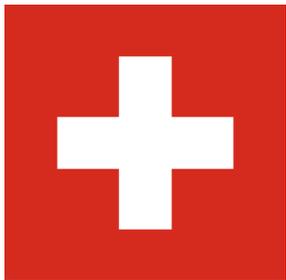


## **EITI requires disclosure of payments**

- Approved by oil, gas, mining companies on board



## **US Dodd Frank Reforms Act**



## **Swiss Parliament and Federal Council Agree on Mandatory Disclosures**

- Major market for oil trading companies

# Why companies are involved in Tax Avoidance

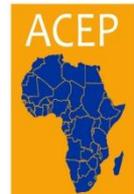
- Three main reasons
  - To reduce tax liability
  - To shift profits offshore
  - To protect shareholder value
- Technically legally, morally bankrupt, and fiscally distressful to source countries
- These happen at the expense of the host governments

# How do companies avoid Taxes

- **Debt loading**
- A process by which a foreign multinational corporation lends capital to its subsidiary at an unusually high interest rate.
- Any profit made is used to repay the foreign subsidiary.
- For the purposes of company tax records, the profits are recorded as a loss in the form of an interest payment on the loan.
  - E.g. Chevron in Australia borrowed over \$2.5 billion from foreign subsidiaries, many in known low or no tax jurisdictions. The interest payments on these loans added up to 62.5% of their sales revenue in 2014 and 45% in 2013.

# How do companies avoid Taxes

- **Profit alienation**
- is a tax avoidance technique whereby corporations hold intellectual property rights or other intangible assets in low or zero tax jurisdictions.
- Profits made are then used to pay the parent company for the use of its intellectual property.
  - E.g. Apple Inc. subsidiaries sell products to one another at prices so high that they make little to no commercial sense. Apple's net profit margins in Australia are typically 75% lower than the corporation's global margins. The result? Apple paid just 1.2% tax on revenue in 2013-14.



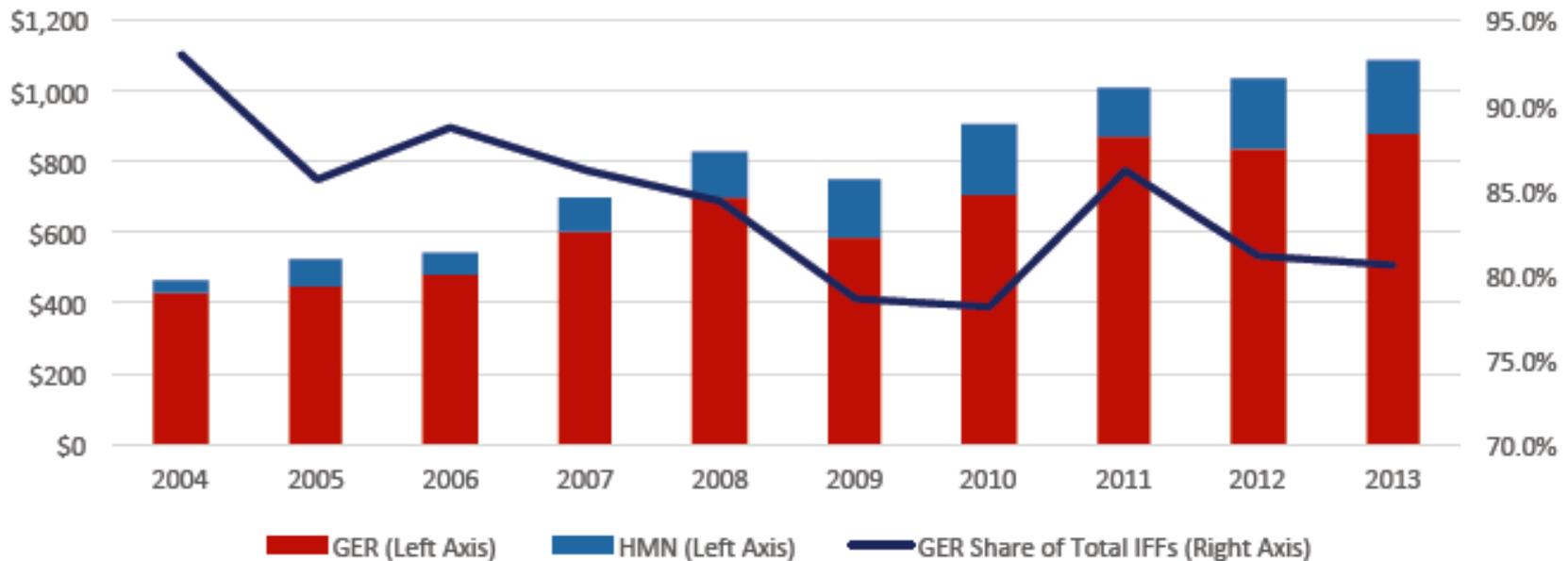
# Illicit Financial Flows from Developing Countries, by Component, 2004-2013

