CHAPTER ONE

Why Contract Transparency?

There is a growing movement for contract transparency, supported by an increasing number and diversity of organizations and institutions. Civil society organizations such as RWI and the Publish What You Pay campaign are among those calling for further openness. Among international financial institutions, the World Bank, the IMF and the IFC are beginning to encourage contract transparency; the strongest of these proponents is the IMF, which has endorsed contract transparency as key to the good governance of extractives.[4] Governments in a number of countries require oil, gas or mining contracts to be voted on publicly by the parliament, while other countries without such parliamentary requirements—including East Timor, Peru and Ecuador—have nonetheless made contracts publicly available in one or more of their extractive sectors. A few countries explicitly support contract transparency as a fundamental principle in managing their extractive sector; examples include Liberia, in its EITI bill, and Ghana, in its nascent but rapidly developing oil sector. While not an exhaustive list, the following are some of the recurrent arguments for contract transparency.

Contract transparency is essential for the responsible management of natural resources and the potential for growth and economic development that those resources can provide. Governments, citizens, and investors all have much to gain from contract transparency. Governments will be able to negotiate better contracts if they have access to contracts other than their own, as industry certainly does. Coordination among government agencies in enforcing and managing the contracts will be made easier. Citizens' suspicions of the hidden horrors will decrease, creating a more stable contract that is less likely to be subject to calls for renegotiation and better relationships with communities.

Citizens have a *right* to know how their government is *selling their resources*.[5] In most countries around the world, sub-soil resources such as minerals, oil, and gas are the property of the nation, not the individual property owner of the surface rights.[6] Citizen ownership is not such a simple proposition when it comes to particulars, however; in countries with mineral and hydrocarbon resources, the ways in which the region, community and nation divide the benefits of these resources can be highly controversial. Accordingly, contracts involving oil, gas and mineral resources may cover a range of information to which citizens should rightly have access, as the owners of such resources. The "value" of a contract cannot be captured in a single number; contracts typically contain information about fiscal terms and the allocation of risk that are essential to understanding the benefits and risks—the real value—of the deal. Beyond the fiscal aspects that are necessarily involved, contracts may also contain provisions covering many other areas that directly affect citizens, including (but not limited to) environmental mitigation and protection measures, sections on land use and rights, and provisions dealing with the displacement of local communities and their rights.

It is *undemocratic* for these contracts to be kept secret. Contracts are essentially the law of a public resource project, and a basic tenet of the rule of law is that laws shall be publicly available. The size and scope of many extractive projects is so large that they directly affect the lives, livelihoods and living conditions of a large population for decades. The contracts governing these projects may constitute the most significant rules affecting the surrounding populations. Where contracts create their own law—because they modify existing laws, freeze the application of those laws, or elaborate on outdated or incomplete laws—it is all the more important to disclose their contents for democratic accountability.

In the legal framework that regulates the extractive industries, contracts are an essential missing piece. Contracts are one piece in understanding the "value chain" of multiple, interconnected points for natural resource development. At each point in the chain—from the decision to exploit the resources to the exploration and exploitation, revenue collection, and eventual state expenditure of the revenues—there are critical opportunities to improve or undermine the value for the population. Contract transparency will not be the panacea for improving the use of resources for broad-based growth and development. But without access to contracts, a full picture of the value chain is impossible, and meaningful citizen participation in the process is undermined. Transparency is particularly critical for the effective enforcement of contracts, most crucially for potential social and environmental violations, where the citizens are best placed to monitor compliance.

Without contract transparency, fears of the worst flourish, and mistrust and conflict are magnified among stakeholders. Following several high-profile reports on contracts, national debates in a number of countries, and campaigns by international organizations like Oxfam, Amnesty International and Global Witness, citizens and local civil society organizations are increasingly aware of the critical role of contracts and some of their worst excesses. Amnesty International's reports on the Baku-Tblisi-Ceyhan (BTC) and Chad-Cameroon pipeline contracts, and various civil society reports on the Mittal Steel contract in Liberia, played an important role in raising international awareness.[7] National campaigns in Liberia and the Democratic Republic of Congo brought attention to the problems of contracts concluded without transparency during protracted war and hesitant transitions. In the face of mounting calls for transparency, those who fail to disclose, or to provide a plausible explanation for nondisclosure, are seen to have something to hide.

Contract transparency will help governments get a better deal for their resources, provide an incentive for governments and companies to make more durable deals, and deter corruption. Extractives are imperfect markets where governments are often at a disadvantage when negotiating with companies. The asymmetry of information can lead to sub-optimal deals, even if the government is negotiating in the interest of its citizens. Contract transparency is one important factor in creating a level playing field between companies and governments.

But governments may not behave in their citizens' best interests, not necessarily for nefarious reasons, but because of the "principal-agent" problem. When citizens have more information about government policy and actions, the government has a greater incentive to respond to the citizens' interests, thus reducing the principal-agent problem. Public access to contracts and greater contract literacy will provide governments with an incentive to satisfy as many constituencies as possible; this will in turn lead to more durable contracts and lessen the need for renegotiation over time.

