MEMORANDUM

TO : File No.

FROM: Elliot Staffin
Special Counsel
Office of Rulemaking
Division of Corporation Finance
U.S. Securities and Exchange Commission

DATE : October 17, 2017

RE : Meeting with representatives from Publish What You Pay-U.S., Oxfam America, EarthRights International and Global Witness

On October 17, 2017, William Shirey, Bryant Morris and Connor Raso of the Office of General Counsel, Elizabeth Murphy, Michael Seaman and Elliot Staffin of the Division of Corporation Finance, and Adam Yonce and Vladimir Ivanov of the Division of Economic and Risk Analysis met with representatives of Publish What You Pay-U.S., Oxfam America, EarthRights International and Global Witness, as noted below, to discuss issues related to the rulemaking regarding the disclosure of payments by resource extraction issuers.

In attendance were: Jana Morgan, Director and Waseem Mardini, Policy Advisor from Publish What You Pay-U.S.; Isabel Munilla, Senior Policy Advisor, Extractive Industries from Oxfam America; Michelle Harrison, Attorney from EarthRights International; and Corinna Gilfillan, Head of the U.S. Office of Global Witness.

The attached documents were submitted to the staff at the meeting.

Why is Niger still losing out to Areva?

By By Quentin Parrinello, Oxfam France & Publish What You Pay France on September 18, 2017

In 2014, Niger announced it had successfully renegotiated uranium extraction contracts with French state-owned company Areva to secure a greater share of the wealth deriving from their uranium resources. Three years later, an analysis carried out by Oxfam based on data released by Areva calls into question the benefits for Niger in the contract renegotiation.

This analysis was carried out as part of the data extractor program developed by Publish What You Pay.

You can read more about Areva in Niger and more in the English version of "Beyond Transparency: Investigating the Investigating the New Extractive Industry Disclosures." This report was published by Publish What You Pay France, Oxfam France, ONE, and Sherpa.

power. Most of the uranium used for nuclear combustion in France is supplied by Areva. Up to 1 in 5 lightbulbs in France would be lit up thanks to Nigerien uranium.

For years, civil society organizations have for the uneven partnership with Niger. Despite vast resources in uranium, Niger has yet to convert this valuable resource into tangible wealth: the country still ranks second to last in the

The renegotiation: a game-changer for Niger?
In 2013, Oxfam and ROTAB, a Nigerien NGO – both members of Publish What You Pay – launched a denouncing the unbalanced partnership between Areva and Niger and calling for the renegotiation of the contracts. Oxfam and ROTAB specifically pointed that enabling Areva to pay a lower rate of royalty than the applicable regime in Niger. Royalties make up the majority of uranium mining revenues to the Nigerien government.

In 2014, after months of pressure from civil society organizations around the world, Areva and Niger agreed to a new contract without the sweetheart clause. In June 2014, a Strategic Partnership Agreement signed between Areva and Niger stressed that Areva would be subject to the legal royalty regime, raising hopes of a fairer share of the revenues for Niger. This agreement was published on the Journal Officiel- the official gazette of the Republic of Niger where major legal official information are published.

In August 2016, Areva released for the first time the payments the company makes to governments where it mines uranium, as part of new EU regulations. In Niger, it was the first time the public had access to Areva's payments since the renegotiation took place in Niger. And the results are surprising:

Country / Project	Production entitlements	Taxes or changes	Royalties	Dividends	Premiums	Fees	Infrastructures	Other payments	TOTAL	Currency
Canada										
AREVA Resources Canada	0	14 500 000	49 080 381	0	0	913 376	0	0	64 493 756	CAD
KIGGAVIK	0	0	0	0	0	379 300	0	0	379 300	CAD
McCLEAN	0	0	0	0	0	3 462 133	219 198	0	3 681 331	CAD
Midwest	0	0	0	0	0	314 551	0	0	314 551	CAD
Kazakhstan										
KATCO	0	14 513 014 243	6 300 066 419	20 797 313 824	0	1 294 958 187	0	911 134 345	43 816 487 018	KZT
AREVA Mines SA succursale KAZ.	0	50 958 199	0	0	0		0		50 958 199	KZT
Niger										
AREVA Mines SA succursale Niger	0	0	0	0	0	61 176 500	0	841 378 467	902 554 967	XOF
SOMAÏR	0	0	7 094 970 527	0	0	1 445 811 422	1 248 952 584	678 852 417	10 468 586 950	XOF

Source: Areva Report on payments made to governments for fiscal year 2015

Among the payment listed we find one for Somaïr – the company owning one of the largest uranium mines in the world in terms of production. Areva owns 64% of Somaïr. The remaining share is owned by Sopamin a Nigerien public company. Areva's report shows the French company paid more than 7bn FCFA (around 10.8 million euros) in royalty fees to extract uranium from the Somaïr mines in 2015. The company's annual report outlines that Somaïr extracted 2,509 tons of uranium that year.

Niger is a member of the Extractive Industry Transparency Initiative (EITI). By the time Areva released its first payments to governments report in 2016, the most recent payments data available in Niger were from 2013 – right before the contract renegotiation. Niger's 2013 EITI report shows that Areva paid almost 10bn FCFA (about 15.3 million euros) in royalty fees to extract uranium in Somaïr mines. The amount of uranium extracted from the mine is slightly superior – 2730 tons – but not enough to justify a massive decrease in royalty payments.

In two years, Areva's royalty payments decreased by 4.5 million euros. What went wrong?

Royalties are what companies pay in exchange for the right to mine a particular mineral. They usually represent a fraction of the value generated by the mine – or the gross revenues of the mine – which means they depend on the amount of mineral produced (i.e. the production volume of the mine) and the valorization of the mineral (i.e. the price at which the company value the mineral).

Since 2006, Niger imposed a sliding-scale royalty regime, which means that the royalty rate increases with the profitability of the company

Mining Code	Profitability less than 20%	Profitability between 20% and 50%	Profitability more than 50%
Royalty rate	5.5%	9%	12%

Profitability corresponds to the net margin of the operator

Following the agreement over the new contracts Areva was subject to this regime for the first time. As numerous reports previously documented how uneven the partnership was, one would have expected the French company to pay a higher amount of royalty fees. Our comparison with the 2013 royalty payment outlines a small decrease in the production volume, but not enough to explain why Areva paid 4.5 million less in royalty fees. What about the price?

Areva: the price is wrong?
Until 2013, Areva directly negotiated a price of extraction with the government of Niger. This price corresponds to the market value of uranium extracted from the mines operated by Areva in Niger. In 2013, the extraction price was 73,000 FCFA per kilogram of uranium (kgU) (about 111€/kgU). Thanks to data released by Areva, we are able to determine the 2015 extraction price of uranium:

1. Find the applicable royalty rate
2. Calculate the gross revenues
3. Calculate the price

1. Find the applicable royalty rate: 5.5%
In Areva's 2015 annual report, the company discloses Somaïr's income and revenue that we use to calculate the mine's profit margin. This is the indicator that we need to determine the applicable royalty rate.

(in millions of euros)	Imouraren Mining	Somaïr Mining
Country	Niger	Niger
Minority interests	[illegible]	[illegible]
Revenue	-	**197**
EBITDA	**(34)**	**40**
Net income	**(236)**	**5**

Source: Areva 2015 reference document p.223

Somaïr Net Margin= (Somaïr Income/ Somaïr Revenue)*100
Somaïr Net Margin = (5/197)*100
Somaïr Net Margin = 2.5%

Somaïr Net Margin being 2.5%, the applicable royalty rate is 5.5% according to the sliding-scale royalty regime described above.

2. Calculate the gross revenues: 196 658 415€
If the applicable royalty rate is 5.5%, the amount of money disclosed by Areva as a royalty fee corresponds to 5.5% of the gross revenues of the mine:
Royalty Fee = 5.5% * Gross Revenues
Gross Revenues = Royalty Fee / 0.055
Gross Revenues (FCFA) = 7 094 970 527 / 0.055
Gross Revenues (FCFA) = 128 999 464 127
We calculate the price in euros
Gross Revenues (€) = 128 999 464 127 / 655.957
Gross Revenues (€) = 196 658 415
3. Calculate the price: 78.38€/kgU
Using Somaïr's production volume disclosed by Areva, we can calculate the price:
Gross Revenues = Volume * Price
Price = Gross Revenues / Volume
Price (€/Ton) = 196 658 415 / 2509
Price (€/Ton) = 78 381
Price (€/kgU) = 78.38

According to Areva's payments to governments report, the extraction price for the uranium extracted from Nigerien mines operated by Areva decreased by almost 33€ per kilogram of uranium. The effect of a price decrease is twofold:

1. With a lower valuation of the uranium, the gross revenues generated by the mines are smaller which means the royalty fee – a fraction of the gross revenues – are also smaller
2. With a lower valuation of the uranium, the profits of the mines are less important which means the profitability of the mine is lower and the applicable royalty rate is the lowest possible – 5.5%.

Before the new contracts were signed in 2014, the price of uranium was fixed through direct negotiation between Areva and Niger every couple of years. The latest known extraction price was agreed in 2013 and reached 73 000 FCFA per kgU (about 111€/kgU). Our analysis suggests that it was not applicable anymore in 2015.

Backing our analysis is the Strategic Partnership Agreement signed between Areva and Niger. When it was released, civil society organizations paid attention to the provision stating that Areva would be subject to the 2006 mining law.

1. Convention minières de SOMAÏR et COMINAK

Le renouvellement des conventions minières de SOMAÏR et de COMINAK se fera conformément à la loi minière n° 2006-26 du 9 août 2006.

Excerpt from the Strategic Partnership Agreement signed between Areva and Niger in 2014

However, another provision in the document states that the extraction price of uranium for the two mines operated by Areva will be calculated as follows:

2. Prix Niger

Le Prix Niger en euros (1 euro = 655,957 FCFA), par kg d'uranium métal auquel tous les actionnaires des sociétés minières SOMAÏR et COMINAK enlèveront leur quote-part d'uranium du Niger du 1er janvier 2014 au 31 décembre 2016 sera déterminé comme suit :

Prix (n) = (50% * SPn-1 + 50% * LTn-1)*2,5998.

Excerpt from the Strategic Partnership Agreement signed between Areva and Niger in 2014

This rather complicated formula essentially means that the extraction price is to be indexed on both short-term market prices (also called spot market prices) and long-term market prices.

Indexing the extraction price on market prices has lowered the value of uranium in Niger. In particular, the indexation on spot market – spot contracts are traded at a lower price – has had an important impact on lowering the price. The problem is Areva is not operating on spot contracts. Uranium extracted in Niger is systematically sold to another subsidiary of the Areva group to be refined into nuclear fuel. This nuclear fuel is provided to Areva's commercial partners – mostly on long-term contracts. For example, Électricité de France has signed a contract with Areva to secure a supply of 30,000 tons of uranium until 2035.

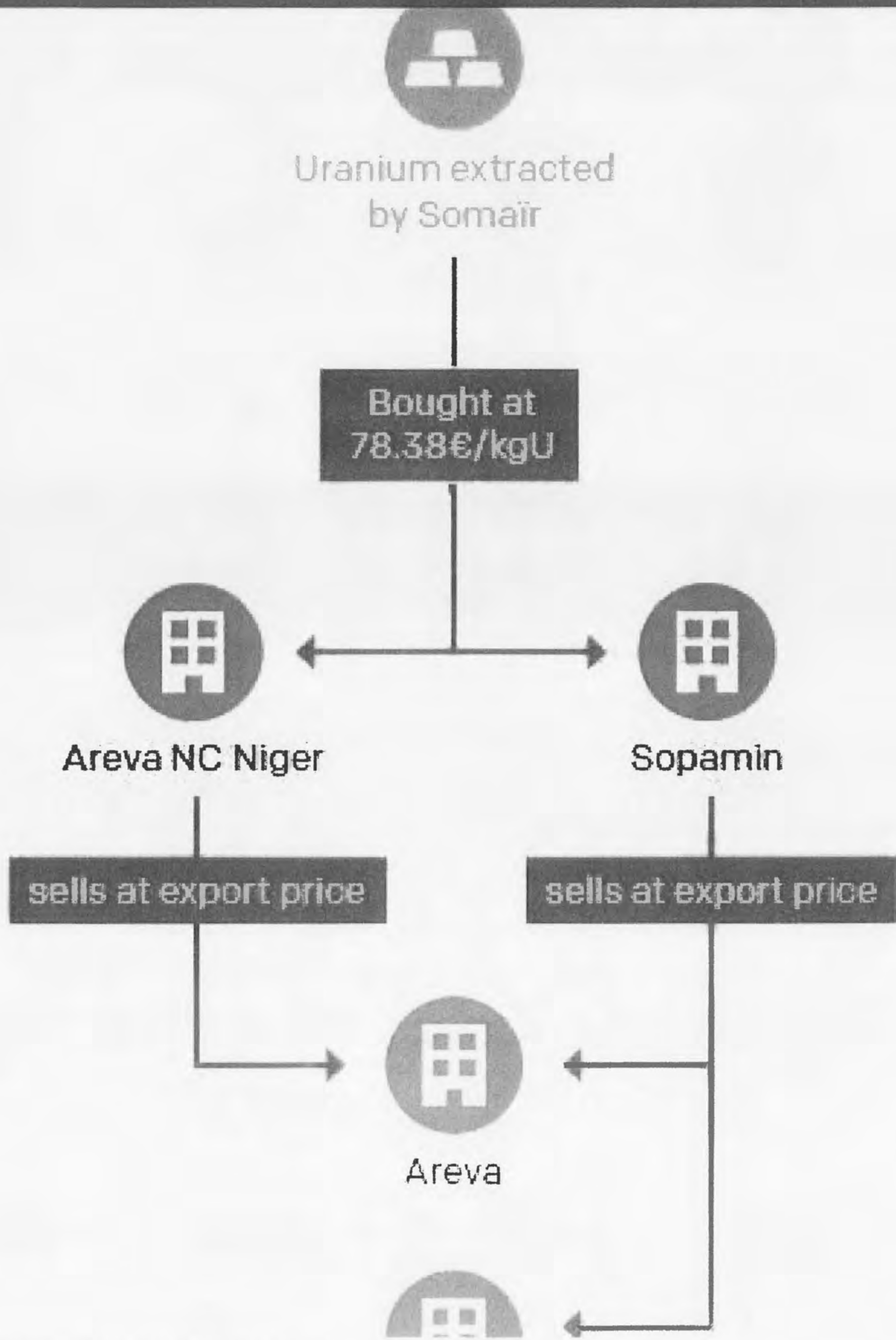
1. Uranium market prices are down, there is no doubt about it. However uranium extracted from Areva's Nigerien mines was not indexed on market prices before the renegotiation. Using a market benchmark to value Nigerien uranium was a decision between Areva and Niger in 2014 – it has nothing to do with the current market trend.

2. The formula used to value uranium include an indexation on spot prices. It does not reflect Areva's economic model. : Nigerien uranium is traded within the Areva group, refined in Europe and sold on long-term contracts to nuclear power companies.

[illegible] together with spot [illegible] disclosed by Cameco – one of Areva's competitors – we can double check that the price is indeed 78.38€/kgU.

The stark decrease in price had an important impact on revenues to the Nigerien government. With the new sliding scale royalty regime, we calculated that Niger would have received an extra 15 million€ in royalty fees had extraction price have been left unchanged at 111€/kgU.

Does a decrease in price benefit Areva?
Intuitively, a decrease in a mineral's price would not appear to benefit a mining company: the lower the price, the lower the profits. However in this case, it does benefit Areva because of the way the company structures its activities in Niger:


Uranium extracted
by Somaïr
Bought at
78.38€/kgU
Areva NC Niger
Sopamin
sells at export price
sells at export price
Areva

Other buyers

To formally get ownership over the uranium extracted in the Somaïr mines, Areva and Sopamin (Areva's minority partner in the Somaïr's mines) have to buy the uranium at extraction price – 78.38€/kgU. Areva buys this uranium through its Nigerien branch before selling it to another subsidiary that will take care of refining uranium. Areva is therefore not only a seller but also a buyer. It has an incentive to export uranium at a cheaper price: the cheaper the uranium is, the better for the company that can refine and sell nuclear fuel at a lower price than competition.

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DATA EXTRACTAFACT

Welcome to Extract-A-Fact

By Jana Morgan on June 22, 2016

Photo by Daniel Sallai available under a Creative Commons License

This post originally appeared on www.extractafact.org on June 3, 2016

Publish What You Pay – United States (PWYP-US) is excited to launch the Extract-A-Fact project!

"Are we getting a good deal on our natural resources?"

Extract-A-Fact will provide training modules detailing useful and creative ways to find, analyze, and visualize extractives data, as well as blog posts from PWYP-US and our partners as we dig deeper into oil, gas, and mining sector data to answer questions critical to communities impacted by natural resources.

Over the last 14 years Publish What You Pay coalitions around the world have advocated for a more transparent extractives sector by petitioning governments to require oil, gas, and mining companies to publish what they pay for the right to explore, develop, and extract natural resources. There are now mandatory disclosure laws in force in over 30 countries, and the first company reports were released in 2015. These reports can be analyzed alongside other data sources to get a more complete picture of a country's natural resource sector.

The goal of Extract-A-Fact is to enable civil society organizations, citizens, journalists, government officials, academics, and other stakeholders to effectively analyze this data and put it to use to hold both companies and governments accountable for how natural resources are extracted and managed.

In the coming weeks and months, we will feature blogs and training modules that will help readers enhance their ability to work with and explore the data. But we also want to hear from you – Extract-A-Fact is intended to be a collaborative space for those interested in working with the growing set of extractives sector data. Please tell us what questions you would like to answer, or if you wish to collaborate on a training or story.

"How do I make a map to show mining revenues owed vs. revenues paid to my community?"

These are exciting times for the transparency movement, as the books are now being opened on the payments that oil, gas and mining companies make around the world. It is now time for us to translate this new data into accountability. We hope you will join us in this effort and that Extract-A-Fact will be a useful resource in your work.

———— Help us spread the word – use #ExtractAFact to tell folks about this project!

Jana Morgan is the Director of PWYP-US, follow her on Twitter @janalmorgan and @pwypusa

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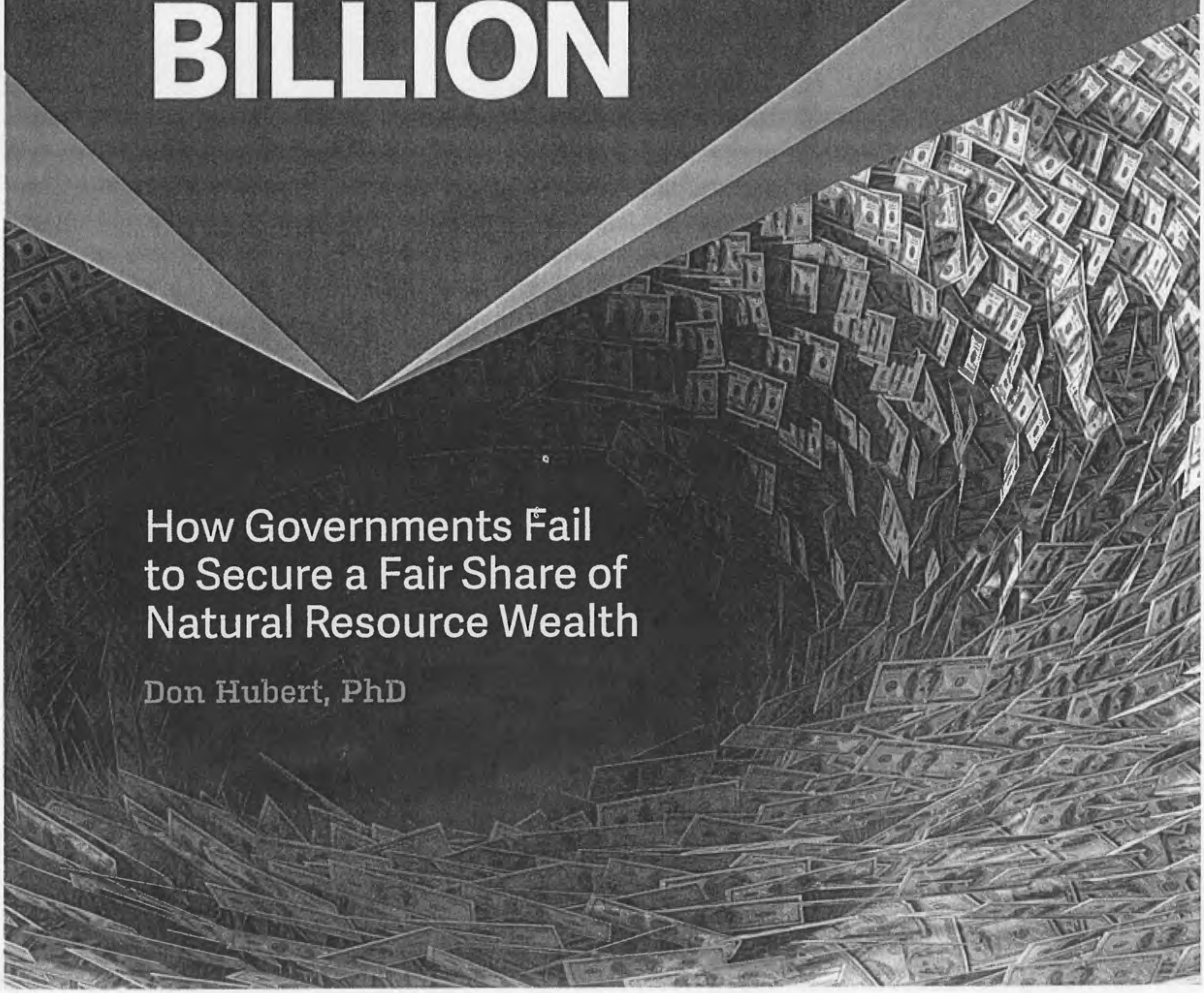

How Governments Fail to Secure a Fair Share of Natural Resource Wealth

Don Hubert, PhD

About **Publish What You Pay** and **Publish What You Pay Canada**

PUBLISH WHAT YOU PAY

Publish What You Pay is the world's leading coalition of civil society organizations united in the call for a more transparent and accountable extractive sector. With more than 800 members, a global secretariat and 40 national coalitions that span the globe, PWYP is committed to working together to ensure that citizens have a say over whether their resources are extracted, how they are extracted and how their revenues are spent.