(in billions of U.S. dollars, nominal)

Year	Trade Misinvoicing Outflows (GER)	Hot Money Narrow Outflows (HMN)	Total IFF
2004	433.0	32.3	465.3
2005	449.2	75.4	524.6
2006	482.0	61.6	543.5
2007	602.8	96.3	699.1
2008	698.8	129.2	828.0
2009	587.6	159.5	747.0
2010	708.2	198.5	906.6
2011	867.5	140.2	1,007.7
2012	839.6	196.3	1,035.9
2013	878.2	212.0	1,090.1
<b>Total</b>	<b>6546.9</b>	<b>1301.3</b>	<b>7847.8</b>

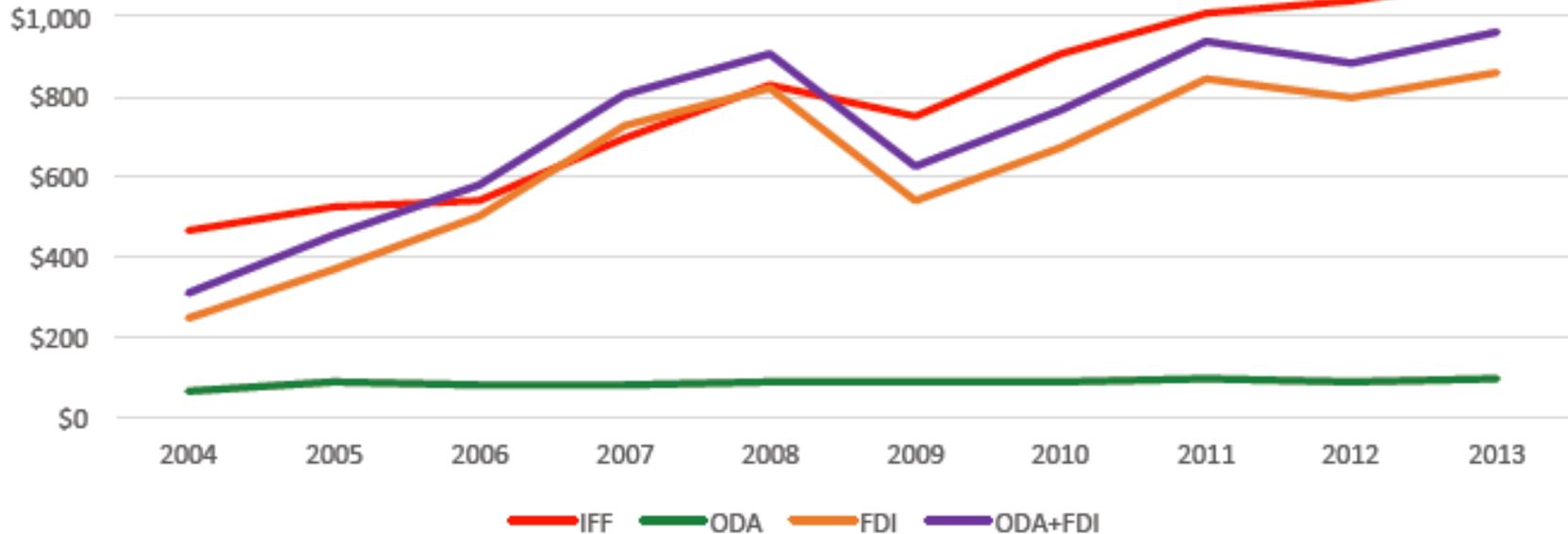
Source: Global Financial Integrity – December 2015

# Composition of IFF from the developing World



Source: Global Financial Integrity – December 2015

# Comparison of IFFs, FDI and ODA



Source: Global Financial Integrity – December 2015

# National & Global Efforts

- Global Initiatives
  - Bilateral Tax information Exchange Agreements
  - Multilateral Convention on Tax Information Exchange (G20)
  - Automatic Exchange of Information
- National Initiatives
  - The United Kingdom's Diverted Profits Tax – also known as the “Google Tax” – came into effect on April 1, 2015.
  - The policy imposes a minimum tax rate of 25% of profits sent overseas for corporations deemed to have arranged their business structure to avoid tax.