Finally, the systematic publication of contracts will deter special provisions in contracts that are the product of corruption. This is especially true when countries have model contracts with few variables. Significant deviations in contracts, while not conclusive evidence of corruption, may indicate that special favors were negotiated.

Effective government management of the industry will be enhanced by contract transparency. Conflict over natural resource issues can extend to branches or agencies of the government—such as legislatures or taxing authorities—that are bypassed when natural resource contracts are treated as the exclusive preserve of one agency, as they sometimes are. Transparency would enhance coordination within government and enable its various branches and agencies to fulfill their respective legislative and regulatory obligations to ensure accountability.

Why not? While some countries publish contracts systematically, contract transparency is not the norm.[8] Most of the counterarguments made by industry and states are relatively undeveloped, and will be discussed further in the following chapters. As previously noted, these include:

- The need to protect commercially sensitive information;
- A fear of having to match concessionary deals, or competing in a "race to the bottom;" and
- The desire to avoid antagonizing constituents and exposing incompetence or corruption.

While these factors may have contributed to secrecy in the sector, the most significant reasons for the current practice may lie elsewhere. One of the strongest explanations may be that *no one asked*. Confidentiality is a deeply ingrained industry practice, and one that hardly harms companies, as they have far greater access to contracts than their government counterparts. No one wants to take the risk of diverging from the practice without a strong incentive; in fact, for most of recent history, none was provided. From the period of nationalizations and corruption scandals that ended in the 1970s until the post-Cold-War boom in oil and natural resource prices in the 1990s, there was little systematic pressure on companies or countries to disclose contracts. Even as more attention turned to the social, environmental and human rights impacts of extractive projects, contract transparency was not a focus issue.

Activism around the Chad-Cameroon pipeline project illustrates the evolution in citizen interest in contracts. In 1998, World Bank financing was sought for the Chad-Cameroon pipeline. Local and international advocacy groups rose to stop or alter the project to ensure that the benefits would not simply reinforce a corrupt dictatorship. The controversial upstream and pipeline projects resulted in myriad mechanisms intended to prevent such an outcome, including unprecedented revenue transparency and restrictions on expenditures with both national and international oversight. But while the pipeline contracts, funded directly by the World Bank, were made public, the upstream exploration and exploitation agreement—completed a decade earlier with a private consortium—was not. Nor was the latter agreement high on the advocacy agenda, which was almost exclusively focused on the World Bank and the government of Chad.

The transparency in Chad did eventually contribute to calls for the disclosure of state-investor contracts. Perhaps most notably, activists called for the disclosure of the BTC pipeline contracts when financing from the IFIs was sought for that project.[9] In 2003, Amnesty International published its analysis of parts of the pipeline contract, *Human Rights on the Line*, the first time contracts were the central focus

of a human rights report. Amnesty International criticized the contract, primarily for insulating the project from domestic law and indemnifying the companies for any changes that might occur. As Amnesty reported on the effect on human rights legislation in Turkey:

> The agreements place a substantial price on signing up fully to international standards. Turkey may well find itself having to enter reservations exempting the pipeline from each new international undertaking it makes—so pushing those affected by the project more deeply into second-class status. Alternatively, it may decide to push ahead and apply the new standards, in which case it could face a claim for heavy damages from the consortium. This prospect will have a chilling effect on Turkey's willingness to meet its human rights obligations.[10]

With this report, the importance of contracts, and stabilization clauses in particular, became clearer to activists. For some, more shocking than any individual contract provision was the fact that secret contracts could subvert national law. Contract transparency became an urgent issue.

Advocates then began to pursue the upstream Chad-Cameroon exploitation contract. Representatives of Exxon-Mobil refused to disclose the contract, though they never actually claimed that it was confidential. Technically, it was not, since Chad—like a number of countries discussed in this report—requires its parliament to ratify contracts. Although no record existed, the parliament had apparently voted on the contract in 1988. Eventually, Chadian civil society organizations obtained the contract; the version distributed around the world bears the name stamp of one of the leading activists working on oil issues in Chad, Gilbert Maoundanodji.

This example illustrates two important findings of this report: while there may be very few countries with laws requiring the systematic disclosure of contracts, other laws, albeit parliamentary, may indirectly require contracts to be public; whether these laws are followed is another matter.[11] Further, contracts do find their way into the hands of industry insiders, government officials and tenacious activists.

A. Which Contracts?

This report is concerned with the contracts between governments and companies, often referred to as state-investor agreements or Host Government Agreements (HGAs). Large investment projects are built upon a series of contracts, and require many more during implementation.[12] Some experts estimate that a typical large international project has "forty or more contracts uniting fifteen parties in a vertical chain from input supplier to output purchaser."[13] Resource extraction projects are no exception: one expert interviewed estimated that a typical oil project could have around 100 contracts supporting and flowing from the project. Most of these contracts are between private parties, such as contractors and sub-contractors, private banks, and individual financiers.