Publish What You Pay CANADA

Publish What You Pay Canada is the Canadian coalition of the global PWYP network. Since its foundation in 2007, PWYP-Canada has been at the forefront of the national movement for transparency in the Canadian extractive sector, championing and driving forward the passage of legislation that requires that Canadian extractive companies disclose their payments to governments in Canada and across the globe. In addition, the coalition has worked to actively encourage and support the use of Canadian company information in global advocacy efforts.

Acknowledgements

PWYP-Canada would like to thank the Omidyar Network, the Natural Resource Governance Institute, World Vision Canada and the Publish What You Pay Secretariat for the generous financial support to PWYP-Canada that made this publication possible. We would also like to extend our gratitude to the network of individuals who provided comments on the many different drafts of this report and to the PWYP Secretariat who helped get the report over the finish line.

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RESOURCES for DEVELOPMENT CONSULTING

Don Hubert is the President of **Resources for Development Consulting**, a firm that assists resource-rich developing countries to secure a 'fair share' of extractive sector wealth. The firm draws on a wide range of experts to deliver tailored, project-specific and sector-wide analyses. Services include the design of EI fiscal regimes and contracts, design and delivery of financial and fraud audits, preparation of revenue risk assessments and government revenue projections, and design and delivery of capacity development programs for government officials, parliamentarians and civil society. The firm has conducted detailed economic analyses of petroleum and mining projects in more than a dozen countries for clients that include governments, the World Bank, bilateral donors and non-governmental organizations.

Foreword

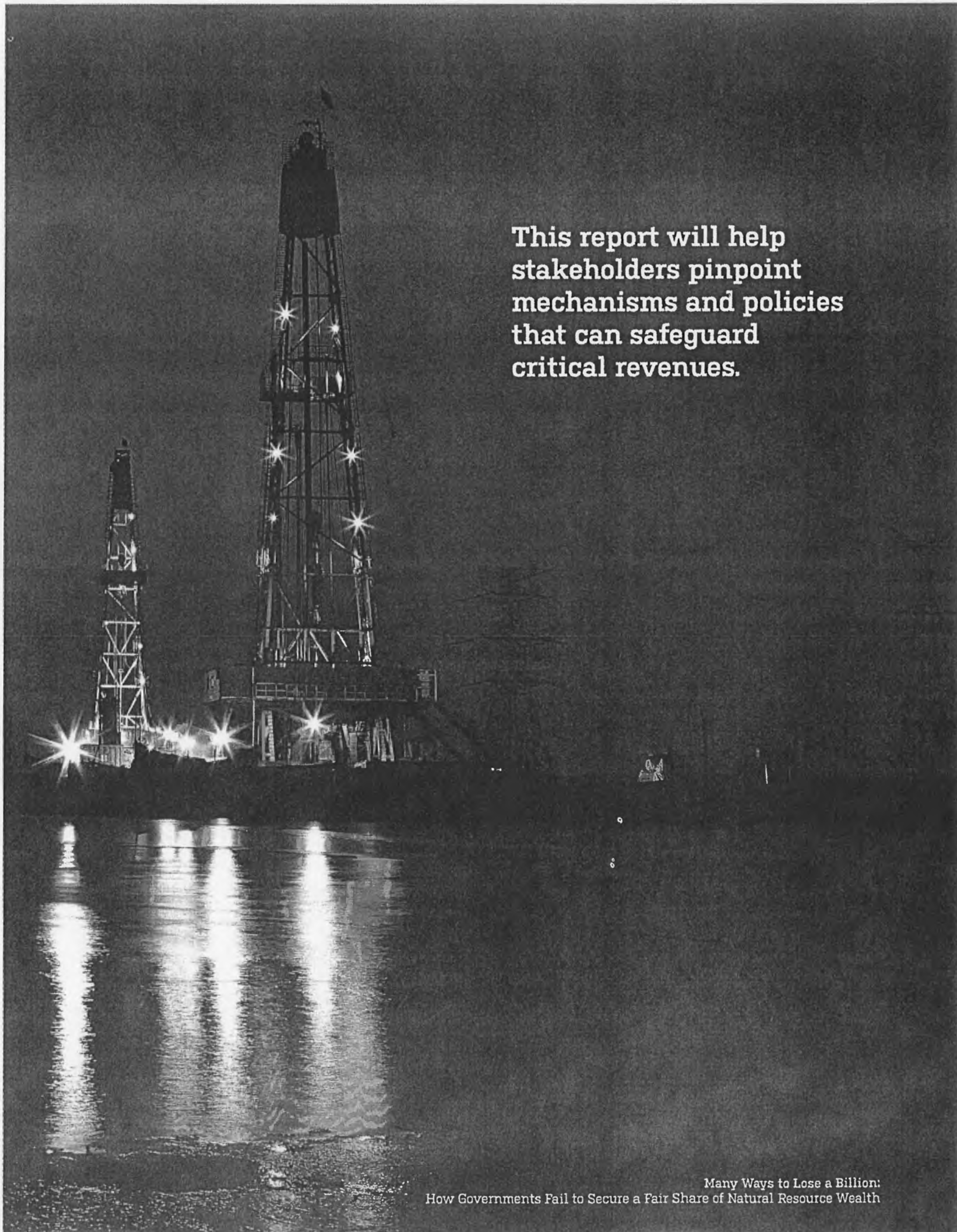
Over the 10 years that I have been involved with the Publish What You Pay (PWYP) global network, the coalition has expanded its reach and the breadth of issues it works on, all while demonstrating a clear ability to affect global change. Our work has been complemented and amplified by other global movements focused on illicit financial flows, tax evasion, corporate accountability and, more recently, open data. Despite persistent challenges, the result of this collective work is an extractive sector that is more transparent and accountable than it was just a decade ago.

With greater transparency, the link between transparency and accountability is being tested. Civil society is challenged to use new disclosures to change government policies, company behaviour and even global systems. Despite many documented successes, the complexity of both global corporate arrangements and the national laws/contracts that govern the extractive sector, pose a serious analytical challenge. As this report shows, companies can employ a wide array of legal and illegal means to reduce their payable taxes and royalties, often in an environment where there is insufficient government oversight.

This report responds to a persistent question: is my government receiving its fair share of revenues from extractive sector projects? While no single report can specify what constitutes a fair share for every resource project, by identifying and illustrating the common pathways to government revenue loss in the extractive sector, this report will help stakeholders pinpoint mechanisms and policies that can safeguard critical revenues. It will equally serve as a tool to enable deeper and more systematic analysis of data on company payments to governments. A need made more pressing as new laws, such as that in Canada, see hundreds of extractive companies report payments to governments around the world every year.

Publish What You Pay has very successfully advocated for new laws and standards that require that mining, oil and gas companies disclose the payments they make to governments. We have equally worked for changes to standards that support contract disclosure and transparency of company ownership, amongst other things. With new data at hand, there is a growing focus on strengthening the mechanisms by which transparency is used for accountability. At the global level, the PWYP network has recognized this challenge and is developing different programs focused on using the data. At the national level within the PWYP global network, there is a plethora of initiatives focused on putting data to use. This report aims to enhance and enable those discussions; to be a critical tool for those analyzing government revenues and fiscal regimes; and to be a platform for more informed discussions about whether governments are receiving their 'fair share.'

Claire Woodside
Director, PWYP-Canada



This report will help stakeholders pinpoint mechanisms and policies that can safeguard critical revenues.

Executive **Summary**

Countries rich in oil, gas and minerals often fail to secure a fair share of their natural resource wealth. Revenue loss from the extractive sector is particularly significant given the large number of countries that depend on natural resource revenues for a substantial portion of their annual budgets. Companies employ a wide range of strategies to minimize their payments to governments. Their efforts to avoid tax are facilitated by weak institutions, inadequate policies and regulations, badly negotiated contracts, and insufficient government monitoring and auditing.

There has been a flurry of activity in recent years, at the international level and at national levels, to combat extractive sector tax avoidance. But much more still needs to be done. Reliable data on the scale of potential revenue loss is not available. However, the experiences of both developed and developing countries suggest that many billions of dollars in government revenue are at stake.

The extraordinary success of the global movement for greater transparency surrounding extractive sector revenues has made it easier to assess whether governments are receiving a fair share from oil, gas and mineral extraction. But for greater transparency to translate into increased extractive sector revenues, the data must be analyzed and that analysis must be used.

There are many mechanisms companies use to reduce their payments to governments, but the pathways are not unlimited. There are clear patterns to how companies reduce payments to governments. Knowing what to look for can help those seeking to conduct more effective data analysis.

This paper sets out a revenue risk assessment framework that maps the main pathways through which governments lose extractive sector revenues (See **Textbox 1**). The framework is based on a comprehensive review of public domain information on risks to government revenue. The main pathways introduced in this report are all illustrated by real-world case studies.

The framework distinguishes between revenue loss due to the *tax rates* applied to an extractive sector project, and revenue loss due to the *tax base* against which those revenues are assessed.

Tax **Rates**

While companies may make many payments to governments, the bulk of government revenue usually comes from only two or three sources, including a production-based tax, often a royalty, alongside profit-based taxes, such as corporate income tax or production entitlements. To promote investment, governments may grant investment incentives or tax holidays, which can significantly reduce government revenues. These fiscal terms are often locked in for the lifespan of the project through stabilization agreements, making them difficult to revise even when they are recognized to be unfair. Best practice suggests avoiding, or at least carefully limiting, stabilization provisions in new contracts. For existing projects, where fundamental circumstances have changed and game-changing revenues are at stake, governments should renegotiate the fiscal terms.

Negotiating the most favourable tax terms possible is not the only way that companies can reduce payments, they can also take advantage of the existing network of Double Taxation Agreements (DTAs) to reduce or even eliminate withholding taxes on dividends and interest payments as well as taxes on capital gains. This is accomplished by creating a shell company in a jurisdiction that has a DTA with the producing country and sending payments through that subsidiary. When negotiating or renegotiating DTAs, governments should ensure that agreements are designed to deny treaty benefits to companies that create mailbox companies in order to engage in "treaty shopping."

Textbox **1:**

Revenue Risk Framework and Case Studies

Risks to Revenues

Tax Rates

TAX BREAKS

Tax Incentives
- Accelerated depreciation

Tax Holidays
- Corporate tax exemptions

TREATY SHOPPING

Withholding Taxes
- Dividend payments
- Interest payments

Capital Gains Tax

Tax Base

UNDER-REPORTED PROJECT REVENUES

Production Volumes
- Under-reporting production
- Non-reporting of by-products

Sale Price
- Intra-firm sales agreements
- Excessive marketing fees
- Forward sales / price hedging

OVER-REPORTED PROJECT COSTS

Ineligible Costs
- Falsified or duplicate invoices

Misallocated Costs

Inflated Goods and Services
- Over-priced used machinery
- Transport (rail, ports, pipelines)
- Management fees

Debt Financing
- Thin capitalization
- Abusive interest rates

Resources for Development Consulting (2016)

Tax Base

Where governments believe that they are not receiving a fair share, they often seek to revise the tax rates, such as increasing royalty rates. In many cases, however, the problem is not the tax rates [illegible] in the tax base [illegible] which the rates are applied. [illegible] incentive to shift profit as a result of the differing tax burden between producing countries, home countries and tax havens. Through elaborate networks of subsidiaries, companies shift profits out of highly taxed producing countries to lower tax jurisdictions, while at the same time shifting costs into those same highly taxed producing countries.

There are many ways that companies reduce the project revenue that they report. For example, companies can under-report the quantity or quality of the principal commodity produced or fail to declare valuable by-products. To guard against both practices, it is important that the government independently assesses the quantity and quality of production. Another means by which a company can reduce project revenue is to under-report the market value of the commodity. This can be done by selling at a reduced price to an affiliated company, through the use of forward sales or price hedging, or by inflating the costs of marketing the commodity. Under-reported project revenues affect both production- and profit-based taxes, profoundly impacting government revenues. While efforts can be made to ensure actual sales reflect fair market value, for many commodities it may be more effective to establish a reference price for the calculation of royalty and tax payments.

Inflating costs is the second main way that governments lose revenues through tax base erosion. The main effect of inflated costs is a reduction in profit-based taxes as inflated costs result in a decrease in net (taxable) revenue. Companies can increase costs in several ways: by claiming costs that are ineligible because invoices were falsified, submitted twice, or are explicitly disallowed according to the contract or tax legislation; and by inflating costs in transactions with affiliated companies in order to shift profits to lower-tax (or no-tax) jurisdictions. Transfer mispricing is common in the provision of goods and services, with head office costs and debt financing being areas of particularly widespread abuse. Careful government monitoring, including risk-based audits, are essential to ensure fair payment of profit-based taxes.

Protecting
Government Revenues

Strengthened tax administration is essential for governments to secure a fair share. In most countries, however, the profound imbalance in expertise between the lawyers and accountants working for the companies and officials working for the government cannot be addressed quickly or easily. A solution may be to build tax administration capacity, while at the same time revisiting contracts and tax laws, not necessarily to change the tax rates, but rather to close tax loopholes and introduce simple, if crude, anti-avoidance measures.

External monitoring can help to maximize government revenues. More data is available in the public domain than ever before. In addition to showing what companies have paid, this data can help answer whether those payments are consistent with contract terms and tax legislation and whether they represent a fair share. However, answering these questions requires comprehensive project-level economic analysis based on production volumes and costs, commodity prices and tax terms.

Applying the risk assessment methodology set out in this report to specific extractive sector projects can assist those seeking to ensure that countries maximize revenues from the sale of their non-renewable resources.

Strengthened tax administration is essential for governments to secure a fair share.

Many Ways to Lose a Billion:
How Governments Fail to Secure a Fair Share of Natural Resource Wealth

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GLOSSARY

Arm's length transaction: A transaction where the buyer and the seller have no significant prior relationship. As both parties seek to maximize their own interests, the resulting sale price is considered to be an approximation of fair market value.

Base erosion and profit shifting (BEPS): The company practice of moving revenues and costs between different jurisdictions (often through transfer mispricing) to minimize taxation. Also an international process led by the OECD to address government revenue loss.

Capital costs: Costs incurred after a decision has been made to develop a project, including the costs of constructing the site, installing equipment and purchasing machinery (sometimes "capex").

Capital gains tax: A tax on the income gained when a capital asset (or a stake in a capital asset) is sold.

Corporate income tax: A tax assessed as a percentage of the net profits of a company, after deducting allowable expenses (sometimes "CIT").

Cost oil: The portion of oil production that is allocated to the company to reimburse for past and current costs (exploration, development, operating, etc.)

Cost recovery: The process of recouping the costs of producing a commodity, usually established in the fiscal regime.

Accelerated depreciation: A process by which the costs of a capital asset can be deducted in full or in part against revenues accrued over a very short time period. This is a common investment incentive.

Double taxation agreement (DTA): Treaties that seek to avoid the taxation of the same income in both the host and home country.

Fiscal regime: The set of terms, agreements, laws and regulations that together determine how the revenues from extractive projects are shared between company and government.

Fiscal instruments: Policy tools that enable governments to generate revenues, including: bonuses, taxes, royalties, dividends and production entitlement, amongst others (sometimes "fiscal terms").

Gross revenues: Total of all revenues collected from commodity sales (production × sales price) without any deductions for costs or taxes (sometimes "project revenues").

Hedging: The practice of securing the value of future production as a means to insure against price volatility.

Illicit financial flows: The movement of illegally acquired money across borders from smuggling, corruption and tax evasion.

Investment incentives: A range of policy options that governments employ in order to attract investors, including, but not limited to, full or partial deferral of taxes, capital investment credits and accelerated depreciation (sometimes "tax incentives").

Long-term sales agreements: Contracts between two separate or related entities that stipulate the price, or the formula for how the price will be determined, for future sales of a commodity.

Net revenues: Income after expenses, according to the appropriate accounting rules (sometimes "net income" or "profit").

Production sharing: A system where the oil produced ("profit oil") is divided between the oil company and the government after the company has recovered its costs ("cost oil").

Production sharing contract: The principal contract between a government and a private oil company setting terms for oil exploration and future production (sometimes "production sharing agreement").

Profit oil: The portion of oil production that is split between the government and company after cost oil has been deducted and allocated to the company.

Progressive fiscal regime: A set of tax terms that allows the government to capture a larger share of revenues for more profitable projects.

Reference pricing: Establishing a commodity price that is not based on the invoice price but rather on an international benchmark price, often with a formula for discounts or premiums (sometimes "norm" or "benchmark" pricing).

Ring fencing: Establishing an economic perimeter around a project, often at the level of the contract or concession, so that the company cannot offset the income inside the fenced area with losses from other projects outside the fenced area.

Royalty: A fiscal tool commonly applied to resource extraction, often based on the value of the commodity extracted.

Shell company: A corporate entity that serves as a vehicle for business transactions and has no physical office or employees (sometimes "mailbox company").

Stabilization clause: A contractual provision assuring investors (and their lenders) of the durability of the initial terms, particularly related to taxation.

Tax avoidance: The legal practice of seeking to minimize a tax bill by taking advantage of a loophole or exception to the rules, or adopting an unintended interpretation of the tax code.

Tax base: The revenue against which tax rates are applied, or the method of calculation set out in contract or tax laws.

Tax evasion: The illegal non-payment or under-payment of taxes, usually by deliberately making a false declaration or no declaration to tax authorities, declaring less income than actually earned, or overstating deductions (sometimes "tax fraud").

Tax exemptions: The waiving of specific taxes that would normally apply, such as a value-added tax or customs and excise duties.

Tax havens: Jurisdictions that attract economic activity to their territory by applying no or minimal taxes. They are often also secrecy jurisdictions.

Tax holiday: An incentive designed to stimulate investment that reduces or eliminates corporate taxation for a defined period of time.

Thin capitalization: The financing of an extractive sector project through a high level of debt, with financing often provided by an affiliated company at high interest rates.

Transfer mispricing: The abusive manipulation of transfer prices, where affiliated companies transfer goods or services between themselves at non-market prices.

