

ENERGY & THE LAW

COMPLIANCE & INTEGRITY IN ENERGY DEALS

16 January 2007

Alex Msimang
Partner
Vinson & Elkins

Introduction

- Bribery and corruption
- Wider social responsibility principles
- Government integrity and investor protection

Corruption

- Some figures:
 - US\$80 billion in bribes paid each year
 - 40% of businesses pay bribes
 - 15% in developed world pay bribes
 - 60% in FSU pay bribes

- Bribery abroad is a crime under:
 - US FCPA 1977
 - UK ATCSA 2001
 - Local law (typically)

Corruption

- Energy sector is a prime target for bribe requests:
 - Signature bonus diversion
 - Consents to assignment
 - Local partners
- Energy sector is a main target for enforcement

Corruption – Penalty examples

UK IPO

- Banker accepted transfer of funds to family trust
- No loss suffered by bank or any third party
- Sentence: 2 years in prison; £0.5 million confiscated

Steel contract

- Company director accepted house in return for placing contract
- Sentence: 3.5 years in prison
- Appeal: Court of Appeal says 3.5 years is “lucky”

UK council officer

- Second hand car
- Gift of Fiat Uno (used)
- Sentence: 18 months in prison
- Appeal: Reduced to 12 months

Corruption – Challenges

- Challenges:
 - Local expectations
 - Competition

- Solutions:
 - Rigorous compliance and record-keeping
 - Other local participation solutions?

Wider social responsibility

- Local content within projects
- Local investment outside the project
- Equator Principles

Local content

Local content:

- Employment of local population
- Procurement of local goods and services
- Training of NOC staff and local population
- JVs with Local Content Vehicles

Legal approach to local content obligations

- Consistent aims worldwide but different approaches
- No single approach
 - in certain jurisdictions, such as UK, EU and US, imposing local content obligations might be unlawful
- Similar approaches
 - other petroleum producing nations tend to adopt similar approaches

- Might be required by:
 - local law
 - production sharing contract/concession/licence
- Might simply be good industry practice

Examples of “personnel” local content provisions

NIGERIAN PSC – staff numbers:

- **The number of non-Nigerian staff shall be kept to a minimum**
- **From the Effective Date the number of citizens of Nigeria employed by the CONTRACTOR must be as follows:**
 - **10 years - 75% of total**
 - **15 years - 80% of total**
 - **20 years - 85% of total**

Examples of “personnel” local content provisions

V&E

NIGERIAN PSC – staff retention:

- **No Nigerian employed under this Contract shall be disengaged without the prior written approval of the Ministry of Petroleum Resources.**

Examples of “personnel” local content provisions

V&E

Cameroon PSC:

- **“Contractor must not practise any discrimination whatsoever based on race, religion or nationality”**
- **“Contractor must favour the employment of Cameroonian workers and give priority to local enterprises”**

Risks in meeting local content obligations?

- Delays in Project Schedule caused by:
 - Less experienced workforce
 - Insufficient quantities or quality of materials
- Higher costs of locally procured goods and services
- Unrealistic expectations of local communities

Typical characteristics of local content terms

- **Likely terminology**
 - “Give due preference”
 - “Gradually introduce”
 - “Typical international standards”
 - “On terms mutually agreed”
- **Subjective**
- **Dangerous...**

Consequences of breach

“Government shall be entitled to terminate this PSC if the Contractor defaults in the performance of any of its obligations hereunder”

IOC Protections

- Make the targets clear and achievable
- Consider specific remedies for breach
- Consider alternative default remedies
- Consider other/fast-track dispute resolution mechanisms

Local Content Vehicles

- Participation of “Local Content Vehicles” or “LCVs”
 - The next stage in the local content concept?
 - Locally formed, managed and owned entities
 - Full equity participation in the project
 - Participation can either be from signature of PSC (e.g. Nigeria) or from declaration of a commercial discovery (e.g. Indonesia)

Local Content Vehicles

- Issues with LCVs can arise:
 - credit-worthiness of the LCV
 - technical capability and expertise of LCV
 - FCPA / OECD Convention concerns

Governmental integrity

- Illustrations for consideration
 - Algeria
 - 30 Dollar windfall tax
 - Russia
 - Sakhalin 2
 - TNK-BP

Governmental integrity

V&E

- Venezuela
 - migration to state/nationalisation
 - royalty rates

- United Kingdom
 - Supplementary Charge (10% then 20%)

Investor protection

- Bilateral investment treaties
- Careful project structuring and dispute resolution mechanisms
- Appetite for risk and a strong stomach

Conclusions

- Compliance burden for all international companies is increasing
- Regulators/enforcement agencies are scrutinising energy sector in particular
- Governments feel heightened awareness of national energy interest
- Public and private sectors need continuous dialogue and trust to maintain required levels of investment

Vinson & Elkins

V&E

'The World's Leading Energy Law Firm' (*Euromoney*)

Contact Details:

Alex Msimang +44 (0)20 7065 6022
Partner amsimang@velaw.com

Vinson & Elkins
One Ropemaker Street
London EC2Y 9UE

Switchboard: +44 (0)20 7065 6000
Facsimile: +44 (0)20 7065 6001

Worldwide offices include:

Austin, Beijing, Dallas, Dubai, Hong Kong, Houston,
London, Moscow, New York, Shanghai, Tokyo, Washington D.C.