

# Policy Arguments and Counter Claims

Having now addressed the value of contract transparency, the contractual constraints to it, and the balance between commercially sensitive information and the public interest, we wish to address a number of questions about whether the battle is worth the effort. Specifically:

- a) *Will contract transparency really help fight corruption?*
- b) *Aren't these contracts too complex for the public to understand?*
- c) *Won't contract transparency result in renegotiations?*
- d) *Will contract transparency lead to a race to the bottom...or the top?*
- e) *Will companies ever agree to contract transparency?*

## **A. Will Contract Transparency Really Help Fight Corruption?**

Inexplicable giveaways and major asymmetries in contracts, while they may simply be due to a lack of capacity of the negotiators, could also point to official misconduct resulting from corruption. Contract transparency provides a strong incentive for government officials and company representatives to operate within the bounds of the law and not to deviate from general contract forms and terms, as any discrepancies would be publicly disclosed. While it may not prevent lower-level corrupt acts that are beyond contractual terms, it is a deterrent to the manipulation of contract terms due to corruption.

## **B. Aren't These Contracts Too Complex for the Public to Understand?**

Extractive contracts are complex. Experts will disagree on how to value them and untrained readers may be misled or offended by their language. As a result, they may be exploited by demagogues or political opponents. But it is not clear that contract secrecy prevents such an outcome; furthermore, much government information is complex, but that is not a sufficient reason to keep it from the public. While the public may not have a full understanding of the complexities of the extractive sector, citizens and civil society organizations are developing the skills to analyze these documents and pose the right questions about them.

Citizens understand that national resources, and the benefits resulting from their extraction, belong to them. However, they may be skeptical about whether governments and companies have their best interests at heart; keeping contracts secret will only increase this skepticism. Contract transparency signals to the public that companies and governments have nothing to hide, that they honor citizens' rights of access to these contracts, and that they respect citizens' rights to have a say in how resources are used.

Rather than fighting against disclosure, a long-term and ultimately more sustainable response is to educate the public about the agreements.<sup>70</sup> In countries where one agency has often monopolized the process, contract transparency will enable better understanding and more effective management of the extractive industries. Easily accessible public databases of a country's contracts will make the administration and monitoring of these agreements easier for governments and citizens alike.

Finally, contract transparency, over time, will help governments overcome the information asymmetry that currently exists when governments are negotiating contracts with companies. While companies have access to their own contracts around the world, and can easily pay for access to contract databases and consultancies that survey and rank contracts, governments will generally have only their own contracts as a guide in negotiation. The gap in understanding and leverage between companies and governments does not end there; often the consultants, bankers, economists, and lawyers that a company will bring to negotiations will likely far outnumber a government's negotiating team. Contract transparency will not completely correct this imbalance, but is a critical step towards gaining better terms, better enforcement, and thus greater benefits for resource-rich countries in their dealings with extractive companies. These benefits make contract transparency worth the time and effort.

### C. Won't Contract Transparency Result in Renegotiations?

Governments and companies are apprehensive about opening themselves up to the criticism or embarrassment that could result from the public disclosure of contracts. A contract will rarely satisfy all interested constituencies in a country. Even when the terms may have been reasonable when negotiated, circumstances may have changed, making a deal that looked good when signed seem like a windfall to a company. In short, it is not hard to envision contract transparency resulting in calls for the renegotiation of contracts.

Based on recent experience, publication has been an important element in some—though certainly not all—calls for contract renegotiation. Moreover, for myriad economic reasons, natural resource contracts are already among the most likely to be renegotiated: “Across all types of FDI (foreign direct investment), contracts and concessions to foreigners in natural resources and infrastructure have proven to be the most unstable.”<sup>71</sup>

While contract renegotiation may be costly and provoke negative market reactions in the short term, an open process of renegotiation, with buy-in from citizens, will result in more durable contracts in the long run. Contract transparency should create an incentive for the parties to ensure that they “get the deal right” and communicate this to citizens. Secrecy only prevents the court of public approval from serving its purpose, thus creating instability.