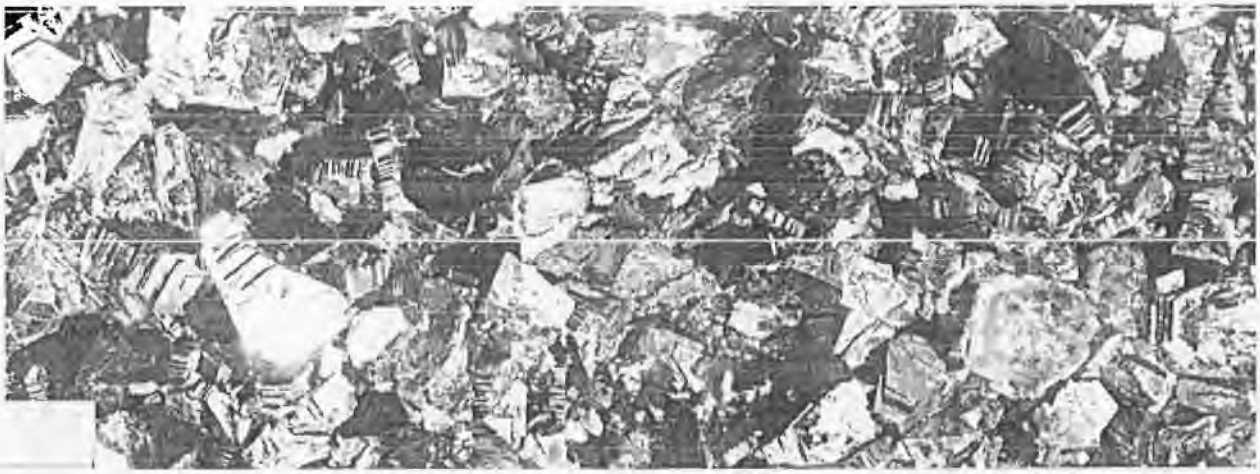
Treaty shopping: The establishment of a legal entity in a specific country in order to obtain the benefits of that country's double taxation treaty.

Windfall tax: An additional tax (e.g. resource rent tax) designed to allow the government to capture a larger share of revenue for highly profitable projects.

Withholding tax: A tax levied on payments to non-residents, often applied to payments to non-resident subcontractors as well as to foreign interest and dividend payments.

Tax exemptions:

The waiving of specific taxes that would normally apply, such as a value-added tax or customs and excise duties.



Introduction

Resource-rich developed and developing countries often fail to secure a fair share of their natural resource wealth. The concern that multinational companies in general are not paying the taxes that they should is hardly surprising. Since the financial crisis there has been outrage in both rich and poor countries that companies from across many sectors are employing ever-more aggressive tax avoidance strategies in order to maximize profits.[1] Revenue loss from the extractive sector, however, is particularly important given the number of countries that depend on natural resource revenues for a substantial portion of their annual budgets.

It is impossible to quantify the scale of extractive sector revenue loss. Research on illicit financial flows in Africa has concluded that the main source of government revenue loss is neither smuggling nor corruption but rather company tax avoidance.[2] The scale of potential loss seems to be in the billions of dollars each year, though there are significant limits to the methodologies being employed.[3]

Concern over tax leakage has resulted in a flurry of international activity in recent years. The Organisation for Economic Co-operation and Development (OECD) launched a major initiative to combat what it terms "base erosion and profit shifting" (BEPS). Several OECD initiatives have been directly focused on extractives, including policy dialogues on natural resource-based development and a dedicated project on mineral pricing.[4] The United Nations (UN) Tax Committee has mobilized around similar issues, with a strong emphasis on the concerns of developing countries in the context of "Financing for Development,"[5] including specific work on the extractive industries.[6] Other developments include a new joint International Monetary Fund (IMF)/World Bank Group initiative on strengthening tax systems in developing countries.

Risks to government extractive sector revenues have also been a prominent part of the Canadian political landscape. There have been Parliamentary hearings on tax evasion,[7] a private member's bill seeking to close tax loopholes,[8] and commitments by the Liberal party to reverse cuts to the Canada Revenue Agency (CRA) and crack down on tax haven abuse.[9] Concerns have been exacerbated due to the commodity downturn and its impact on provincial budgets, particularly in Alberta and Newfoundland. Specific examples have also become part of the public debate, including the CRA's reassessment of Cameco and Silver Wheaton[10] (See **Textbox 2** and **Textbox 7**) and reporting on marginal revenues from the diamond sector in Ontario.[11]

Analyzing Disclosure Data

Great progress has been made over the past 15 years in bringing transparency to what have historically been highly secretive industries.[12] Revenue payment data is now publicly available for nearly 50 countries participating in the Extractive Industries Transparency Initiative (EITI). That data will become even more useful following the decision to require project-by-project reporting for all EITI countries.[13] Long-standing advocacy efforts to require extractive companies to report on their payments to government have taken a step backwards in the United States but are now bearing fruit in the European Union, Norway and Canada. For example, Canada expects over 700 companies to report payments to governments in over 100 countries by the end of 2017.

There is growing concern, however, that we are entering a period with lots of transparency but little accountability. Transparency alone can be a deterrent to corruption. For greater transparency to translate into increased extractive sector revenues the data must be analyzed and that analysis must be used.

The growing volume of available data represents both an opportunity and a challenge. Large volumes of high-quality data make it possible to identify and analyze trends across regions, countries and sectors. At the same time, when seeking to better understand what taxes ought to be paid, and whether the level of this taxation is fair for host countries, it can be hard to know where to start. Looking for revenue loss in the midst of the available disclosure data can be like looking for a needle in a haystack.

There are many potential mechanisms through which companies seek to reduce their payments to governments. But the pathways to revenue loss are not unlimited. There are clear patterns to how companies reduce payments to governments. Knowing what to look for can help those seeking to conduct more effective data analysis. This paper sets out a revenue risk assessment framework, mapping the main pathways through which governments lose extractive sector revenues.[14]

Target **Audience**

This revenue risk assessment framework is designed to be used by government officials who have responsibility for petroleum and mining projects. It is also relevant for those outside government who have a role in strengthening revenue accountability, including parliamentarians, civil society organizations and journalists. Despite progress in recent years to build capacity among these groups to conduct revenue analysis, capacity remains uneven.

Within governments there is frequently a gap between those who understand the sector but are primarily concerned with attracting inwards investment and moving projects forward, and those with mandates for revenue generation who are often excluded from early contract negotiations and sometimes lack the sector expertise necessary to anticipate the full range of revenue-related risks. Defending a government's revenue interests requires both the capacity and willingness to confront companies. The American state of Alaska, for example, has spent hundreds of millions of dollars in litigation in order to recover billions in lost government revenue (See **Textbox 11: Securing the Government Take in Alaska**).[15]

For actors outside of government, there is a tendency to focus on high-profile risks that are easy to analyze and for which data is relatively easily available. The result is often greater attention to royalties (a small, though important, source of government revenue) than corporate income tax (the main source of revenue for many extractive projects).

A comprehensive approach to revenue risk assessment is needed. The full range of pathways to government revenue loss should be considered before deciding which risks are most relevant to a particular sector, company or project.

Despite progress in recent years to build capacity among parliamentarians, civil society organizations and journalists to conduct revenue analysis, capacity remains uneven.

Methodology and Structure

This report is based on a comprehensive review of public domain information on risks to government revenue from the extractive sector.[16] It draws from material on fiscal regime design for the extractive industries,[17] on the challenges of tax administration,[18] and on recent guidance on managing transfer mispricing risk in the mining sector.[19]

The analysis is grounded in the experiences of resource-rich countries and their legal and institutional responses to try to stem revenue loss. Given the scale of the alleged abuses it is perhaps surprising that it is difficult to find clear examples of companies making use of the various pathways to government revenue loss in the public domain. Considerable effort has been devoted, therefore, to identifying real-world case studies to illustrate the specific nature of the risks in a more concrete way.

The analysis is grounded in the experiences of resource-rich countries and their legal and institutional responses to try to stem revenue loss.

Several of the case studies were prepared specifically for this study. Many of the case studies come from Resources for Development Consulting's extensive database of extractive sector tax avoidance cases. Real-world examples are drawn from both petroleum and mining sectors, and from various commodities within those categories. They are also drawn from a broad range of both developed and developing countries, including Australia, Canada, Chile, Indonesia, Mongolia, Mozambique, Sierra Leone, Tanzania, Timor-Leste, Trinidad, Uganda and the United States.

The study begins with a framework chapter that introduces a series of key concepts, including the main fiscal instruments through which governments generate revenue from the extractive industries, the important distinction between tax rates and the tax base against which those rates are applied, and the role of subsidiaries in low-tax jurisdictions in the corporate structures of multinational extractive sector companies. It introduces a four-part framework for analyzing revenue risks: two related to tax rates (contract terms and treaty shopping) and two related to the tax base (under-reporting revenues and over-reporting costs). The remainder of the report comprises sections examining each of these four risks in detail.

A Framework for Assessing Revenue Risks

Securing a fair share of government revenue from extractive sector projects is a two-step process: establishing a fair tax *rate* for the project at the outset, and then protecting the tax *base* over the lifespan of the operation. Shortcomings on either front can result in significant loss of government revenue.[20]

Building on the basic distinction between tax rates and the tax base, the table below provides a framework for considering the various ways in which extractive sector revenue can be lost (See **Textbox 1: Revenue Risk Framework and Case Studies**).

Textbox 1:
Revenue Risk Framework and Case Studies

		Risks to Revenues	Examples
Tax Rates	TAX BREAKS	**Tax Incentives** • Accelerated depreciation **Tax Holidays** • Corporate tax exemptions	**Peru Mining:** Accelerated depreciation **Mali Mining:** Corporate tax exemptions
Tax Rates	TREATY SHOPPING	**Withholding Taxes** • Dividend payments • Interest payments **Capital Gains Tax**	**Turquoise Hill** (Mongolia / Netherlands) **Heritage Oil** (Uganda / Mauritius)
Tax Base	UNDER-REPORTED PROJECT REVENUES	**Production Volumes** • Under-reporting production • Non-reporting of by-products	**Congo Brazzaville:** Diamond smuggling **Chile:** Tax avoidance on tailings production
Tax Base	UNDER-REPORTED PROJECT REVENUES	**Sale Price** • Intra-firm sales agreements • Excessive marketing fees • Forward sales / price hedging	**Uranium Sales:** Cameco (Canada) **Natural Gas:** Mozambique South Africa **Iron Ore Sales:** Sierra Leone **Marketing Hubs:** Australia / Singapore
Tax Base	OVER-REPORTED PROJECT COSTS	**Ineligible Costs** • Falsified or duplicate invoices **Misallocated Costs** **Inflated Goods and Services** • Over-priced used machinery • Transport (rail, ports, pipelines) • Management fees	**Chile Mining Company:** False invoices **Indonesia:** Cost recovery abandoned due to abuse **Timor-Leste:** Cost claims against producing block **Alaska:** Inflated pipeline and shipping costs **Tanzania:** Inflated costs in the mining sector
Tax Base	OVER-REPORTED PROJECT COSTS	**Debt Financing** • Thin capitalization • Abusive interest rates	**Chile:** Mining company debt financing **Chevron Australia:** Financing costs disallowed

Resources for Development Consulting (2016)

Establishing the **Tax Rate**

Once the contract is signed establishing the basic tax rate, it is difficult for governments to make changes.

The tax terms that should determine the proportion of extractive sector project revenue allocated to the government are normally set out in both project-specific contracts (host country agreements) as well as national tax and investment laws and regulations. The sources of government revenue from extractive sector projects are often different than for normal businesses. In the mining sector, the mix of fiscal instruments commonly includes royalty payments and corporate income tax (and increasingly a windfall or "resource rent" tax), while in the petroleum sector a production sharing system is common, sometimes in combination with a royalty payment and/or corporate income tax.

There are often concerns that governments have negotiated bad deals that will see the bulk of project profits go to foreign companies. In some cases these deals appear to be the result of corruption, but in many cases they are likely the result of the profound asymmetry of expertise between multinational companies and relatively inexperienced government officials.

It is common for governments to offer investment incentives or tax holidays in order to encourage companies to explore and produce. In some cases tax holidays reduce or even eliminate corporate income tax. Once the contract is signed establishing the basic tax rate, it is difficult for governments to make changes. Extractive sector contracts normally contain stabilization clauses that provide protection for the investor from changes to the fiscal terms.

Companies often seek to expand the set of tax breaks that apply to their project by taking advantage of double taxation agreements through a process known as treaty shopping. By creating subsidiaries in jurisdictions like the Netherlands or Mauritius, companies can reduce or even eliminate a range of taxes, including withholding taxes on the repatriation of interest and dividend payments, management fees and capital gains on the sale of resource rights.

Defending the Tax Base

The tax rate described above determines the categories of tax and the corresponding percentages that should be paid to the government. These so-called "headline terms" tend to attract the bulk of the attention in comparisons of fiscal regimes. For example, an analysis of mining taxes commonly compares royalty rates in percentage terms. While headline tax terms are important, it is at least as important to evaluate the tax base against which those rates will be applied. For example, a five percent royalty only becomes meaningful when applied against the value of actual commodity sales. Similarly, a 30 percent corporate income tax only becomes meaningful when applied against company net (after-cost) income.

There are two basic paths through which the tax base can be eroded. First, gross revenues can be under-reported. This can be done either by reporting less production than has actually taken place or by reporting a sale price below the fair market value. The second path to tax base erosion is the inflation of project costs. Because the bulk of government revenue normally comes from profit-based taxes – that is taxes that are assessed on net (after-cost) income – inflated costs can significantly reduce the tax base.

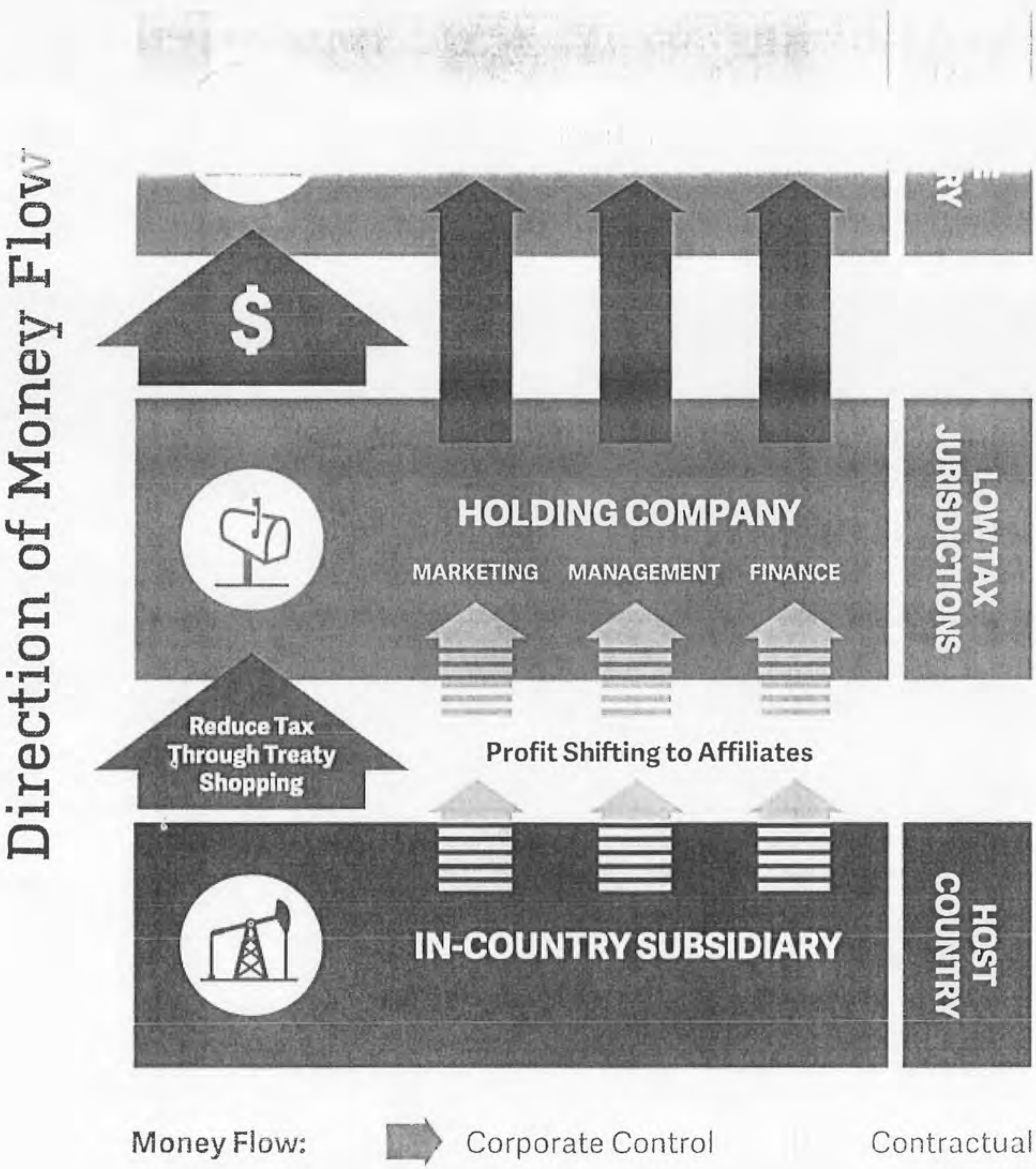
Protecting the tax base is challenging given the relatively high effective tax rate in the extractive sector.[21] The overall tax take in producing countries is normally much higher for parent companies incorporated in OECD jurisdictions where the main tax liability would be corporate income tax, with rates often around 25 to 30 percent, than those in tax havens, where income taxes are extremely low or waived entirely.

The difference between the tax rates in different jurisdictions creates major incentives for companies to minimize the tax base by both shifting <u>profits out</u> of high tax jurisdictions and shifting <u>costs into</u> high tax jurisdictions. By doing this, companies minimize the tax payments that they will be required to make in either home or host countries, while maximizing the profits shifted to zero or low-tax jurisdictions.

The ability to move revenues and costs between jurisdictions is based on the complex corporate structures adopted by multinational corporations.[22] As shown in Figure 1, parent companies often use conduit companies – subsidiaries incorporated in tax havens or other low tax jurisdictions[23] (See **Textbox 2: Silver Wheaton Repatriates Unreported Income from Cayman Subsidiary**[24]). The parent company may have affiliates that are involved in purchasing commodities, providing contractor services, and/or providing management services and financing.

Figure 1:

Using Subsidiaries to Reduce Taxes



Textbox 2:

Silver Wheaton Repatriates Unreported Income from Cayman Subsidiary[24]

Silver Wheaton Corporation is a precious metal streaming company incorporated in Ontario, headquartered in Vancouver and listed on the Toronto Stock Exchange and the New York Stock Exchange. The company provides financing to mining companies in return for future delivery of silver and gold production at pre-established prices: a process known as "streaming." Financing and purchase/sale of the streams is undertaken through the wholly owned subsidiary Silver Wheaton (Caymans) Ltd.

Silver Wheaton (Caymans) Ltd. pays no corporate income tax in the Cayman Islands. Silver Wheaton took the position that this subsidiary was a separate entity and that income generated in the Cayman Islands need not be reported in Canada, even though company executives and most employees were in Canada and all major corporate decisions were made in Canada.

In September 2015, the CRA did a 2005-2010 reassessment based on transfer pricing regulations, indicating "the income of Silver Wheaton subject to tax in Canada should be increased to *substantially all of the income earned outside of Canada by the Company's foreign subsidiaries.*" Unreported income of $715 million CAD would result in a $207 million CAD tax bill, combined with a $72 million CAD transfer-pricing penalty and $80 million in interest and other penalties. The company is appealing. CRA audits continue for 2011-2013 and are likely for 2014-15. It is expected that reassessments for these years could amount to $416 million CAD.

Tax Breaks and Government Revenue

In some countries, natural resource extraction is undertaken by state-owned enterprises. In most countries, however, private companies are involved either as partners with state-owned companies or acting independently. The challenge for governments is how to ensure that they maximize government revenue even while encouraging inward investment by private companies.

Taxing the Extractive Sector

The fiscal regime or framework determines both the government's share of the revenue and the timelines for revenue coming on stream (See **Textbox 3: Benchmarks for Assessing a "Good Deal"**). This framework is set out either in national legislation, or more commonly in project-specific contracts. Fiscal frameworks evolve over time, but normally the terms agreed at the outset govern the project through its full lifecycle. There are many similarities, but also important differences, between government revenue generation in the mineral and petroleum sectors.[25]

The extractive industries are fundamentally different than other sectors of the economy due to the scale of upfront investment required (frequently measured in the billions of dollars), the timelines of the projects (often 25 years or more) and the potential for super-profits when commodity prices spike. As a result, taxation of the extractive industries is also different from other sectors of the economy.

First, it is common for countries to offer exemptions from some taxes, including value-added taxes, customs duties and excise taxes. Second, it is common for countries to supplement the standard corporate income tax with resource-specific taxes, including royalties and windfall (resource rent) taxes. Some countries use a royalty tax system for both the mining and petroleum sectors, but many countries have chosen to use a production sharing system for their petroleum sectors.