Among these contracts, there is one "primary" contract between the state (or state-owned company) and the company (or consortium of companies) that is superior to the other contracts. However, there does not appear to be a standard industry term for this concept. As used in this report, the "primary contract" is the contract concerned with exploration or exploitation of the resource. There

are some differences among commentators as to the categorization of extractive industry contracts; however these distinctions are generally considered to be a matter of political rhetoric, not salient legal difference, in most cases. Accordingly, primary contracts generally take one of four basic forms, or some combination of these forms: concession agreements, license agreements, production sharing agreements and service agreements. Additionally, if a government holds an equity stake in a project, then the shareholders' agreement between the government and the company would also be a kind of "primary contract."

Under these broader headings are various other types of contracts with many different names, such as exploration and exploitation agreements, development agreements, bids, licenses and leases. Primary contracts can also vary in complexity and length, ranging from an eight-page license agreement for exploration that is identical from company to company, with the only variable being the company's name, to a model contract with one fiscal term as a variable, such as the royalty rate, to 200-page mineral development agreements in which all terms are negotiable. While there are other contracts for financing, operating and managing an extractive project, the primary contract addresses (or at least should address) the broad issues within these other contracts, to the extent that it is not already established in law. Where the laws and regulations set out most of the rights, duties and obligations of extractive companies, the contract serves mostly to grant a particular company, or group of companies, legal title to a particular area of land. For purposes of this report, the term "contract" includes licenses, leases and agreements.

B. Information in "Primary Contracts"

Discussions with various stakeholders (government, civil society and industry) indicate confusion about the breadth of information that is typically in the primary contract between the state or state-owned company and the extractive company. This confusion could be a barrier to contract transparency, as individuals may believe that certain information is in these contracts when in fact it is typically not.

All primary contracts tend to have a similar form and include the following information. How much detail is included in the contract is generally a result of how much is already established by law.

(a) Recitals/Preamble

The beginning of the contract typically describes the parties involved, the effective date, and the general purpose of the contract. It summarizes, generally in slightly less legalistic language, the main reasons for entering into the contract.

(b) Definitions

Early in the contract, there will be a section defining the key terms used in the contract.

(c) Grant of formal legal title

Formal legal title is granted from the state to the company.

(d) Oversight

Contracts may include provisions on how decisions regarding operations will be made by the government and the company. These provisions may set up a technical committee, advisory committee or other body empowered to make such decisions, and may provide information about how this body will operate (voting rights, quorum, etc.), what decisions are under its jurisdiction, when it will meet, and other details concerning its powers and responsibilities and how they will be fulfilled.

If the state has equity participation in the project, a contract may specify the structure and level of financing of the participation, resource allocation (i.e., how much of the commodity the state will receive in-kind pursuant to its share in the project), operational control, and provisions on how decisions will be made, much as described in the above paragraph (voting rights, allocation of seats on the board, minority shareholder protections, etc.).

(e) Rights, Duties, and Obligations

This section may contain provisions on:

- *Obligations*: work obligations or expenditure requirements; infrastructure, local and foreign employment requirements; training, health and safety standards; reporting and accounting standards; environmental standards and harm mitigation measures; how and when public and private land can be acquired; compensation to local communities; and community development obligations.
- *Fiscal Provisions*: license and area fees; taxes; royalties; signing bonuses; exemptions from taxes and levies; and definitions of the nature and calculation methods of taxes, royalties and other payments.
- *Fiscal Considerations*: foreign exchange arrangements; dividend and capital repatriation; provisions for debt repayment and debt-to-equity ratios; revenue distribution requirements; and criteria to regulate intercompany transactions.[14]

(f) Confidentiality

Near the end of the contract, there will usually be a confidentiality clause that lays out which information is confidential and for how long, and describes various exceptions to the confidentiality obligation.

(g) Termination

Also near the end of a contract will be provisions laying out the term of the contract as well as the triggers for termination prior to the contract's stated end. These provisions describe when a breach is forgivable (e.g., *force majeure*) and whether and how a breaching party may have the opportunity to cure the breach prior to termination. Renewal provisions are generally found near the end of a contract as well.

(h) Dispute Resolution

Often adjacent to or combined with the termination clauses, these clauses deal with the consequences of a dispute between the parties. Extractive contracts commonly require resolution through arbitration. Remedies for a breach may be detailed. Frequently associated with dispute resolution provisions is a "choice of law" clause.

(i) Assignment

These clauses deal with the possibility that a company may decide to transfer title to the land, how a transfer of title would occur, and what the government's rights are in that situation. Transfer of stock in the corporation may also be addressed.

C. Information Not in Primary Contracts

While impossible to cover all concerns, the information that is *not* provided in primary contracts, but to which citizens may seek access, generally falls into these categories:

- environmental mitigation costs;
- assumptions used for assessing commercial terms;
- quality and quantity of the reserve;
- operational data;
- cost information;
- manufacturing processes;
- pending litigation;
- identity of shareholders;
- revenue and cash flow data;
- capital expenditures and operating expenditures; and
- employee information.

As stated above, this report focuses on the primary contract and the information within it. But information that will generally come after contract signing, such as revenue payments and geologic information, is referred to as well, particularly in the next chapter on confidentiality clauses. It is important to distinguish between these two categories of information: (1) that which is contained in the contract and (2) that which flows from it. Generally only the latter is covered by the confidentiality clause in the contract, although both may be explicitly covered.