# Transparency has suffered set back due to some Myths

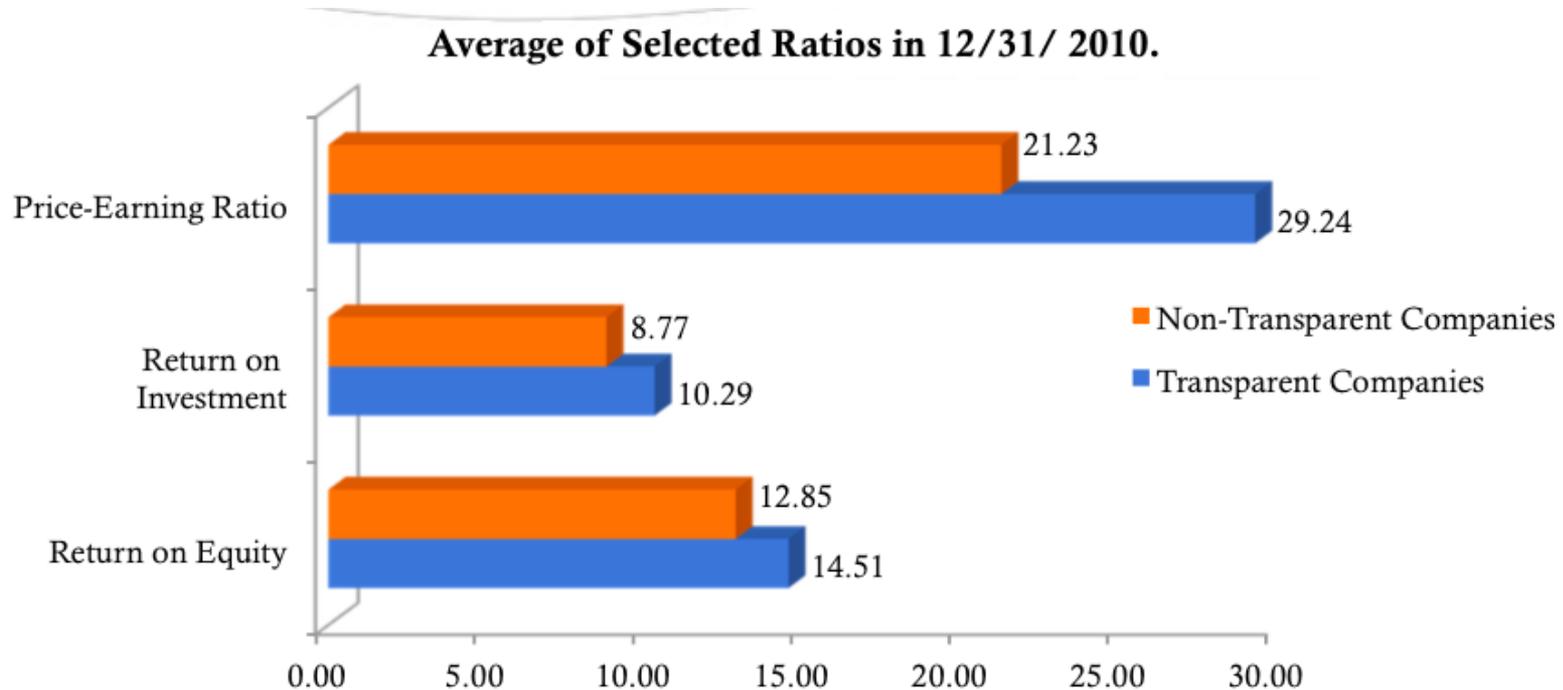
- **Contracts contain commercially sensitive information that could cause competitive harm if disclosed**
- **Contract transparency might scare off investors**

# Myths about contract transparency

- **Myth 1: Contracts contain commercially sensitive information that could cause competitive harm if disclosed.**
  - Contracts are often usually shared among private sector operators
  - Contracts themselves do not contain information that impact on company competitiveness
  - Contracts are disclosed on stock markets where they are materially important



# Transparency and competitive advantage



## Notes

Transparent companies: 17 companies that disclosed payments on a country-by-country basis in 2010

Non-transparent companies: 17 companies that are either EITI or GRI supporters but do not disclose payments on a country-by-country basis

# Myth 2

- **Myth 2: Contract transparency might scare off investors.**
- There is no evidence of this in practice. In fact, open contracting can reassure financial investors.
- Countries such as Guinea, Liberia and Ghana have received significant investment while disclosing contracts.
- Companies are by themselves also publishing their contracts – Due to:
  - Systematic country level contract publication policies (ExxonMobil in the U.S. and Liberia; for Rio Tinto in Guinea)
  - Ad-hoc publication by either governments and/or companies (BP, SOCAR, Amaco, Lukoil, Elf and Statoil in Azerbaijan)
  - Stock market requirement (US SEC - Tullow and Kosmos in Ghana; Total in Gabon; Canadian Securities Administration – Lion Petroleum in Kenya).

# Myth 2 Cont.

- Some investors have really openly supported contract transparency:
  - Tullow Oil has stated that they “take the position that should a government wish to make these agreements public, we would fully support them in doing so”

Andrea K. Bjorklund (2015), Yearbook on International Investment Law & Policy, 2013-2014, Oxford University Press, p.563.

# Thanks

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