Production-based taxes: Production taxes or royalties are payments based on the quantity of the resources extracted.[26] There are several different ways in which royalties are assessed, including the volume of the commodity produced (e.g. a price per ton) and the value of production (e.g. a percentage of the market price). In some cases, the royalty rate is linked to the price of the commodity. Some countries also use profit-based royalties, though they function more like an additional corporate income tax. In most cases, the royalty is paid from the time that commercial production begins. Traditionally, production taxes were seen as compensation for the depletion of a non-renewable asset. Royalties are now more commonly seen as a political necessity, guaranteeing at least some government revenue in the early years of production before income tax payments begin.

Profit-based taxes: Income taxes are "profit-based," meaning they are assessed on project income after deducting project costs. The percentage at which the rate is assessed may be less important than the rules governing the calculation of the income against which it will be applied. Income tax should represent the majority of the government take over the lifetime of a mine, but may be delayed as companies recover the costs of their investments.[27] Increasingly, countries are putting in place "resource-rent taxes" that complement basic income tax by applying a higher percentage tax to windfall profits.

Petroleum production sharing: The production sharing system, first developed by Indonesia in the 1960s, has become the most common approach to petroleum development amongst developing countries. As the name suggest, the main source of government revenue is a share of the petroleum produced. It is based on a two-step process. First, production is allocated to the company for the recovery of costs. Second, the remaining production is split between the company and the government, normally on the basis of a sliding scale responding to volumes of production or profitability. As the government's share comes after costs have been recovered, it functions somewhat like a profit-based tax.[28] Many governments have supplemented the production sharing system with a royalty and corporate income tax.

Textbox 3:

Benchmarks for Assessing a "Good Deal"

Four benchmarks provide a useful starting point for assessing whether a government negotiated a good deal in return for the depletion of its non-renewable resources.

Take: The government take is the share of divisible (after-cost) revenue allocated to the government over the life cycle of the project.

Timing: As companies can normally recover their investments quickly, the bulk of government revenue comes later in the project life cycle. Fiscal regimes that are "rear loaded" may generate little government revenue for five to 10 years.

Progressivity: The government's share of net benefits should increase for more profitable projects. Adding some kind of "windfall" tax can make the overall fiscal regime "progressive." As many fiscal regimes do not have a progressive tax, the government would not capture a higher share when commodity prices skyrocket, when the grade is particularly high, or when production costs are particularly low.

Administration: Fiscal regimes are often designed to be economically efficient – finding an ideal balance between investor and government interests – with little attention given to their application in practice. From the outset, fiscal regimes should be developed to minimize vulnerability to company tax avoidance strategies and to work within the capacity of government tax authorities.

Revenue Risks in Extractive Contracts

When considering whether the government is securing a fair share of extractive sector wealth, the initial focus is on the fiscal terms negotiated for the project. In some cases, the lack of government revenue from profitable projects has nothing to do with company tax avoidance. It is the result of generous contractual terms and investment incentives.

Tax holidays are an obvious example. During the 1990s, particularly in Africa, it was common for governments to reduce or even waive the application of corporate income tax for a defined period from the start of the project. There are many cases that could be cited. In Mali, for example, contracts signed in the 1990s commonly included a provision indicating that no corporate income tax (the main source of government revenue) would be paid for the first five years.[29] The IMF has repeatedly warned that tax competition was resulting in a "race to the bottom."[30] Tax holidays obviously reduce government revenue. They also create incentives for companies to exploit the resource quickly but inefficiently (a process known as high grading) and can complicate tax administration where multiple projects have differing tax rates applying over different periods.

Textbox 4: Accelerated Depreciation in Peru[31]

In Peru, little income tax was paid by the mining sector throughout the 1990s. By the end of the 1990s combined income taxes from mining were less than $100 million per year, amounting to about seven percent of government revenues. As the benefits to companies from accelerated depreciation gradually declined, and as metal prices increased, government revenues rose substantially. Between 2000 and 2006, the annual income tax revenue from mining companies rose from $70 million to $1.8 billion, accounting for more than 40 percent of total government revenue.

How quickly companies are allowed to recover their capital costs is another investment incentive that can have a significant impact on the timing of government revenue.

Normally, for tax purposes, capital costs are "depreciated." This means that only a portion of the initial capital costs can be claimed in the calculation of taxable income in any single year. Extractive sector projects, however, are known to be particularly capital intensive. Given the scale of the upfront costs, it is normal for companies to be allowed to recoup these costs rapidly. This provision is known as "accelerated depreciation." Due to accelerated depreciation, it is not uncommon for companies to pay no income tax at all during the first five to 10 years of production, even when projects are very profitable (See **Textbox 4: Accelerated Depreciation in Peru**[31]).

While depreciation terms should be more generous for extractive sector projects, in a number of cases countries place no restrictions at all on the timeframe for claiming capital expenses.[32] Accelerated depreciation delays the onset of profit-based taxes early in the project lifecycle. It can also reduce or even eliminate profit-based tax payments immediately following large capital investments during project expansion, resulting in a short-term collapse of government revenues.[33]

Tax Planning, Avoidance or Evasion?

Tax planning reduces taxes in ways that are consistent with the letter and spirit of the law.

Tax avoidance, sometimes referred to as **aggressive tax planning**, reduces taxes in ways that are inconsistent with the overall spirit of the law. Tax avoidance is based on activities undertaken before the occurrence of a tax liability.

Tax evasion is a criminal act and can also be called **tax fraud**. It often involves making a false declaration to tax authorities declaring less income than actually earned, or overstating deductions. Tax evasion is based on activities undertaken after a tax liability has arisen.

As the defining line between avoidance and evasion is often unclear, this report uses the general term tax avoidance to cover the range of practices that fall outside the spirit of the law, including those that are illegal.

Negotiation and Renegotiation

Significant efforts are being made to strengthen the capacity of government negotiators, including the development of draft contract language (e.g. the International Bar Association's Model Mining Development Agreement[34]) and the provision of direct negotiation support (e.g. African Legal Support Facility or the World Bank's Extractive Industries Technical Advisory Facility). Recognizing that it is hard to anticipate all eventualities, it is also prudent to write time-bound review provisions into contracts.

Extractive sector contracts commonly contain stabilization provisions stating that the basic economic position of the company, as set out in the original contract, should be retained. International best practice suggests avoiding, or at least significantly limiting, stabilization provisions. Too often in the past, stabilization has provided one-way benefits. Companies have secured guarantees that their economic position will not be undermined while at the same time ensuring that they can benefit from any future changes. If stabilization is to be included, it should apply to only specific fiscal terms and should be time-bound. In some countries, stabilization is offered only in return for an increase in royalty or income tax rates.

Where broad stabilization clauses exist, there is strong pressure on governments to respect the sanctity of the original terms, not only from companies but also from international actors such as the World Bank and the IMF. Nevertheless, when circumstances fundamentally change renegotiation is not only reasonable, it may be unavoidable. In fact, as oil prices rose through the 2000s, many petroleum-producing countries in both the developed and developing world renegotiated their contracts.[35] When managed badly, renegotiation can undermine credibility and make future investors wary. Conversely, for projects that offer potentially game-changing government revenues, the risks of maintaining overly generous contracts could well exceed the risks of over-riding stabilization provisions.[36]

Treaty Shopping to Expand Tax Exemptions

Some taxes that would apply to an extractive sector project can be minimized or even eliminated in cases where double taxation agreements (DTAs) apply. These bilateral treaties have been put in place over past decades in order for companies to avoid being taxed twice on the same income – once in the country where the income is earned and again in their "home" jurisdiction.[37] Increasingly, however, there is concern that treaties designed to avoid double taxation are resulting in companies paying little or no tax.

Countries sign DTAs in the hope that offering tax concessions to specific trading partners will encourage greater foreign direct investment. Common provisions in DTAs include reductions or exemptions in both withholding taxes and capital gains taxes. Withholding taxes are imposed when funds are transferred from a resident company to a non-resident company. Examples can include a withholding tax on management fees and interest and dividend payments. In addition to being a source of government revenue, withholding taxes can also reduce the incentive for some forms of profit shifting. Capital gains taxes are sometimes imposed when rights to a project, or a stake in a project, are sold. DTAs also normally contain provisions on the exchange of tax information.[38]

Whether a country benefits from a DTA depends on whether it generates sufficient additional Foreign Direct Investment (FDI) inflows to offset the revenue loss due to these reductions and exemptions. Developing countries have commonly entered into DTAs without careful analysis, often more as a political gesture than a matter of careful tax policy.[39]

Revenue Loss From Treaty Shopping

Multinational corporations frequently create "conduit" or "mailbox" companies in a specific jurisdiction in order to obtain treaty benefits that would not be available directly – a practice known as "treaty shopping." In the absence of restrictions,"a treaty with one country becomes a treaty with the rest of the world."[40]

The Netherlands, home of the world's first corporation (the Dutch East India Company) is a highly attractive location for multinationals to establish subsidiaries. Having concluded tax treaties with more than 90 countries, routing money through a subsidiary in the Netherlands allows companies to minimize withholding taxes on interest and dividends.[41]

The Netherlands' role in corporate tax avoidance strategies has attracted significant attention in recent years. Mongolia and Malawi have both cancelled tax treaties with the Netherlands due to concerns over lost revenue from mining projects (See **Textbox 5: Mongolia Mining Revenues at Risk in the Netherlands**[42]).

Research has illustrated the widespread existence of mailbox subsidiaries in the Netherlands. It has also revealed how the way in which Taxation Treaty benefits are exploited works at cross-purposes to Dutch support for international development.[43] In 2016, Oxfam Novib published a report asserting that the Netherlands should be classified as a tax haven.[44] In response to external pressure, the Dutch government initiated a review of its DTAs with 23 developing countries.[45] As of June 2016, the Ministry of Finance reports that anti-abuse measures have been inserted into treaties with nine countries, with negotiations currently underway in another 11.[46]

Mauritius is another common country of concern, often for investments in Africa, as they have 16 tax treaties with African countries. Deloitte, for example, has provided detailed advice to investors on how to use Mauritius to minimize tax payments.[47]

Some governments are now clearly alert to the risks. Indonesia cancelled a DTA with Mauritius in 2004 over allegations of treaty shopping and India is currently in the process of renegotiating its tax treaty with Mauritius. The government of Uganda denied treaty benefits to Heritage Oil, for example, when it tried to use Mauritius to dodge a major capital gains tax bill following their sale of oil rights (See **Textbox 6: Heritage Creates Mauritius Subsidiary in Attempt to Avoid Ugandan Tax**[48]). Other countries, however, may not have fully assessed the potential risks. Tax Justice Network Africa, for instance, is currently fighting to stop a proposed DTA between Mauritius and Kenya.[49]

In 2012, Mongolia's Ministry of Finance conducted research into Mongolia's DTAs, comparing the benefits offered with the DTAs of peer countries [illegible] could lose billions of dollars in potential mining revenue due to a DTA signed in 2002 with the Netherlands. Under this treaty, if a Dutch company invests in Mongolia it is entitled to pay dividends back to the Netherlands free of the normal 20 percent Mongolian withholding tax.

The focus of the analysis was a company called Turquoise Hill Resources, which developed the Oyu Tolgoi mine, the country's largest mining project. Although the parent company is Canadian, it has a subsidiary in the Netherlands (Oyu Tolgoi Netherlands BV) that allowed it to benefit from the Netherlands' DTA with Mongolia. While Turquoise Hill was the focus of the study, it was not alone. According to the Mongolian authorities, almost 70 percent of all foreign direct investment was coming through the Netherlands, and thus utilizing the DTA Mongolia signed with the Netherlands as a tax shield.

In November 2012, Mongolia terminated the DTA with the Netherlands effective 1 January 2014. Ultimately, however, ending the agreement with the Netherlands will not impact Turquoise Hill or the Oyu Tolgoi mine. A stabilization clause in the 2009 contract means that the tax terms in place when the contract was signed, including the provisions of DTAs, will remain in place for 30 years.

Stopping Treaty Shopping

The nature of the abuse seems obvious: companies create subsidiaries with the sole intent of securing treaty benefits that would otherwise be unavailable to them. However, denying treaty benefits even where the tax avoidance rationale is transparent has proven to be difficult. Uganda ultimately succeeded in securing a capital gains tax payment from Heritage Oil (See **Textbox 6: Heritage Creates Mauritius Subsidiary in Attempt to Avoid Ugandan Tax**) but there are relatively few examples where countries contest treaty shopping and, of those, many are lost in court.[50] For example, the Indian Supreme Court, in a case where OECD companies were using mailbox subsidiaries to benefit from the India-Mauritius DTA, ruled that treaty shopping was lawful in the absence of a specific anti-abuse provision.[51]

Canada is another good example of the challenges of successfully denying treaty benefits. The CRA has lost several cases, even though the evidence clearly demonstrates that the conduit company has been created with the sole purpose of securing tax reductions through treaty benefits.[52] Canadian courts have indicated that treaty shopping to minimize tax, on its own, is not illegal.[53]

Trinidad and Tobago provides a clear example of the challenges of treaty shopping for a resource rich country. Petroleum companies producing in Trinidad and Tobago with headquarters in the United States and Canada have established subsidiaries in neighbouring countries covered by the Caribbean Community (CARICOM) Tax Treaty (e.g. Barbados, Saint Kitts and Nevis), thereby avoiding withholding tax on both dividends and interest. As a result, Trinidad loses an estimated $200 million per year. The government has been fighting these exemptions in the courts since 2005 without any successful resolution.[54]

The OECD initiative on base erosion and profit shifting (BEPS) recognized the abuse of DTAs as a significant source of lost government revenue. It suggested the adoption of a "principal purpose test" where "the benefits of a double taxation convention should not be available where a main purpose for entering into certain transactions or arrangements was to secure a more favourable tax position."[55]

The principal purpose test has been adopted by the Netherlands in its DTA renegotiations. Revised treaties negotiated with Malawi and Zambia, for example, state that "No relief shall be available under this Article if it was *the main purpose or one of the main purposes* [...] to take advantage of this Article."[56] It remains to be seen, however, whether this "principal purpose" test would deny treaty benefits to extractive sector companies that will undoubtedly argue that their Dutch subsidiaries were created for reasons other than to minimize withholding taxes.

Denying treaty benefits even where the tax avoidance rationale is transparent has proven to be difficult.

Heritage Oil Corporation was a Canadian corporation (Alberta) that managed its global operations through subsidiaries in Barbados [illegible] secondary listing on the TSX. That same year, it moved its corporate headquarters from Calgary to the tax haven of Jersey.

On 27 July 2010, Heritage completed the sale of its stake in Uganda's Lake Albert fields to Tullow Uganda Limited (Isle of Man) for $1.45 billion. During the negotiations in advance of the sale, Heritage was worried about the imposition of a 30 percent capital gains tax on the transaction. Documents leaked as part of the Panama Papers reveal that in addition to pressing the government not to impose the tax, the company re-domiciled from the tax haven of the Bahamas that did not have a double taxation treaty with Uganda, to the tax haven of Mauritius, which did. Heritage Oil and Gas Limited was incorporated in Mauritius on 15 March 2010.

The Government of Uganda imposed a $404 million capital gains tax on the sale and required Heritage to deposit 30 percent of that upfront. A series of legal battles followed. Heritage initially offered to pay $36 million that they later increased to $120 million. The Ugandan Tax Appeals Tribunal rejected Heritage's claim that the double taxation treaty with Mauritius should shield them from the capital gains tax. In the meantime, Tullow was forced to pay the remaining tax owing in order to move the project forward. It then successfully sued Heritage in London to recover the funds.

Under-Reporting Project Revenue

When assessing the fiscal terms that govern extractive projects, there is a common tendency to focus on the main fiscal terms: the percentage rates for the payment of royalties and income tax, or the government's share of post-cost production. This is particularly the case in countries where there is a widespread belief that the government is not reaping adequate rewards in the face of the depletion of their non-renewable assets. In such circumstances, there is often a call to redesign the fiscal system and even renegotiate the terms of existing contracts. A good example of this is the series of fiscal changes in Zambia that have been implemented, and subsequently revoked.[57] However, in many cases where government revenues are not meeting expectations, the reason is not the percentage rates associated with the main fiscal terms but rather the tax base against which those rates are applied.

The starting point in protecting the tax base is to ensure accurate reporting of the components that comprise overall project revenue: the quantity and quality of the commodity produced and the resulting market value. Under-reporting gross project revenue results in a reduction of all the main government revenue streams. Production-based taxes such as royalties are reduced, where they are a percentage of the sale value. Profit-based taxes – including corporate income tax, resource rent taxes and petroleum production sharing – are reduced because taxable income falls while costs remain unchanged (See Annex 1).

Any assessment of the tax base must start with the volume of resources actually produced. This is more difficult than it sounds.

Alluvial production, including gemstones and gold, is vulnerable to under-reporting, particularly in the artisanal and small-scale mining sectors. In many cases these commodities are simply smuggled out of the country, resulting in no reported income at all. In the early 2000s, for example, Congo-Brazzaville was a significant exporter of diamonds. According to the Democratic Republic of Congo (DRC), most of the diamonds came from the DRC and were being smuggled into neighbouring Congo-Brazzaville in order to take advantage of lower export taxes (two percent versus three percent in the surrounding countries). More importantly, Brazzaville made no effort to accurately value the diamonds, allowing the export tax to be imposed on a fraction of their true value. A Kimberley Process review mission concluded that Brazzaville produced few, if any, of its own diamonds, and the country was temporarily excluded from the certification scheme. The following year, DRC diamond exports increased by more than 65 percent.[58]

Even in large-scale production, there is a risk that production volumes are not accurately reported. For example, a recent report by the OECD on risks associated with assessing the value of mineral production notes that "companies may engage in straight tax evasion by misreporting the value of product shipments they are making."[59] One particular area of concern is the non-reporting of valuable mineral by-products. Copper concentrate, for example, commonly contains gold, silver, nickel and cobalt that are separated at the smelting stage. To illustrate the potential revenue risk, the OECD report offers a scenario of a copper-producing developing country exporting $1.9 billion copper concentrate, including $120 million in gold. In this specific scenario, undervaluing the copper by 10 percent and failing to report the gold contained in the concentrate results in the loss of around $40 million in annual government revenue.[60]

Determination of the volume of petroleum produced is easier than for most minerals as the methodologies for measurement are widely accepted. Nevertheless, careful government monitoring is essential. The Norwegian government, for example, employs five individuals to ensure the accurate metering of petroleum production and export. The Norwegian Petroleum Directorate notes "even small deviations in the volume of production can have a significant impact on government revenues." In their example, an error of just 0.35 percent at one of their metering stations would amount to a loss of four million NOK (US$660,000).[61] In the United States, the Government Accountability Office noted that while oil and gas produced from federal leases generated over $6.5 billion in government revenue, the "Department of the Interior's measurement regulations and policies do not provide reasonable assurance that oil and gas are accurately measured."[62]

Ensuring fair taxation depends not only on tracking the volumes produced, but also that they are applied against each relevant fiscal instrument. Chile, for example, imposes a special mining tax (IEAM) on the sale value of the minerals produced after deducting direct costs and expenses. Some companies were paying this tax only on minerals extracted from the mine itself, but not on minerals produced from old tailings. The discrepancy was uncovered during an audit. The companies defended their position, claiming that the IEAM applied only to new production. The tax authority, however, claimed that the mining code was clear that "extraction" applied to production from the tailings as well, a position ultimately accepted by the country's Supreme Court.[63]

The solution to protecting government revenues from under-reporting of production is effective monitoring of both the quantity and quality of the natural resources extracted and exported. Although this may seem obvious, in many jurisdictions reporting on production is based on self-assessment and there is little government oversight. Tanzania only began tracking the quantity and quality of mineral production with the creation of the Tanzania Mineral Audit Agency, while Zambia has recently launched a project to independently monitor copper production.[64]

Any assessment of the tax base must start with the volume of resources actually produced.

Even where the quantity and quality of production is accurately reported, under-reporting sale value can erode the tax base. There are many ways in which the value of the commodity can be under-reported, most of which involve selling the commodity to an affiliated company involved in trading, marketing or processing.

Long-term sales agreements provide a degree of revenue predictability and are often necessary to secure project financing. However, they also present significant risks to government revenues. In some cases, they may allow for generous deductions. In other cases, they may contain formulas for setting the price that fall well below the market value.