## D. Will Contract Transparency Lead to a Race to the Bottom...or the Top?

Contract transparency will affect the negotiating posture of countries and companies by adding to the information at their disposal. The benefits and burdens will vary; but inconsistent application of transparency may place unequal burdens on some companies.

Some companies argue that contract disclosure will force them to offer the same or better terms in the future. From the point of view of citizens, government and investors that intend to remain in a country over the long term, contracts that provide a good deal for all parties is desirable, and the goal of contract transparency.

Others argue that when items such as tax and royalty rates are disclosed in combination with project-level production and payment data, this information could reveal the cost structure and pricing strategy of a company, giving competitors crucial information that they could either mimic or use against the disclosing company. If transparency is piecemeal, some argue, it will disadvantage transparent companies over non-transparent ones, since non-transparent companies may gain information and use it against their transparent competitors, and governments with no interest in transparency may choose non-transparent companies over their competitors.

Governments may fear pressures to lower their standards to match other competitors, in the same way that some governments were perceived to lower human rights standards to attract low-cost manufacturing. Another version of the “race to the bottom” concern is fear that governments will be pressured to give concessionary terms in later contracts (e.g., tax holidays, lower tax rates, etc.) or renegotiate contracts to give better terms to currently operating investors. As the IMF states: “The reason usually advanced by governments (and to some extent by companies) is that disclosure would erode their bargaining power for future contracts.”<sup>72</sup>

*It seems unlikely that contract transparency would cause a race either to the top or to the bottom.* Contracts are already available through pay-for-access sites, existing government disclosures, and industry publications. Companies currently operate and continue to seek opportunities in countries where contracts are publicly disclosed, including Congo-Brazzaville, Ecuador, Liberia, Peru and Timor Leste. While companies do have significant bargaining power over many governments, the resources on which their industry depends are finite and location-specific, giving governments some measure of bargaining power. Contract transparency, in countries where it has occurred, does not appear to have been a deterrent to investment (see Chapter Five: International Policy and Practice on Contact Transparency).

The arguments warning of disparities between transparent and non-transparent companies only further support consistent application of transparency rules. However, the wide availability of contracts for purchase within the industry indicates that most competitors, transparent or not, are already the best informed. It is unlikely that contract transparency will result in a race to the bottom; nor will it provide a windfall to governments. The most likely long-term outcome is contracts that fall within a flexible and reasonable rate of return for both parties being less susceptible to renegotiation, an outcome that is desirable for serious investors, governments, and citizens.

## E. Will Companies Ever Agree to Contract Transparency?

To answer the question of whether private enterprise will ever fully embrace transparency in the extractive industries, we need to know who is really driving contract secrecy: companies or governments? Interviews, experience and research indicate that the answer depends on individual governments and companies and the power dynamics of particular situations.

Some believe that governments are driving secrecy, and there is some anecdotal evidence to support this belief. In Uganda, activists and parliamentarians are currently seeking access to contracts signed with Tullow Oil Plc. The company has publicly stated that it will disclose contracts, but only if the government allows it.<sup>73</sup> On the other hand, individuals involved in the negotiation of Ghana's recent oil contracts report that the government was afraid of company reaction if it committed to contract transparency. It seems that governments and companies will rarely make contracts public unilaterally, even if the law allows it.

This was the case with BP and its partners when they faced an international campaign against the proposed Baku-Tblisi-Ceyhan (BTC) pipeline, the most notable example of a company taking the lead in disclosing contracts. BP lawyers and other industry members involved in the pipeline project noted that the consortium would not have disclosed the contracts if the contracting countries had not had existing laws that should have made them public in any event. Some even said they felt sure that government officials at the highest level, in particular President Aliyev of Azerbaijan, would have been consulted before any disclosure was made, the laws notwithstanding.