The risk that minerals are being undervalued was raised repeatedly by mineral exporting countries and Civil Society Organizations (CSOs) as part of the OECD BEPS initiative.[65]

According to a recent OECD report,"One relatively straightforward form of base erosion is for MNEs [multinational enterprises] to sell mineral products to a related entity abroad at prices below equivalent sales to unrelated parties, thereby moving sales revenue and profits offshore, to take advantage of lower tax rates abroad."[66] For example, Cameco, a Canadian uranium mining company, signed a long-term sales agreement with an affiliated company based in a low-tax canton in Switzerland, significantly reducing its tax liabilities in Canada (**Textbox 7: Cameco Sells Cheap Uranium to Swiss Subsidiary[67]**).

Textbox 7:

Cameco Sells Cheap Uranium to Swiss Subsidiary[67]

Cameco Corporation (TSX) produces almost 20 percent of the world's uranium from mines in Saskatchewan, the US and Kazakhstan.

In 1999, Cameco established a subsidiary (Cameco Europe Limited) in the low-tax canton of Zug, Switzerland (effective tax rate of 10 percent, compared with 27 percent in Canada). Cameco then signed a contract with its Swiss subsidiary to purchase Canadian uranium at a fixed price for 17 years. The price is confidential but spot prices were US$10/lb in 1999, US$140 in 2007 and around US$40 in 2016.

The Canada Revenue Agency began reassessing Cameco in 2008 based on transfer pricing violations. They argue that the Swiss subsidiary existed only to avoid Canadian tax (it has a Board of Directors and CEO, but no employees and no office in Zug) and that no independent company would have signed such an unfavourable agreement.

The revised tax bill for 2003-2009 is reported to be $820 million CAD. Audits continue for 2010-2015 and the total tax liability could be as high as $2.2 billion CAD. Court proceedings began in early 2017.

Long-term sales agreements, particularly between affiliated companies, appear to be a feature of all commodities in both the petroleum and mining sectors. The scale of potential revenue loss, however, seems to be greater for some commodities, particularly those that do not have clear international market prices. Natural gas, for example, is hard to transport from source to market and must be transported via pipeline or liquefaction (Liquefied Natural Gas). The scale of the required capital investments means that the gas is normally sold through long-term sales agreements. A lack of attention to the terms of these agreements can cost governments billions of dollars (See **Textbox 8: Natural Gas Sales Agreements and Government Revenue Loss**[68]).

Sales agreements can also involve explicit discounts for investors. In Sierra Leone, for example, an investor discount on the sale of iron ore resulted in reduced royalty and tax payments (See **Textbox 9: Sierra Leone Iron Sold at Discount to Affiliated Company**[69]).

Larger extractive companies frequently have subsidiaries dedicated to the trading and marketing of the commodities that they produce. These subsidiaries, often created in low-tax jurisdictions, represent a significant risk for transfer mispricing. First, there is a risk that the sale price between affiliated companies does not reflect the true market value. Second, it is often difficult for producing countries to evaluate what are legitimate versus illegitimate costs involved in marketing and trading.

Some countries have taken action to minimize the revenue loss due to profit shifting through marketing hubs (See **Textbox 10: Mining Giants Profit Shift using Singapore Marketing Hub**[70]). In other cases, governments are aware of the scale of potential losses, but find it difficult to find effective remedies. In Trinidad and Tobago, for example, petroleum companies sell liquid natural gas (LNG) to their own marketing subsidiaries at about $4 per tonne below the average price of the three relevant benchmarks. Annual production amounts to more than 10 million tonnes, resulting in a potential under-reporting of gross revenues of more than $40 million. In addition, the LNG is sold to the marketing subsidiaries at a further discount of about five percent.[71] In many other countries these profit-shifting techniques go undetected.

Textbox 8:

Natural Gas Sales Agreements and Government Revenue Loss[68]

One natural gas project in Mozambique involves the South African energy giant Sasol selling gas from Mozambique to an affiliated company in South Africa. While the fiscal terms for the project are very generous, the main source of government revenue loss is the gas sales agreement. Sasol sells the gas to its affiliate in South Africa at a fraction of the value of the gas in the South African market.

In another example, Yemen signed three liquid natural gas (LNG) sales contracts in 2005 that included a price cap of $3.80/mmbtu. When Asian LNG import prices skyrocketed to more than $15/mmbtu Yemen failed to secure any additional benefits. Reports suggest that Yemen renegotiated the contracts to increase the price cap to more than $7/mmbtu, which could result in annual government revenues increasing from $300 million to $1 billion.

Similarly, Equatorial Guinea had a comparable experience in LNG sale contracts with BG. In that case, the sale price was benchmarked against the American gas market (Henry Hub), as that was the target destination. When US prices plummeted, BG began to sell the gas in Asia for around $15/mmbtu while paying tax on the US benchmarked price of around $3 and making an extra $1 billion in profit each year.

Textbox 9:

Sierra Leone Iron Sold at Discount to Affiliated Company[69]

There are many reasons why government revenues from Sierra Leone's iron mines have not met expectations. One reason is transactions between related parties. Until recently, the Tonkolili Iron Ore (SL) Ltd (Sierra Leone) was co-owned 75 percent by African Minerals Limited (UK) and 25 percent by Shandong Steel Hong Kong Resources Limited (Hong Kong). Government revenues were reduced due to an "investor discount" on the sale price of iron exported to China.

Reports suggest that through 2013 and 2014, Tonkolili ore sold at an average discount of 25 percent to the benchmark price, due in part to a $5/t investor discount for sales to Shandong Iron & Steel (Hong Kong). In 2014, Shandong had the right to purchase 6.5 million tons, accounting for nearly 50 percent of total mine production, at the discounted price. Estimates suggest that overall customer discounts resulted in $5.9 million in lost royalty payments, even though the Mines and Minerals Act of 2009 explicitly excludes discounts, commissions or deductions in the calculation of royalties.

Significant transfer mispricing risks exist where related companies are involved in both producing and refining commodities. For example, Kenmare Resources plc (Ireland) operates the Moma titanium mine in Mozambique through two Mauritius subsidiaries. One subsidiary is responsible for mining operations and was able to secure generous tax terms, including a three percent royalty on the value of minerals sold and a 50 percent reduction in corporate income tax over the first 10 years of production. The second subsidiary is responsible for processing and operates under export promotion tax terms with no taxes assessed during the first six years and a one percent tax on turnover thereafter.[72] There is, therefore, a very strong incentive for Kenmare Mining to reduce the tax it pays by selling at below market price to Kenmare Processing.[73] While the tax authorities are aware of the risk, it is difficult to determine what an arm's length transfer price would be for the titanium ore before processing.

The examples offered above provide only a sample of the ways in which transactions between affiliated companies can lead to under-reporting of project revenues. There are many more. For commodities that depend on significant transportation infrastructure (e.g. railways and ports or pipelines), royalties and taxes are often calculated after deducting transportation costs. If affiliated companies own the transportation infrastructure they have a strong incentive to shift profits from the producing company (high tax rate) to the transportation company (low tax rate).

Company pricing structures can also be used for profit shifting. In order to manage price volatility, companies often engage in forward sales (also known as hedging) where they sell future production at a predetermined price. For sales between affiliated companies, however, it can be difficult for the government to distinguish between contracts designed to manage risk compared to contracts designed to minimize tax.[74] One solution is to "quarantine" all hedging efforts so that hedging losses can only be offset against hedging gains, and not against overall project revenues.[75]

Textbox **10:**

Mining Giants Profit Shift Using Singapore Marketing Hub[70]

Mining giants BHP Billiton and Rio Tinto both have marketing hubs based in Singapore – a jurisdiction identified by both the International Monetary Fund and the United States as a tax haven. The difference in tax rates creates a strong incentive to shift profits. According to Rio Tinto, the tax rate in Australia (including royalties) can be as high as 57 percent, while the tax rate in Singapore is no more than five percent and may be as low as zero.

In 2013 the Australian Tax Office (ATO) initiated audits of at least 15 natural resource marketing hubs based in Singapore and Switzerland. The ATO audits cover more than a decade from the early 2000s. Reports suggest that between 2005 and 2014 BHP avoided tax on $5.7 billion AUD in profits. Faced with a tax reassessment of around $900 million AUD, BHP representatives seemed to dismiss the significance of the amount claiming that it represented less than two percent of their overall tax payments in Australia. Rio Tinto reassessments also amounted to more than $500 million AUD.

The scale of the abuse led the ATO to issue detailed guidance in 2017 on transfer pricing and marketing hubs. Companies have 12 months to reassess past tax assessments without incurring additional penalties. In the meantime, the Senate Committee has widened its inquiry into company tax avoidance to including the country's burgeoning liquid natural gas (LNG) sector.

Some commodities are much more vulnerable to mispricing than others. Several examples are offered below.

Mining

Gold: Low risk. The transportation and processing costs are marginal and the market price is comparatively easy to establish.

Copper: Medium risk. Copper is sold in multiple forms (concentrate vs. cathodes), often to affiliated companies. Transportation infrastructure is also often owned and operated by affiliated companies. International market prices are available but various charges and penalties are deducted as part of a normal sales contract.[76]

Diamonds: High risk. As with all gemstones, expert analysis (often parcel by parcel) is required, particularly on gem-quality diamonds, in order to assess their market value.

Petroleum

Oil: Medium risk. Large volumes are commonly sold through national oil companies and the marketing arms of major oil companies. These risks are partly offset by the existence of clear international benchmark prices and well-established discounts/premiums for quality differences.

Natural gas: High risk. Unlike oil, gas is hard to transport and requires either pipelines or liquefaction. There is no international market price, though there are regional benchmarks. Most gas is sold through long-term sales agreements and bad terms can significantly reduce government revenues.

To mitigate the risk of undervalued production, resource prices may be assessed based on prices listed on international exchanges, or by specialized firms that offer pricing services.

Ensuring Taxation Based on **Fair Market Value**

For oil, one common method of valuation is to take the average value of sales to non-affiliated companies at the end of each month or quarter. However, as the case study of Alaska demonstrates, this solution remains vulnerable to abuse (See **Textbox 11: Securing the Government Take in Alaska**[77]). Even where sufficient arm's length transfers exist, companies commonly manipulate the "average" price to their advantage. In 2006, "the United Kingdom revised its petroleum valuation rules to curb substantial tax losses resulting from this kind of manipulation."[78]

Reference prices are one way to manage this risk. Norway, for example, uses a system of "norm prices" for petroleum valuation, rather than depending on the price established through non-affiliated sales. A Petroleum Price Board made up of representatives of Government Ministries establishes a reference price for each oil field, taking into account input from companies. This price is then used for all sales, including both affiliated and non-affiliated parties.[79] Nigeria establishes reference prices for their oil fields and then calculates taxes based on the higher of either the reference price or the actual sale price.[80]

Pricing is of even greater concern in the mining sector. The OECD project on "Addressing Information Gaps on the Prices of Mineral Products" has provided useful case studies on gold, copper and iron and a checklist to assist revenue authorities in identifying potential risks.[81]

The starting point is to work from international price benchmarks. However, the prices of some commodities are not listed on international exchanges. Furthermore, resource prices may vary depending on the quality of the resource and transportation costs. In such cases, tax authorities may need to rely on the sector ministry to provide market intelligence and monitoring to establish credible export prices.

Reference prices can also be established in the mining sector. In Chile, for example, the value of a metric ton of fine copper is determined by the Comisión Chilena del Cobre (Chilean Copper Commission) according to the average value of Grade A Copper as posted on the Metal Exchange.[82] Many African countries – including Guinea, Tanzania and Zambia – use reference prices to determine the tax base against which royalties are assessed. Reference prices seem less common in the determination of the tax base against which corporate income tax is assessed.[83]

Awareness of the risks is an essential first step. Valuation provisions in contracts commonly establish the point of valuation: in the mining sector it may be the mine gate or the port of export and in the petroleum sector the wellhead or the entry flange to a pipeline. Valuation provisions can also establish alternative procedures where the bulk of the sales are to an affiliated company. In many cases, however, contracts will contain stabilization provisions, making it difficult for the government to impose new approaches to valuation, even where the risks to government revenue are clear.

Textbox 11:

Securing the Government Take in Alaska[77]

The challenges of securing a fair share of revenues are not limited to developing countries. Over a 25-year period, "one dollar out of every six that Alaska received from its oil development was obtained through legal challenges to the industry's original payment."

Alaskan officials claimed "industry chronically reduced the bases for calculating royalty, severance, and income tax payments by underestimating the market value of a barrel of oil at the point of sale. Overstated pipeline shipping charges (tariffs) had the same result." By tracking the export and value of each barrel of oil being exported, Alaskan authorities demonstrated that overall revenues were deliberately minimized by misrepresenting the actual sale value of oil and by inflating the costs associated with transporting oil by pipeline and tankers.

Between 1977 and 1994, the Alaskan Department of Law reported that it had paid contract lawyers and accounting specialists from 30 different companies a total of more than $217 million to follow up on these legal claims. The money was well spent as this litigation resulted in additional company payments to government of $2.7 billion. By 2000, litigation had produced an additional $10.6 billion in revenue, including $6.8 billion in direct payments for taxes and royalties, and an additional $3.8 billion in increased taxes and royalties related to reassessing pipeline transportation costs.

Inflating Costs to Undermine the Tax Base

Experiences in resource-rich developing countries suggest that ineligible and inflated costs are an important source of lost government revenue. Inflating project costs reduces government revenue because it lowers net (after-cost) income upon which profit-based taxes are assessed.

Ineligible Costs

In some cases, costs claimed are simply ineligible. In extreme cases, false invoices are filed even when no work was actually done (See **Textbox 12: False Invoices from Chilean Mining Company**[84]).

More commonly, claims are made for costs that should be excluded, but are often not caught by the relevant authorities. Case study evidence demonstrates that this includes companies seeking to claim expenses that: were incurred prior to the signing of the contract; were for the personal interests of expatriate employees and families; involved duplicate invoices for goods or services that have already been expensed; and which are clearly ineligible, such as costs related to mergers and acquisitions, or transfers in participating interests (See **Textbox 13: Indonesia Abandons Cost Recovery Due to Abuse**).

The revenue impact of accepting ineligible costs is heightened in a production sharing system where the main source of government revenue is their share of overall production (termed "profit oil"). Profit oil is divided between the company and government only after "cost oil" has been allocated to the company to reimburse eligible project costs. Any increase in project costs results in a decrease in available profit oil. Where increased expenses are legitimate, both the company and the government suffer. There is simply less "profit oil" to be shared. But where ineligible or inflated expenses are accepted, the company receives the full value in cost oil rather than only a portion of the value through profit oil. (See **Textbox 13: Indonesia Abandons Cost Recovery Due to Abuse**).

Textbox 12:

False Invoices from Chilean Mining Company[84]

The Sociedad Química y Minera de Chile (SQM) is a private Chilean mining company extracting, processing and marketing [illegible] scandals involved the payment of false invoices that resulted in an underpayment of taxes.

Following investigations by the Chilean Internal Tax Service (SII), SQM reported to its investors that the company had paid more than 800 invoices totaling more than $11 million between 2009 and 2014 "that may not meet the requirements to be qualified as tax expenses under the Chilean tax code." A lawsuit by investors in the United States claims that they were "false invoices for fictitious services."

According to testimony, companies had been encouraged to submit invoices to SQM even though they had not provided any services to SQM and had not had any contact with SQM. When the invoices were paid, most of the money was transferred to politicians.

In 2015, the company submitted amendments to its tax returns for the 2009 to 2014 tax years and paid taxes and interest totaling approximately US$7 million.

Misallocated Costs

There are also strong incentives for companies to misallocate costs between different categories and, for some fiscal regimes, between different concessions or blocks.

Most fiscal regimes draw a clear distinction between capital costs (e.g. permanent infrastructure and machinery) and annual operating costs (e.g. salaries and consumables such as fuel). Operating costs can be fully claimed in the year in which they were incurred. In most cases, however, capital costs are "depreciated," meaning that they are claimed over a series of years. The depreciation of capital costs affects the timing of government revenues. Companies therefore have an incentive to classify costs as operating costs when they should in fact be classified as capital costs. Auditors from India have highlighted the revenue risks due to the misclassification of costs between the different project phases (exploration, development and production) and also between capital and operating costs.[85]

Companies have an incentive to classify costs as operating costs when they should in fact be classified as capital costs.

Costs can also be misallocated between different blocks or concessions. It is common, particularly in the petroleum sector, for operations to be "ring-fenced" at the level of the contract area or block. This means that revenues, costs and taxes are calculated separately. Costs can only be recovered, therefore, from future production within the same block. Thus, particularly during the exploration phase, companies can benefit from allocating costs to those blocks that hold the greatest prospect of future production. For example, seismic testing, which is often carried out across multiple blocks, could be disproportionately allocated to a highly prospective block in order to increase the likelihood that the bulk of the costs could be recovered. A concrete example comes from Timor-Leste, where a well drilled in an area to be handed back to the government (relinquished) was claimed against a producing block (See **Textbox 14: Timor-Leste Loses Revenue Due to Misallocated Costs**[86]). A similar dispute is underway in Ghana's oil sector where companies are seeking to claim second-generation project development costs against first-generation project revenues.[87]

Textbox **13:**

Indonesia Abandons Cost Recovery Due to Abuse

Indonesia [illegible] of the [illegible] has abandoned a central tenant of the fiscal system due to uncontrollable abuse by companies. The government long believed that oil companies were inflating cost [illegible] continued to increase beyond what should be expected due to aging wells.

In 2010, the government adopted tighter regulations (No. 79/2010) that required costs to be: related to oil and gas operations within the contract area; based on the arm's length principle if between affiliated companies; and approved in advance by government authorities. The regulation also identified 22 categories of costs that are neither cost recoverable nor tax deductible. While removing some uncertainty around the eligibility of cost recovery claims, major disputes continued. A government-wide audit of cost recovery claims between 2010 and 2012 identified $221.5 million in ineligible expenses.

As stronger regulations were not sufficient to curb abuses, the government has recently adopted a far more radical approach by abandoning the concept of cost recovery for new contracts. Under Regulation No 8 of 2017, new contracts will apply a "gross split" mechanism to allocate production between the state and the contractor. This mechanism was applied t the most recent Production Sharing Contracts (PSCs) signed in January 2017 for the Offshore North West Java block. Existing PSCs will be unaffected, although contractors also have the option to apply the gross split mechanism.

Inflated Costs

In other cases, the price of legitimate goods and services are intentionally inflated. Transfer mispricing is of particular concern for transactions between affiliated companies. In the mining sector, inflating costs allows companies to shift profits out of the producing country, often to a subsidiary in a low-tax jurisdiction. In a production sharing system, inflated costs represent a direct revenue stream to the company through the cost recovery process.

In Ghana, for example, civil society groups alleged there was significant transfer mispricing in the construction of a processing facility of a natural gas project financed through $3 billion in oil-backed Chinese loans. Documents revealed that a competitor could have built a superior facility at a cost savings of $40 million. The Civil Society Platform on Oil and Gas stated: "It is suspected that Sinopec International Petroleum Service Corporation (SIPSC) has overpriced the materials – both the power plant and pipes – by building hidden costs purportedly occasioned by an arrangement with SIPSC's special purpose subsidiary offshore firm called SAF Petroleum Investments (FZE), which is registered in Dubai."[88] The Ghana National Gas Company claims that it reviewed its own tendering process and found the claims without substance or merit. There is no indication that any follow-up investigation was undertaken.

Textbox **14:** Timor-Leste Loses Revenue Due to Misallocated Costs[86]

In 2011, Timor-Leste initiated a series of tax audits covering the years 2005-2010. Among the issues raised in the audits was the misallocation of costs for a well drilled by Conoco Philips that came up dry.

In 2004, a significant portion of one of the main producing blocks (03-12) was scheduled for relinquishment. When the companies sought an extension to drill one last well, the government regulator conceded to the extension on the condition that the costs of the well would not be recovered against revenues from existing production. The company would be allowed to recover its costs only if there was future commercial production in the area to be relinquished.

The Firebird well, drilled in 2005, found only non-commercial quantities of gas. Nevertheless, the companies claimed the $32 million cost of the well against revenues from the Bayu-Undan field, the non-relinquished area of Block 03-12. The cost recovery claim reduced their tax payment by $9.7 million.

The regulator contested the claim as part of its review of the 2005 cost recovery statement, but the issue remained unresolved. In 2010, Timor-Leste ordered the companies to pay $32.4 million, including the $9.7 million in back taxes, as well as a 100 percent penalty for gross negligence and one percent per month interest and penalties for late payment.

General and administrative costs are often a specific point of contention between host governments and extractive companies. Multinational companies commonly incur legitimate costs outside the host country and these are, by definition, transactions with affiliated companies. Support can be in the form of business overhead (e.g., accounting services, human resources management and training, marketing support, procurement), IT services (e.g., software and hardware support, systems acquisition), and proprietary specialized functions and technologies.

One way to analyze management costs is the proportion of overall project revenue allocated to those costs. A recent study of a gold mine project in Zimbabwe revealed that, by agreement with the government, the company is authorized to charge a pre-determined fee for the provision of management services that has amounted to seven to nine percent of gross project revenues in recent years.[89] An analysis of Paladin's uranium mine in Malawi revealed $134 million in management fees over five years, which amounted to one-fifth of overall revenue for a mine suffering from depressed uranium prices. Perhaps not surprisingly, the fees were paid to a subsidiary in the Netherlands, allowing the company to also avoid the withholding tax.[90] In Guinea, a mining subcontractor was found to be paying 30 percent of total revenue in management fees to its parent company. An audit found that many of the services provided were not likely to be required by the subcontractor in Guinea.[91]

The costs assigned to the project should be fair, reasonable and in line with the market. Ideally, clear legislation, regulations and procedures should determine what proportion of indirect costs incurred by an associated company is allowable. In order to limit the potential for abuse, some countries place a cap on the level of head office expenses. Mozambique, for example, allows head office costs of five percent of overall project costs below $5 million but only 1.5 percent of overall project costs over $10 million.[92] While a cap can limit the scale of potential abuse, companies may interpret it less as an upper limit and more as an entitlement.

Debt Financing

A specific area of great potential risk to government revenues is intra-firm financing for capital investments. According to the IMF, "With interest deductible under the CIT [corporate income tax] and low or no withholding taxes, an obvious way to shift profits out of high tax jurisdictions is by lending to them through low tax ones."[93]

There are two separate dimensions to debt financing. First, there is the question of the relative proportion of company debt compared to company equity used to fund capital costs. Many tax regimes put a limit on the debt-to-equity ratio in order to avoid excess debt financing, a phenomenon known as "thin capitalization." Second, there is the question of whether the interest rate charged on the debt is excessive.[94] As with transfer mispricing, affiliated companies often provide the financing. This raises the risks that interest rates are not based on arm's length "market" prices but are rather designed to inflate costs that are deductible against taxable income.

Textbox 15:

Debt Financing Undermines Chilean Revenues[95]

According to Chilean tax authorities, the Compañía Minera Disputada de las Condes copper mine in Chile, owned by Exxon, operated at a loss for more than 20 years. In 2002, however, it sold for $1.3 billion to Anglo American Plc. The mine was clearly profitable from an investment perspective, but not from a tax perspective. The reason was debt financing.

Exxon purchased the mine from the Chilean state in the mid-1970s for $80 million. Technically, the mine operated for 23 years at a loss, accumulating $575 million in tax credits. Instead, funds that could have been declared as profits were paid to affiliated companies in the form of interest payments – including Exxon Financials, based in Bermuda. The company vice president is reported to have admitted "96 percent of liabilities correspond to loans from headquarters or the Bermuda subsidiary, that is why Exxon withdraws interest payments instead of profits."

Public outrage at the case contributed to the introduction of thin capitalization rules limiting the ratio of debt to equity and imposing a 35 percent withholding tax on interest payments leaving the country. It also contributed to the decision to impose a production-based royalty to secure a dependable revenue stream, less vulnerable to company tax minimization strategies.

Debt financing represents a major risk to government revenues. In Chile, for example, a copper mine avoided paying any corporate income tax for decades by shifting profits through interest payments to a subsidiary in Bermuda. The true profitability of the mine was revealed when it was sold for $1.3 billion (See Textbox 15: Debt Financing Undermines Chilean Revenues[95]).

Recent research highlights the prominence given to the issue by representatives of tax authorities in Africa.[96] In one report, the IMF highlights an unnamed African country where $100 billion in investment in the gold mining sector was almost entirely debt financed.[97] In another example, a gold mine in Guinea had been operating for 20 years without paying any corporate income tax due to hundreds of millions of dollars in debts, mostly coming from its parent company. When confronted, the company reduced its declared debt load to $23 million, resulting in a payment of $13 million in corporate income tax.[98]

The risks that debt financing pose to government revenue are clear in the petroleum sector as well. For example, the tax office in Australia recently prevailed in court against abusive debt financing between two Chevron subsidiaries (See **Textbox 16: Chevron Intra-Firm Financing Costs Disallowed**[99]). Production sharing agreements can be particularly vulnerable to debt financing when contractual provisions allow for interest payments to be both recoverable costs and legitimate deductions against taxable income. A range of measures exists to limit revenue loss through debt financing. Thin capitalization rules restrict debt to equity limits. Restrictions can be placed on the rate of interest, often a mark-up on an international benchmark such as the London Overnight Banking Rate (LIBOR). An alternative approach is to restrict interest to a percentage of profits, commonly referred to as an "earning stripping rule."[100]

Textbox **16:**

Chevron Intra-Firm Financing Costs Disallowed[99]

Chevron is a joint venture partner in the $56 billion AUD Gorgon natural gas project in Australia. Chevron Australia Holdings Pty Ltd (CAHPL) admits that it sent a total of $5.15 billion AUD in interest payments to its own subsidiary, Chevron Funding Corporation (Delaware), from 2003 through 2008.

Specifically, Chevron Australia borrowed $2.5 billion AUD from Chevron in Delaware at 8.97 percent interest, even though Chevron Funding Corporation borrowed the money for 1.2 percent. No withholding taxes were paid on the interest payments in Australia and Chevron Delaware did not pay tax on the interest income. Dividend payments from Chevron Delaware to Chevron Australia were also exempt from Australian tax.

Australia's Federal Court ruled that the loans contravened transfer-pricing rules. The loans did not meet an arm's length standard and thus Chevron owed $322 million AUD in back taxes and penalties.

Textbox 17: Tanzania's Mineral Audit Agency[101]

Liberalization of the gold mining sector in Tanzania in the late 1990s generated massive new investments but little government revenue. A government review concluded that natural resource exports in 2006 – valued at nearly $1 billion – generated only $26 million in government revenue. A low three percent royalty combined with investment incentives for capital expenditures were partly to blame. But there were also concerns about aggressive tax avoidance strategies adopted by companies.

Large gold mining companies paid no corporate income tax and claimed large losses each year. Overall losses amounted to more than $1 billion between 1998 and 2005. A government-funded audit concluded that companies had "over-declared" their losses by around $500 million.

In 2009 the government created the Tanzania Minerals Audit Agency (TMAA) in order to monitor all aspects of mining operations related to revenue generation. The agency independently assesses the quantity and quality of minerals mined and exported and supports tax authorities in determining corporate income tax by verifying the authenticity of revenue, investment and expense claims.

Audit queries of the TMAA from 2010 illustrate a number of the pathways through which extractive sector revenues can be lost. The figures represent the dollar value of company claims contested by the TMAA, including the under-reporting of project revenue (e.g. mineral sales understated by more than $12 million) as well as a series of ineligible or inflated project costs.

Common Audit Query	Total Amount
Wrongly claimed hedge financial liability and losses	US$183,645,187
Over-claimed capital allowance	US$179,304,109.43
Unsupported capital and operating expenditure	US$141,253,370.23
Disallowable items	US$53,776,029.65 and TZS 1,729,200,800
Wrongly claimed and premature capital deduction	US$44,453,468
Understated mineral sales	US$12,446,991.13 and TZS 3,001,291,703.81
Payments for technical services of which Withholding Tax was not withheld	US$50,874,325.99 and TZS 1,515,475,586
Management fees for which Withholding Tax was not withheld	US$23,097,348

Since the creation of the agency, revenues have increased substantially. Annual revenues exceeded 100 billion Tanzanian Shillings ($71 million) for the first time in 2010. In all years since, revenues have exceeded 200 billion ($125 million). By 2015 they had reached nearly 400 billion ($200 million).

Effective monitoring and auditing is essential to counter the risk that company cost claims are excessive. Tanzania's Mineral Audit Agency is a commonly cited example of a case in which comprehensive auditing has secured significant revenue dividends (See **Textbox 17: Tanzania's Mineral Audit Agency**[101]).

Transfer mispricing represents a major challenge to tax administrations in both developed and developing countries.[102] Contracts normally contain clauses requiring that all transactions between affiliated companies are based on arm's length prices, but these are notoriously difficult to enforce. There has been considerable effort recently to address these issues within international fora (e.g. OECD BEPS and UN Tax Committee) as well as through capacity-building efforts supported by the IMF, World Bank and Norway.

Constraining transfer mispricing requires a combination of clear laws and strong capacity. For developed countries, there have been some high-profile victories, including the recent Chevron case in Australia (See **Textbox 16: Chevron Intra-Firm Financing Costs Disallowed**). But there have also been many losses, including the Transocean cases in the United States and Norway (See **Textbox 18: Transocean: The Challenge of Taxing a Drilling Company**[103]).

South Africa's experience provides a useful perspective. Clearly the strongest tax authority in sub-Saharan Africa, the revenue authority has a dedicated transfer pricing audit team of 20 people covering all sectors. Reports suggest that 30 audits between 2012 and 2015 resulted in adjustments totalling nearly $2 billion, generating about $500 million in additional government revenue.[104] However, it does not appear that there has been a successful prosecution for transfer mispricing in South Africa. The challenges of administrative capacity are not limited to the revenue authority; they extend to the courts, where judges may lack the capacity to truly understand a complicated transfer mispricing case. The head of the Tax Review Committee, for example, said that he was "not sure that we have a judge that can hear a transfer pricing case at this point."[105]

For developing countries the challenges are immense, with a recent review of Africa showing major weaknesses in both legislation and administrative capacity to manage the risks of transfer mispricing.[106] Representatives of tax authorities from Latin American countries have also highlighted similar challenges.[107]

Textbox 18:

Transocean: The Challenge of Taxing a Drilling Company[103]

Transocean, the world's largest oil drilling company, illustrates the challenges of effective tax administration in developed countries. Transocean was originally incorporated in Delaware, with its headquarters in Houston. In 1999, the company re-domiciled to the Cayman Islands, a move that reduced its overall global tax rate from 31 percent to less than 17 percent, and resulted in a savings of nearly $2 billion in US taxes. In 2008, as Caribbean tax havens came under increasing pressure from US authorities, the company re-domiciled again, this time to the low-tax canton of Zug (Switzerland).

The company retains significant operations (and many subsidiaries) in the US. On multiple occasions the IRS has issued tax reassessments related to alleged transfer mispricing: $413 million plus interest for 2004-05; $278 million for 2006-2009; and $290 million plus interest and penalties for 2010-2011. Transocean has prevailed in court for all reassessments prior to 2010 and anticipates doing the same for 2010-11.

Transocean was also at the centre of Norway's largest ever tax fraud case. Specifically, Norwegian authorities alleged that Transocean engaged in a series of "tax motivated transactions" involving Norwegian subsidiaries while consolidating ownership of 12 drilling rigs in Cayman Island subsidiaries between 1999 and 2002. For example, the Polar Pioneer drilling rig, operating in the Norwegian continental shelf since 1985, was sold during an eight-hour window when it was towed outside of Norwegian territorial waters following maintenance at a Norwegian port in May 1999.

The Norwegian tax authority issued reassessment of $776 million, including interest and penalties. Criminal indictments were also lodged against two subsidiaries and employees of Transocean's external tax advisors. In 2014, an Oslo court dismissed all charges against Transocean, but the government appealed. In January, after nearly 100 days of court proceedings, the Court of Appeal acquitted Transocean and its advisors on most of the charges. The Norwegian authorities decided not to proceed with the remaining charges and fired the lead prosecutor who had been accused of being on a "crusade." The loss is a major blow to the tax fraud office in Norway and may represent a setback for some provisions of Norwegian corporate income tax law.

Next Steps in Protecting Government Revenue

There are many different pathways through which government extractive sector revenues are lost. Closing off one pathway is of little benefit if other pathways remain unchecked. Protecting revenues that should ultimately provide benefits to citizens therefore requires a comprehensive approach.

Emerging **Best Practice**

Obviously, badly negotiated deals guarantee that governments do not secure a fair share of their natural resource wealth. Securing better extractive sector deals is a well-established component of both civil society advocacy and international donor support. Progress on the disclosure of extractive sector contracts and the beneficial owners of companies will help. The now-standard guidance to embed all (or nearly all) fiscal terms in national legislation rather than project-specific contracts will reduce the discretion left to government negotiators. Model contracts, appended to national legislation, can play a similar role where project-specific negotiations continue. International support to assist governments in those negotiations has also been widely endorsed, though its practical impact is difficult to assess. Continued vigilance is needed as bad deals are still being negotiated[100] and companies continue to be offered tax breaks, particularly during commodity price downturns. One crosscutting lesson is the importance of building the capacity for adaptation into contracts by limiting stabilization and including a timeframe (e.g. five years) for a formal review of fiscal terms.

Companies commonly exploit DTAs in order to reduce or eliminate an additional set of taxes, primarily on the repatriation of interest and dividend payments and on the taxation of capital gains. These taxes are not the main sources of government revenue from the extractive sector. Nevertheless, tens of millions of dollars can be lost (sometimes more) when companies secure treaty benefits by creating a shell company in a jurisdiction with generous treaty terms. From a developing country revenue perspective, DTAs warrant much more careful analysis. It appears that one arm of government often promotes DTAs more as a signal of the desire for greater economic interaction, without fully appreciating the potential revenue implications. As a single extractive sector project can fundamentally alter the cost and benefit calculation of a DTA, proactive analysis is essential. Treaty language designed to deny benefits to extractive sector companies using shell companies seems eminently sensible, but it remains to be seen if it will be effective.

Establishing fair tax rates is a necessary condition for governments to get a fair share, but it is not sufficient. The bulk of this study has sought to illustrate that tax rates are meaningless in the absence of the tax base against which they are assessed. Put simply, whether the corporate income tax is 25 or 35 percent is irrelevant if companies report no taxable income. Ensuring that governments receive a fair share of extractive sector revenues therefore requires far greater attention to protecting the tax base.

Protecting the tax base starts with ensuring the accurate reporting of overall project revenue. Effective monitoring is necessary to verify both the quantity and quality of the commodity produced, including any valuable by-products. While this seems obvious, there are many jurisdictions where this kind of verification does not take place. Government revenue is also at risk when the commodity is sold to an affiliated company at below market rates. Consideration should be given to establishing a reference price based on international benchmarks for the calculation of government revenues. Where reference pricing is impossible, great care should be taken wherever companies sell commodities to an affiliated company, particularly when done as part of a long-term sales agreement.

The second main step in protecting the tax base is controlling project costs claimed by the company. These issues are much broader, and sometimes much simpler than transfer mispricing between affiliated companies. Government authorities should undertake risk-based auditing to disallow fraudulent invoices and other ineligible costs and to ensure that eligible costs are properly allocated between different projects and between different categories of costs (i.e. capital vs. operating). With larger multinational resource companies, there is a risk of profit shifting through transfer mispricing. Debt financing is a particularly high-risk area, but scrutiny should be given to all cases where affiliated companies provide goods and services. Engaging with international efforts of the OECD or the UN processes may help but, in general, countries will need to develop and implement national-level solutions to limit the ability of companies to inflate costs. Simple anti-avoidance measures might include establishing or increasing withholding taxes, and setting caps on certain types of expenditures such as head office costs.

Strengthening **Tax Administration** and Closing **Tax Loopholes**

Strengthening tax administration capacity is an obvious starting point when seeking to protect government revenues. It is interesting to note that while dedicated attention to extractive sector revenues and fiscal regime design by the major donors – including the IMF and the World Bank – can be traced back more than 15 years, it is only in the last five years that similar attention has been given to tax administration.[103] Momentum in this area is growing rapidly, including:

- The provision of detailed guidance on transfer pricing risks and mineral pricing.[110]
- Support for capacity-building programs from the IMF and World Bank, as well as bilateral donors such as Norway, Germany and Canada.
- The mobilization of various mechanisms to strengthen administration and audit capacity, such as the African Tax Administration Forum and the International Organization of Supreme Audit Institutions.

In many cases, the lack of previous government oversight is surprising. Zambia, for example, ranks eighth among the world's copper producers. Minerals account for 70 percent of the value of the country's exports and 30 percent of government revenue. The government was convinced that it was not receiving a fair share of the wealth and implemented, and then revoked, a series of major revisions to the mining fiscal regime.[111] Yet it is only in recent years that significant effort has been given to revenue administration.[112]

It is, of course, never too late to start. Regrettably, however, the results of all this useful work comes after the commodity super-cycle, with much revenue lost in the meantime.

Stronger government capacity can only be a good thing. But it would be unwise to over-estimate the effectiveness of these efforts. A significant imbalance in expertise will remain, for the foreseeable future, between the lawyers and accountants working for extractive sector companies and the government officials tasked with securing a fair share of revenues.

As the case studies from natural resource "superpowers" such as Alaska, Australia and Canada have illustrated, even in developed countries the challenges of securing extractive sector revenues are daunting. There have been important victories, though, such as Alaskan litigation and Australian success against Chevron's debt financing and profit shifting to Singapore marketing hubs. In Canada, the big cases – including Cameco and Silver Wheaton – remain before the courts and their outcome is uncertain. Less attention, however, is often paid to how often tax authorities in developed countries lose in court. Battles between tax authorities in Norway and the US against the world's largest petroleum drilling firm, Transocean, suggest scaling back expectations on the revenue impact of tax administration capacity building.

Perhaps counter-intuitively, the next big step in protecting government revenues might be to revisit fiscal regimes and to renegotiate contracts. The point, however, would not be to revisit tax rates, but rather to find more effective measures to protect the tax base by closing loopholes. For developing countries with comparatively weak tax administration, consideration should be given to a range of simple but robust measures to counter revenue loss.[113]

Reviewing fiscal regimes might even require changing the balance between production-based and profit-based taxes. After 15 years of recommending that developing countries shift towards the taxing of profits and super-profits, some at the IMF are now questioning this approach. A recent IMF volume focused on risks to extractive sector revenues concludes that fiscal regime design might require "tilting the balance between profit-related taxes and royalties further towards the latter than might otherwise be the case, on the grounds that monitoring deductible costs is harder than monitoring revenues."[114]

For developing countries with comparatively weak tax administration, consideration should be given to a range of simple but robust measures to counter revenue loss.

Table 1:

Implications for Government Revenues

Table 1 reviews the government revenue implications of the different scenarios, assuming a simple fiscal regime comprised of a five percent royalty (based on the sale value of the commodity) and a 30 percent corporate income tax. To keep the example as simple as possible, it is assumed that the royalty is not an allowable deduction against corporate income tax.[115]

Scenario	Gross Revenue	Royalty at 5%	Taxable Income	Corporate Tax at 30%	Total Gov't Revenue	Revenue Loss (%)
1	$100 MILLION	$5 MILLION	$40 MILLION	$12 MILLION	$17 MILLION	
2	$100 MILLION	$5 MILLION	$20 MILLION	$6 MILLION	$11 MILLION	-35%
3	$80 MILLION	$4 MILLION	$20 MILLION	$6 MILLION	$10 MILLION	-41%
4	$80 MILLION	$4 MILLION	$0	$0	$4 MILLION	-76%

1. Scenario 1 generates $17 million in government revenue. A five percent royalty on $100 million of commodity sales results in a payment of $5 million. A 30 percent corporate income tax on $40 million in taxable income results in a payment of $12 million.

2. Scenario 2 generates $11 million in government revenue. As the reported gross revenue remains at $100 million, the royalty payment is unchanged. Inflated costs, however, reduce taxable income to $20 million, resulting in a payment of only $6 million. Government revenue is reduced by 35 percent.

3. Scenario 3 generates $10 million in government revenue. With reported gross revenues of $80 million, royalty payments fall to $4 million. With taxable income reduced to $20 million, corporate income tax again generates only $6 million. As under-reporting commodity sales affects both royalties and corporate income tax, government revenue is reduced by 41 percent.