### BTC Contracts

A consortium<sup>74</sup> led by British Petroleum (BP) publicly disclosed the BTC pipeline and upstream contracts in 2003. This is the most prominent example of a company taking the lead in making contracts easily accessible to the public by putting the contracts on the company-led website devoted to Caspian oil development.<sup>75</sup> While there has been much analysis of the pipeline contracts on the part of activists and industry, there is little explanation of why BP and its partners took the dramatic step of disclosing its contracts. The IFC and the BTC consortium believed there were misconceptions about its contracts and how it planned to implement the pipeline project. This concern had two forms: (1) the citizens of the countries through which the pipeline was to pass had unrealistic expectations about the benefits that the project would bring, and (2) there was a large-scale international campaign to stop the project due to fears that it would cause environmental and social harm.<sup>76</sup> Thus, the BTC consortium, along with its public funders, the IFC and the European Board of Reconstruction and Development (EBRD), engaged in a counter-campaign to dispel these perceptions through public consultations and unprecedented transparency.

*Initial Civil Society Concerns.* From the outset, this major project was viewed warily by local and international civil society institutions. After conducting several fact-finding missions to the three countries involved in 2002 and 2003, Friends of the Earth and other civil society organizations began mobilizing protests over the pipeline's construction. Over 60 regional and international NGOs wrote to the IFC, the EBRD and other financial institutions, raising a number of concerns

about the project's social, environmental, economic and human rights impacts. The organizations urged the IFC to make loan approval subject to a number of conditions.

Despite protests, the countries (host and home), companies, and financial backers of the project wanted to see the successful implementation of the project.<sup>77</sup> Most of the interviews conducted, as well as the literature about the pipeline, indicate that some companies in the consortium did not view the pipeline as particularly lucrative. With oil at around \$15 a barrel, a technically, diplomatically and legally complex pipeline was not financially appealing. However, western governments exerted significant political pressure to build the pipeline.<sup>78</sup> The US and the EU saw the region and the pipeline as particularly critical for energy security: the pipeline would supply oil without running through Russia or Iran.<sup>79</sup> There was also a viable economic case to be made: the Azeri-Chirag-Gunashli oil field has an estimated 5.4 billion barrels of recoverable resources.<sup>80</sup> In terms of using modern oil technology, the Caspian region was a major resource that was largely untapped.

*Why did the consortium disclose?* Civil society pressure was the major factor resulting in the decision to disclose the contracts, based on IFC documents and interviews with individuals within the companies that were involved in the decision-making process.<sup>81</sup> Similar international activism for the release of contracts in another country had recently resulted in a major project being stalled and halted.<sup>82</sup> The IFC and the consortium companies sought to avoid the same outcome with the BTC pipeline project.

When BP, as the leading company in the consortium, consulted legal counsel for advice on whether the BTC agreements could be made public, counsel found no compelling reason not to disclose. It was determined that contract disclosure was not problematic from a legal standpoint.<sup>83</sup> The contracts were not considered very commercially sensitive, and they should have been in the public domain in any event since they had the force of law in the three countries. Counsel also noted the political benefits of disclosing the contracts, namely showing support for the EITI process that was just beginning at the time. In fact, the primary concern was not legal, it was offending the government counterparties of Georgia, Azerbaijan, and Turkey.<sup>84</sup>

Even when companies want to disclose, they will be very sensitive to the views of government, likely seeking their express approval before making any major public disclosures of contracts. It seems highly unlikely that a company would disclose without a significantly grounded legal argument or the express consent of the government. However, when it serves their purposes, companies will disclose contracts, as the BTC example demonstrates, and the aforementioned Freeport McMoRan disclosure of its Tenke Fungurume contract via securities regulations, on page 27.

Where governments are more experienced in dealing with companies and their resources are well known, they may be able to exert more pressure to keep contracts secret. This is especially true of governments that are particularly secretive and concentrate power in the executive branch or a small circle of political elite. Transparency may run directly against the interest in maintaining such centralized power.

But even governments that are not particularly secretive may resist transparency. Governments are directly concerned with the interests of a diverse set of players whose interests are less directly aligned to profit maximization than those of companies and their stakeholders. Governments are answerable to several different pressure groups, including local communities, foreign governments and international aid organizations, and various ideological constituencies (pro-business, environmentalists, directly affected communities versus the population more broadly).

This is not to say that companies do not have an interest in contract secrecy. Companies currently have a strategic advantage over governments, with greater access to information, and to contracts in particular. Contract transparency would erode this advantage.