4. Scenario 4 generates only $4 million in government revenue. With $80 million in reported gross revenue, royalty payments remain at $4 million. There is, however, no reported taxable income and therefore no corporate income tax payment. Government revenue is reduced by 76 percent, illustrating how sensitive profit-base taxes are to tax base erosion.[116]

Before leaving this example, it is worth considering a fifth scenario that adds the dimension of time. Tax avoidance strategies are commonly employed already in the exploration and development phase when inflated costs are often not independently monitored and challenged by tax authorities. Fiscal regimes allow for previous year losses to be "carried forward" and applied in the calculation of future year taxable income.[117] In the fifth scenario, the company has $200 million in overinflated past losses that will be used to offset any future taxable income.[118] The combination of these techniques illustrates how a profitable extractive sector project can end up paying no corporate income tax, **ever.**

Notes

1 See for example, Track It! Stop It! Get It!: High Level Panel on Illicit Financial Flows from Africa, United Nations Economic Commission for Africa, 2014; Illicit Financial Flows from Africa: Hidden Resource for Development, Global Financial Integrity, 2010; and "Exposing the Lost Billions How Financial Transparency by Multinationals on a Country by Country Basis Can Aid Development," Eurodad, 2011.

2 See [illegible], Global Financial Integrity, 2012.

3 See, for example, the discussion in The World Bank Group's Response To Illicit Financial Flows: A Stocktaking, World Bank, 2016.

4 "Addressing Information Gaps on the Prices of Mineral Products (Four-Part Consultation Document)," OECD Tax and Development Programme, October 2015. Broader OECD initiatives also have direct relevance, including an assessment of BEPS from the perspective of low-income countries and specific guidance on the use of tax incentives, as well as proposed measures on specific tax avoidance techniques, including transfer mispricing, the deductibility of interest, treaty shopping and country-by-country reporting.

5 For a comprehensive review of the UN's work in this area, see: United Nations Handbook on Selected Issues in Protecting the Tax Base of Developing Countries, United Nations, 2015.

6 See, for example, Secretariat Report on the Expert Group Meeting on Extractive Industries Taxation, United Nations, 28 May 2013.

7 Tax Evasion and the Use of Tax Havens: Report Of The Standing Committee On Finance, Parliament of Canada, 2013.

8 Bill C-621: An Act to Amend the Income Tax Act (Economic Substance), Parliament of Canada, 2014.

9 See, for example, J18 Vancouver Quadra Offshore Tax Havens: Resolutions for Debate, LPC-BC Biennial Policy Convention, 2016, p. 21.

10 See "Consolidated Amended Class Action Complaint for the Violation of Federal Securities Laws," US District Court California, 18 December 2015, (2:15-cv-05146-CAS-JEM); and Silver Wheaton Corporation, Annual Report 2015, 11 April 2016, p. 44-45.

11 See Rita Celli, "Mining for More," 2015.

12 The transparency revolution extends well beyond revenue payments. Extractive sector contracts, closely guarded secrets in the past, are now being published by dozens of countries. See Don Hubert and Rob Pitman, Past the Tipping Point? Contract Disclosure within EITI, NRGI, 2017.

13 See "The Board Reaffirmed That Project-Level Reporting is Required," EITI Press Release, 8 March 2017. For a broader assessment of EITI effectiveness, see Siri Aas Rustad, Philippe Le Billon and Päivi Lujala. "Has the Extractive Industries Transparency Initiative Been a Success? Identifying and evaluating EITI goals," Resources Policy, Vol. 51, 2017, p. 151-162.

14 This analysis focuses on royalties, taxes and production entitlements made by companies to governments. It does not address potential government revenue loss where the state holds an equity share in an EI project.

15 All values, unless otherwise stated, are in US dollars (USD).

16 By design, this report does not address the equally important question of how government revenues are spent.

17 The literature is extensive. For a particularly significant example, see Fiscal Regimes for Extractive Industries: Design and Implementation, IMF 2012.

18 See Jack Calder, Administering Fiscal Regimes for Extractive Industries: A Handbook, IMF, 2014; Pietro Guj et al., How to Improve Mining Tax Administration and Collection Frameworks, World Bank, 2013; and Brian J Arnold and James Wilson, Aggressive International Tax Planning by Multinational Corporations: the Canadian Context and Possible Responses, SPP, 2014.

19 See Pietro Guj et al. Transfer Pricing in Mining with a Focus on Africa: A Reference Guide for Practitioners; World Bank, 2017; Transfer Pricing Issues in Extractive Industries, Committee of Experts on International Cooperation in Tax Matters, E/C.18/2017/CRP.9, 2017; and Alexandra Readhead, Preventing Tax Base Erosion in Africa: A Regional Study of Transfer Pricing Challenges in the Mining Sector, NRGI, 2016.

20 This section is based on an extractive sector risk assessment framework developed by Don Hubert of Resources for Development Consulting, 2016. For its application to a specific project, see Don Hubert, Mapping Risks to Future Government Petroleum Revenues in Kenya, Oxfam Kenya, 2016.

21 "A suitable tax structure and a target range of AETRs [average effective tax rates] result from this analysis. These simulations, and those of other sources, suggest reasonably achievable ranges of discounted AETRs will be 40–60 percent for mining and 65–85 percent for petroleum." Fiscal Regimes for Extractive Industries: Design and Implementation, IMF, 2012, p. 29.

22 For an excellent introduction, see: Foreign investment, law and sustainable development: A handbook on agriculture and extractive industries, 2nd Ed., 2016. Illustrations used here are taken from p. 47 and 25.

23 Research on the 10 largest extractive sector companies in the world demonstrates that they control over 6,000 subsidiaries, of which more than a third were located in tax havens or secrecy jurisdictions. See "Piping Profits," Publish What You Pay – Norway, 2011.

24 See Consolidated Amended Class Action Complaint for the Violation of Federal Securities Laws, US District Court California, 18 December 2015, (2:15-cv-05146-CAS-JEM); and Silver Wheaton Corporation, Annual Report 2015, 11 April 2016, p. 44-45.

25 For clear and concise overviews of taxation in the mining sector see: Farid Tadros and Kristina Svensson, Using Taxation to Enable a Fair and Thriving Mining Industry, World Bank, 2010; Paul Mitchel, Taxation and Investment Issues in Mining, in Advancing the EITI in the Mining Sector, EITI 2009, p. 27-31; and Thomas Baunsgaard, A Primer on Mineral Taxation, IMF Working Paper, WP/01/139, 2001.

26 For the definitive treatment, see James Otto et al, Mining Royalties: A Global Study of Their Impact on Investors, Government and Civil Society, World Bank, 2006.

27 Capital depreciation rules vary, but companies are often allowed to claim investment costs more rapidly than would be the case in other sectors.

28 Where the share of oil is allocated based on a measure of profitability (e.g. an r-factor), it functions more like a resource rent tax.

29 Saji Thomas, Mining Taxation: An Application to Mali, IMF, WP/10/126, 2010.

30 According to the IMF, "a race to the bottom is evident among special regimes, most notably in the case of Africa, creating effectively a parallel tax system where rates have fallen to *almost zero*." Emphasis added. S. M. Ali Abbas et al., A Partial Race to the Bottom: Corporate Tax Developments in Emerging and Developing Economies, IMF, 2012, p 1.

31 World Investment Report, 2007, p. 137.

32 "Many countries south of Sahara have 100% capital allowance and it is hurting a timely government take collection from the industries." Frian Aarsnes, The Taxation of Multinationals in Africa: Fiscal Competition and Profit Repatriation, Econ Pöyry, 2011.

33 Don Hubert, Government Revenues from Mining: A Case Study of Caledonia's Blanket Mine, Oxfam Zimbabwe, 2016, p. 15.

34 Model Mine Development Agreement, International Bar Association, 2011.

35 George Kahal, The Uproar Surrounding Petroleum Contract Renegotiations, Oxford Energy Forum, August 2010, p. 3-5.

36 Consider, for example, the decision by the Dominican Republic in 2013 to renegotiate the contract for Pueblo Viejo, one of the largest mines in the Americas. A similar case for renegotiation could be made for the massive gas reserves off the coast of Mozambique, though the government has chosen not to demand a better deal.

37 Spillovers in International Corporate Taxation, IMF, 2014, p. 26.

38 While tax information exchange is commonly cited as a mechanism for countries to address potential revenue loss, there are indications that developing country governments are often unsuccessful when they try to make use of these provisions. See Alexandra Readhead, Preventing Tax Base Erosion in Africa, NRGI, 2016, p. 31.

39 Spillovers in International Corporate Taxation, IMF, 2014, p. 28.

40 Spillovers in International Corporate Taxation, IMF, 2014, p. 27.

41 See Francis Weyzig, The Central Role of Dutch Financing Companies in Tax Avoidance Strategies, 2007; and Netherlands: 2015 Worldwide Tax Guide, Ernst & Young, p. 982-984.

42 On Mongolia, see: Technical Assistance Report—Safeguarding Domestic Revenue—A Mongolian DTA Model, IMF, Report No. 12/306, 2012, p. 13; and "In tax case, Mongolia is the mouse that roared," Reuters, 2013. According to Article 2.2 of the 2009 Investment Agreement, "Tax to be withheld as a result of the Corporate Income Tax Law shall be calculated at the rates specified in the respective clauses of the Corporate Income Tax Law (as in force on the date of this Agreement), which includes in accordance with any applicable double tax treaties as applied by Article 2.2 of the General Taxation Law, and which rates shall be Stabilized." Malawi terminated the DTA with the Netherlands effective 5 June 2013. It has subsequently negotiated a new DTA (20 April 2015) that includes specific anti-abuse provisions (see below).

43 See: Francis Weyzig and Michiel van Dijk, Incoherence Between Tax and Development Policies: The Case of the Netherlands, Third World Quarterly, 2009; Francis Weyzig, "Tax Treaty Shopping: Structural Determinants of Foreign Direct Investment Routed Through the Netherlands," *International Tax and Public Finance*, 2013; and Katrin McGauran, "Should the Netherlands Sign Tax Treaties with Developing Countries?," SOMO, 2013.

44 The Netherlands: A Tax Haven, Oxfam Novib, 2016.

45 Matt Steinglass, "Netherlands to Review Tax Treaties with Least Developed Countries," *Financial Times*, 6 September 2013.

46 See Kristy Jonas, EU Platform for Tax Good Governance: Adopting Anti-Abuse Provisions in Tax Treaties with Developing Countries, Netherlands Ministry of Finance, 2016.

47 See [illegible], Deloitte, 2013; and [illegible] Advising Big Businesses [illegible] ActionAid, 2013.

48 See Jeff Mbanga, [illegible] The Observer, 7 December 2011; and Tabu Butagira, "Leaked [illegible] Schemes," *Daily Monitor*, 4 April 2016.

49 [illegible], Tax Justice Network – Africa (n.d.).

50 See Roos van Os and Roeline Knottnerus, [illegible] Treaty Shopping [illegible] Multinational [illegible] Investment Protection," SOMO, 2011.

51 See Union of India v Azadi Bachao Andolan, Supreme of Court of India, 7 October 7, 2003 and description of the case in Eduardo Baistrocchi, "The Use and Interpretation of Tax Treaties in the Emerging World: Theory and Implications," *British Tax Review*, 2008, p. 361-62.

52 See Michael N. Kandev, [illegible] Canada: The Door is (Still) Open," Bulletin for International Taxation, October 2008. Two cases are MIL (Investments) S.A. vs. Canada, 2006 and Velcro Canada Inc. vs. The Queen, 2012.

53 Following these losses, in 2013 the Canadian Department of Finance issued its [illegible]. In the 2014 Budget, the government proposed to amend the Income Tax Conventions Interpretation Act (ITCIA) to create a domestic anti-treaty shopping rule. (See Steve Suarez, "Canada to Unilaterally Override Tax Treaties With Proposed New Anti-Treaty-Shopping Rule," *Tax Notes International*, 3 March 2014, p. 797-806.) Implementation of the new measures was put on hold until the OECD BEPS process had run its course. It is expected that the Department of Finance will renew its anti-treaty shopping initiative, though whether that will be based on implementation of the new BEPS standards or unilateral national measures (or a combination of the two) remains to be seen. (Gwendolyn Watson, "Treaty Shopping and Base Erosion and Profit Shifting Action 6," *Canadian Tax Journal*, 2014, 62:4, 1085 – 1108).

54 See Transfer Pricing In The Petroleum Industry Of Trinidad & Tobago, Ministry of Finance, 2015, p. 14-15.

55 BEPS action 6: Art. X, par. 7, Preventing the Granting of Treaty Benefits in Inappropriate Circumstances Action 6: Final Report, OECD, 2015.

56 See for example the anti-abuse clause on interest withholding taxes from the recent DTAs with both Zambia and Malawi: "No relief shall be available under this Article if it was the *main purpose or one of the main purposes* of any person concerned with the creation or assignment of the debt-claim in respect of which the interest is paid to take advantage of this Article by means of that creation or assignment. The competent authority of the Contracting State which has to grant the benefits, shall consult with the competent authority of the other Contracting State before denying the benefits under this paragraph."

57 "Zambia: Selected Issues," IMF Country Report, No. 15/153, June 2015.

58 See Diamond Industry Annual Review: Democratic Republic of Congo, Partnership Africa Canada, 2005, p. 9.

59 See Addressing the Information Gaps on Prices of Minerals Sold in an Intermediate Form, The Platform for Cooperation on Tax, OECD, 2017, p. 7.

60 Scenario assumptions are: 50 shipments to 20,000 metric tonnes of copper concentrate at 31 percent copper by weight and four grams of gold per tonne. Production cost is assumed to be $1.70 per pound of copper and fiscal terms: royalty rates of 3.5 percent for copper, 5 percent for gold and a corporate income tax rate of 30 percent.

61 See Metering for Billions, Norwegian Petroleum Directorate, 2009.

62 See Interior's Oil and Gas Production Verification Efforts Do Not Provide Reasonable Assurance of Accurate Measurement of Production Volumes, Government Accountability Office, 2010; and Interior's Production Verification Efforts and Royalty Data Have Improved, but Further Actions Needed, Government Accountability Office, 2015.

63 See Managing Tax Base: Copper Mining, Servicio de Impuestos Internos, 2016.

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65 See Addressing the Information Gaps on Prices of Minerals Sold in an Intermediate Form, OECD, 2017.

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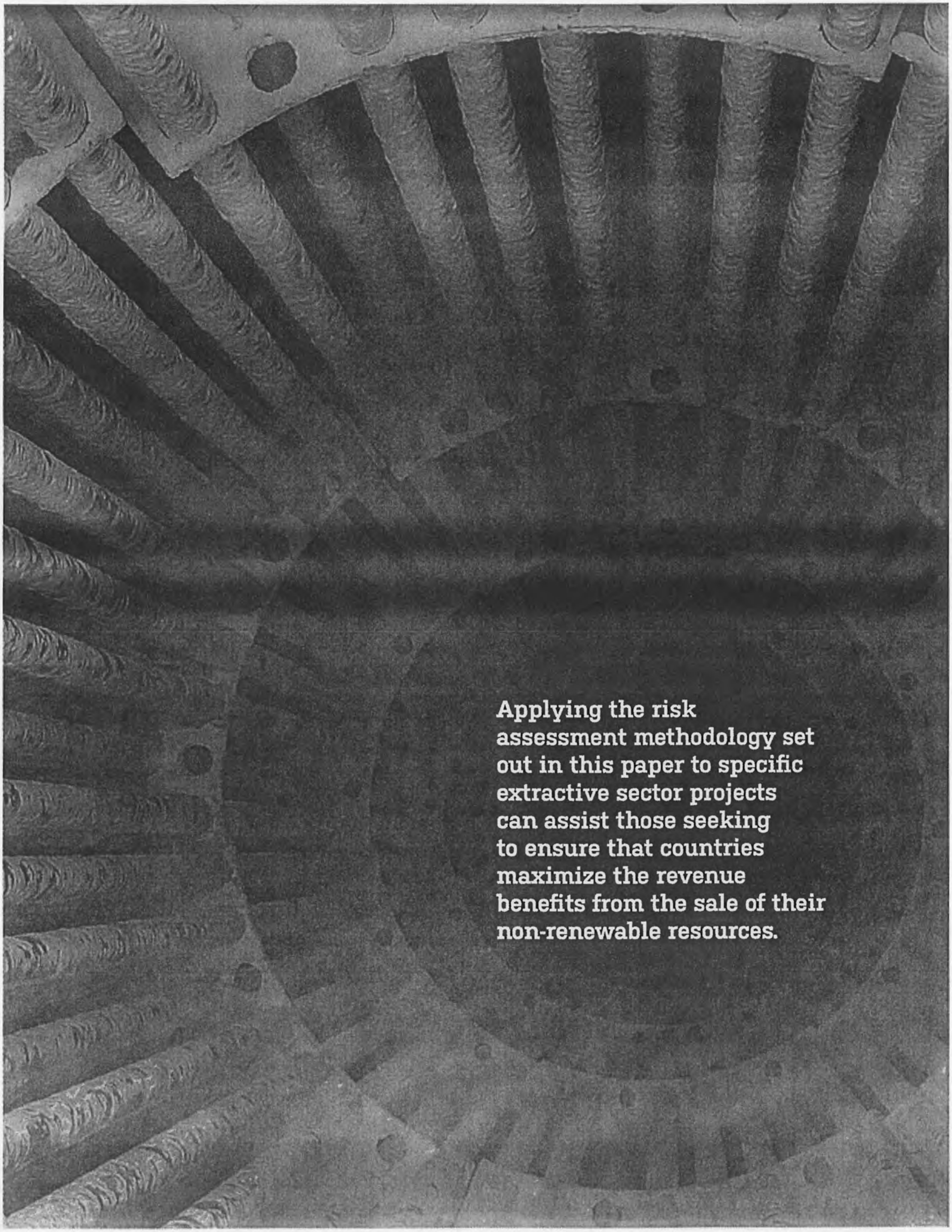

Applying the risk assessment methodology set out in this paper to specific extractive sector projects can assist those seeking to ensure that countries maximize the revenue benefits from the sale of their non-renewable resources.

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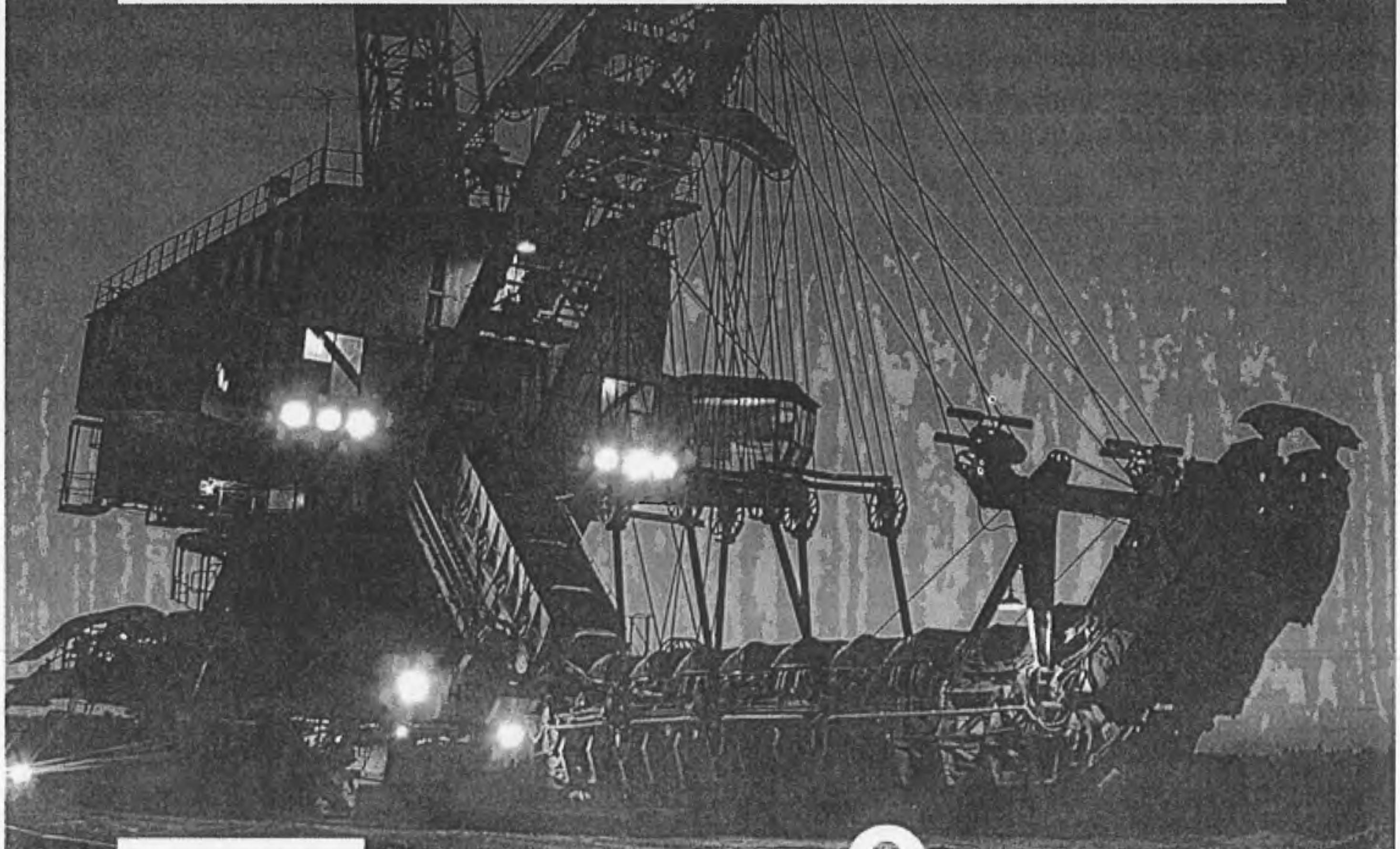
BEYOND TRANSPARENCY

INVESTIGATING THE NEW EXTRACTIVE INDUSTRY DISCLOSURES



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About this report

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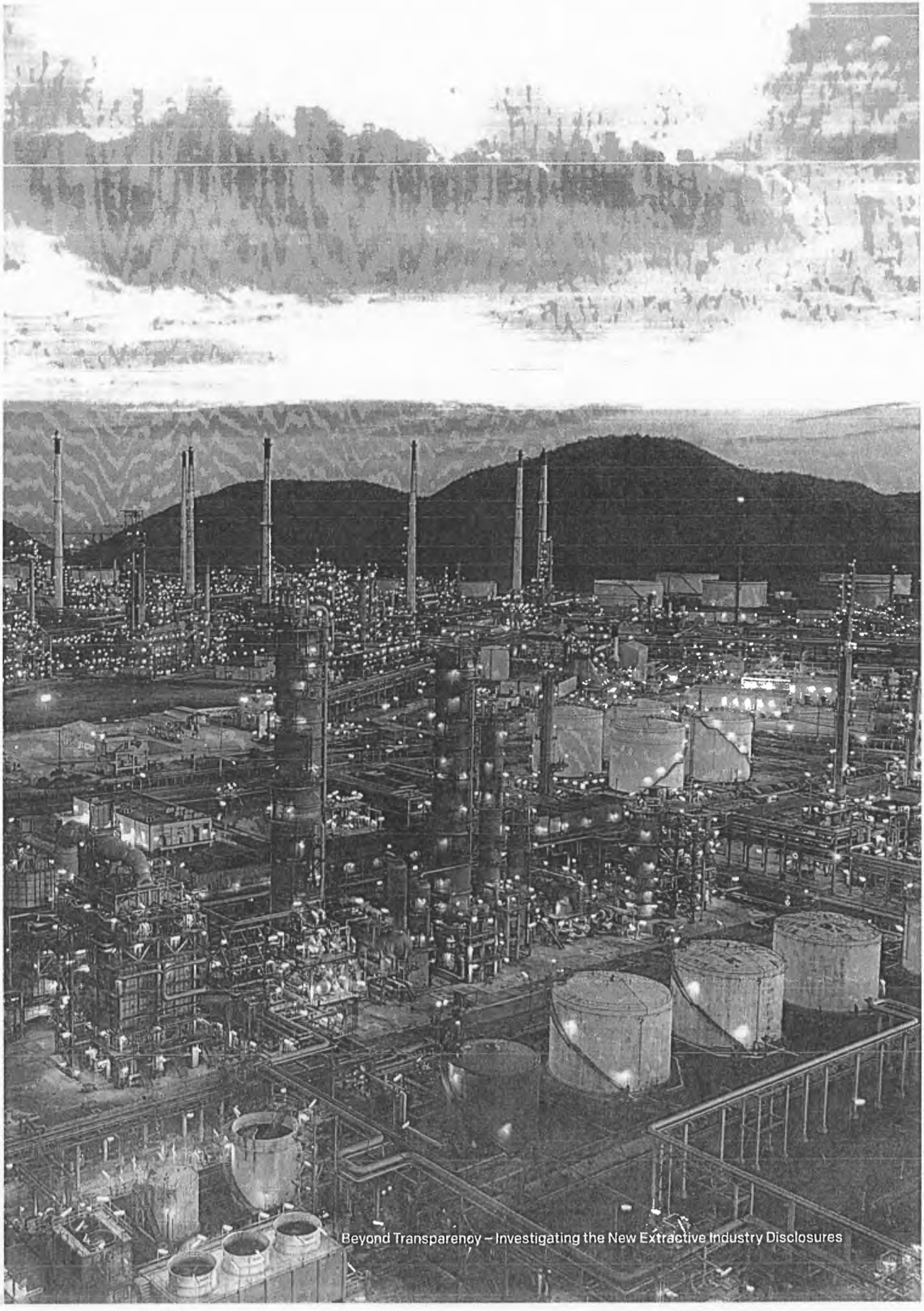

Beyond Transparency – Investigating the New Extractive Industry Disclosures

EXECUTIVE SUMMARY

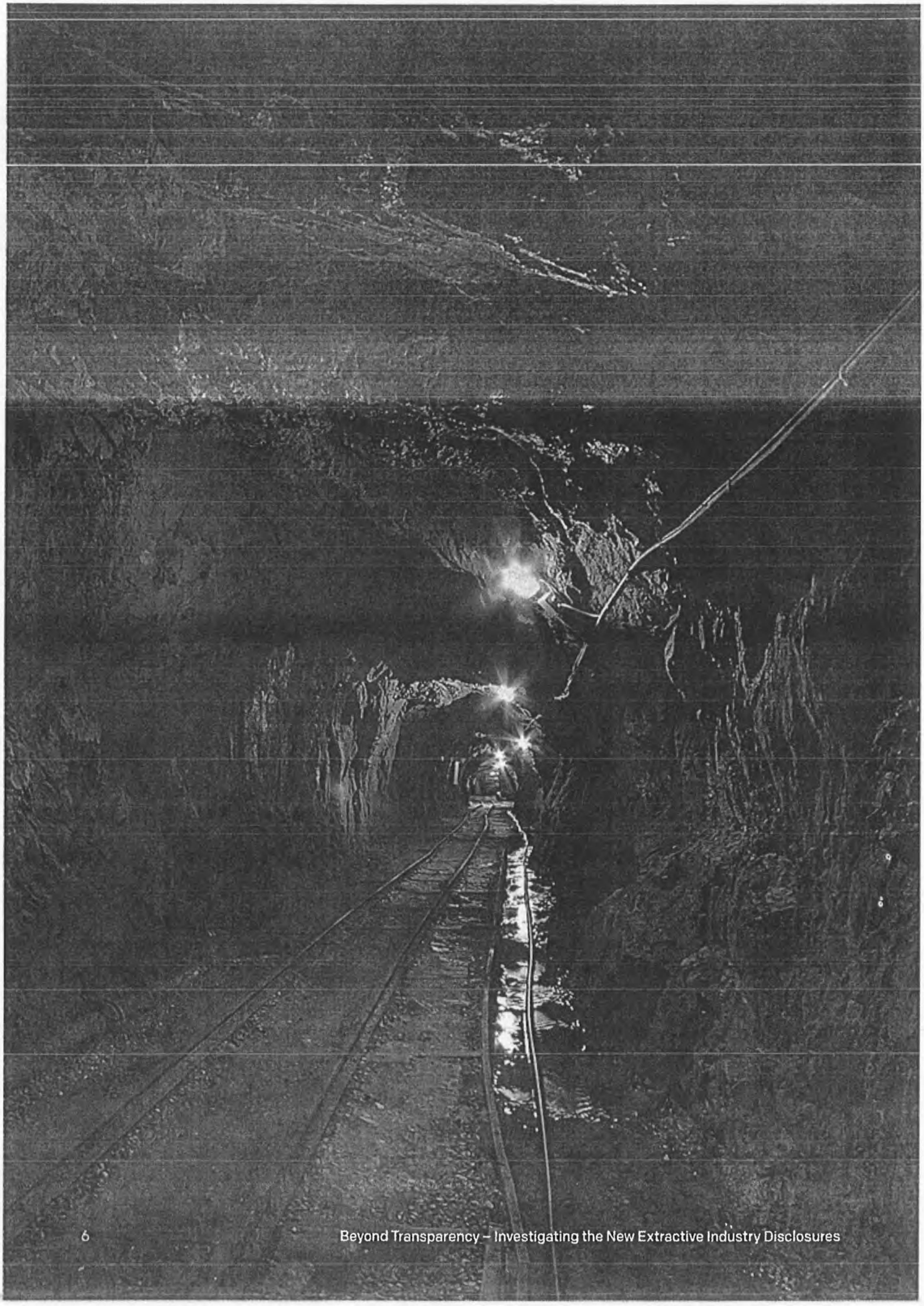
In 2016, French companies extracting natural resources in developing countries made their payments to the governments of these countries public for the first time, detailing the payments for each of their projects. This is a significant step forward in terms of transparency in a notoriously opaque sector.

Nevertheless, while the stated objective of these measures is to facilitate public understanding and monitoring of the activities of companies exploiting natural resources, this report reveals various limitations, such as regarding access to the new data, which remains complicated, particularly for non-specialists. Lack of contextual data surrounding the disclosure of payments makes understanding the data even more difficult. Furthermore, loopholes in the Directives and their transposition into French law also limit possibilities of studying and comparing the different payments.

However, the disclosure of payments to governments shows that the governance of the sector is improving. This report demonstrates how the disclosure of this new information helped inform analysis of the activities of the **French oil company Total in Angola** and the French **uranium giant Areva in Niger**.

For several years, strong suspicions of embezzlement, corruption and tax evasion have plagued the Angolan oil sector. The first disclosure of payments to governments by the French oil company Total provides the opportunity to cross-reference information published by the Angolan government on the revenues generated by oil with data from the French company. **Analysis of data relating to Block 17 shows a difference of more than USD 100 million in 2015 between Angola's disclosed revenues and company payments based on information disclosed by Total.** The following study shows that **this discrepancy could be explained by a difference between Total and the Angolan government in defining and estimating the data to be published, by misappropriation by the Angolan state-owned oil company, or by differences between Total's and the government's valuation of the oil per barrel possibly associated with transfer pricing by Total,** which would allow it to pay less taxes in Angola.

The payment data published by Areva makes possible an initial assessment of the negotiations that took place between Areva and Niger in 2014 when renewing uranium contracts. While civil society hoped to see increased revenues from uranium extraction after this historic agreement, the conclusion is quite clear; the negotiation did not lead to increased payments by Areva to Niger to extract uranium. Nigerien uranium accounts for nearly 30% of the French company's production but Niger receives only 7% of Areva's payments to producing countries. The information published by Areva suggests that **the new pricing formula applied to the royalty fees could have resulted in a 15 million euros decrease in royalty fees paid to Niger.** It also indicates that Areva's **uranium exports from Niger to France could be undervalued compared with prices for Nigerien uranium exports by other companies, which may have reduced Areva's contributions by between 10 million and 30 million euros in 2015.**



1

FRENCH EXTRACTIVE COMPANIES PUBLISH THEIR PAYMENTS TO GOVERNMENTS FOR THE FIRST TIME: WHAT ARE THE IMPLICATIONS?

Gas, oil and uranium in the energy sector, metals in the construction sector, rare earth elements and new technologies... Extractive resources are increasingly present in our societies and their trade represents a major geopolitical and economic challenge. However, their exploitation is marked by widespread corruption and tax dodging, which affect the populations of resource-rich countries. This is augmented by the lack of transparency in the extractive sector, which severely restricts the possibilities for government accountability. But recent legal developments, including the obligation on French extractive companies to publish their payments to governments, which entered into force in 2016, could help to change the situation.

The extractive sector is characterized by an **asymmetric balance of power and wealth** between the companies that benefit from financial flows linked to extractive activity[1] and the countries where resources are extracted, which are often affected by societal and environmental crises: a situation often referred to as the "resource curse". In particular, illicit **financial flows resulting from corruption or tax dodging** have plagued the economies of these extractive countries for years[2].

To root out these problems and to improve the management of revenues from extractive activities, it is essential to know and understand the corresponding financial flows; how much do companies pay to extract resources? To whom are those payments made? Are they fair in the context of the exploited resources? Do the local populations really benefit?

Faced with the opacity that prevails in this sector, transparency represents an essential step for shedding light on the activity of companies. First and foremost, it deters companies from conducting dubious practices and can therefore prevent these from occurring. It also enables citizens, journalists, parliamentarians and civil society organizations to access and verify data and information and hold their local or national institutions accountable for payments they receive, and to ensure that the economic resources benefit the community.

The launch of the Extractive Industries Transparency Initiative (EITI) in 2003 was a crucial step in ending this opacity. This voluntary initiative brings together representatives of governments, businesses and civil society organizations.

Countries deciding to join the EITI must set up a number of transparency measures at national level. At the core of the EITI is the requirement for extractive companies to disclose the payments they make to the host country government and for the government to disclose its revenues from extractive activities, a requirement formulated in the early 2000s by the international coalition Publish What You Pay (PWYP)[3]. Thanks to the EITI, citizens in many countries engaged in extraction now have insight into the financial flows of the extractive sector, especially into payments made by companies and the recipients of those payments.

Currently 52 countries are members of the EITI and publish information on the financial flows of their extractive sector. However, many countries that are rich in oil, gas and minerals (such as Angola, Canada, Russia and China) have not joined the initiative yet, which limits the EITI's ability to ensure transparency of financial flows across the sector worldwide. To complement transparency efforts implemented through the EITI, mandatory disclosure legislation was adopted in the United States in 2010, in Norway in 2013 and in Canada in 2014, which requires extractive companies to publish all project level payments made to governments of countries in which they operate.

The European Union (EU) was not left behind. In 2013, the European Parliament adopted two Directives (the Accounting Directive and the Transparency Directive) requiring oil, gas and mining companies that are registered and / or publicly listed in an EU Member State to publish annually their payments to governments in countries where they conduct exploration and / or extraction activities (these reports are referred to as "reports on payments to governments" or "disclosures" throughout this analysis)[4]. In December 2014, France was the second European country, after the United Kingdom, to transpose these Directives[5]. In 2016, French extractive companies **published for the first time their payments to governments** for financial years starting in 2015[6].

Thanks to the first disclosures of this information by French extractive companies, civil society organizations ONE, Oxfam France and Sherpa, members of Publish What You Pay, in partnership with Le Basic (Bureau d'Analyse Sociétale pour une Information Citoyenne / Bureau for Social Analysis for Citizen Information), were able to:

- analyse and evaluate the way in which companies in the extractive **sector fulfil their transparency obligations regarding their payments to governments;**
- use these disclosures to **better understand the financial flows in the sector and to detect irregularities that could indicate possible practices of corruption or tax dodging**.

The first part of this report therefore discusses issues arising from the disclosures of six French companies active in the extractive sector[7]: **Areva, EDF, Engie, Eramet, Maurel & Prom and Total**. It evaluates the quality of the information provided by the companies and their compliance with French law, and identifies **potential loopholes to be filled in order to fully meet the transparency challenge in the extractive sector**.

In the second part of the report, two case studies are presented regarding the activities of Total in Angola and Areva in Niger, based on their disclosures of payments to governments. The objective of these studies is twofold:

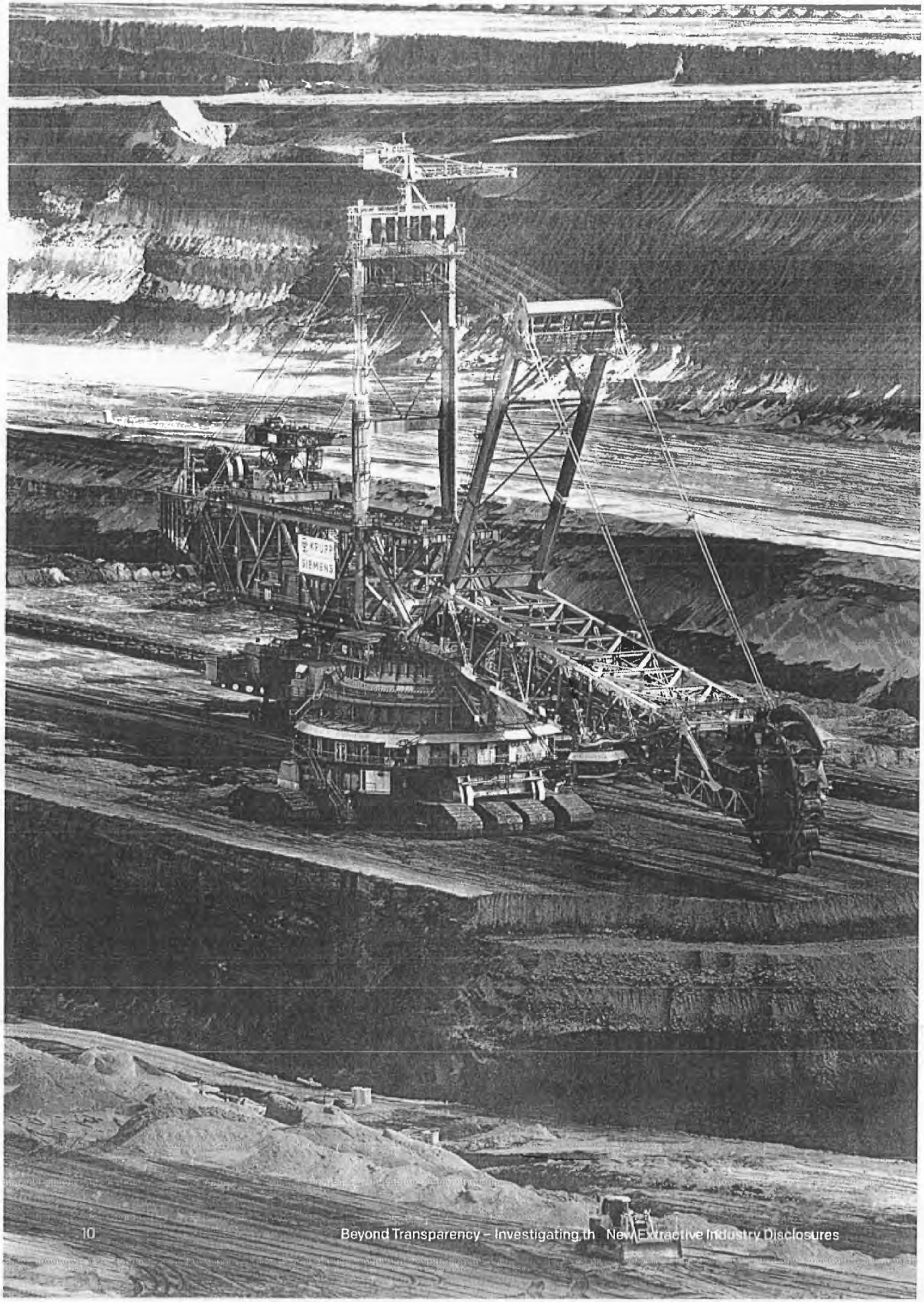
• To evaluate the usefulness of the payment disclosures to **decipher the real financial flows in the field**;
• To determine the extent to which these disclosures can strengthen the ability of local and international civil society organizations to identify irregularities that could **indicate potential cases of corruption or tax dodging**.

The aim of this report is therefore to contribute to the strengthening of transparency in the extractive industries, as well as to propose recommendations in light of the discussions that will take place before the review of the Accounting Directive in 2018.

Figure 1. Overview of the payment to government disclosure requirements under French law

Sectors	• hydrocarbons • coal and lignite • metallic minerals • stone	• rock, sand and clay • chemical minerals and mineral fertilizers • peat • salt and other mineral resources
Activities	• exploring • prospecting • discovering	• exploiting • extracting
Companies involved	Listed companies, large companies that meet two of the following three criteria:	• Total assets: 20,000,000 € • Net turnover: 40,000,000 € • Average number of employees during the year: 250 It should be noted that for the first year of disclosure, only French companies with more than 5,000 employees were affected by the disclosure requirement.
Payment categories	All payments equal to or greater than 100,000 euros, broken down into the following categories:	• Production entitlements • Taxes on the income, production or profits of companies • Royalties • Dividends • Bonuses for signing, discovery and production • Licence fees, rental fees, entry fees and other payments for licences and / or concessions • Payments for infrastructure improvements

The report on payments to governments covers all payments made during the past fiscal year, unlike the EITI, where there may be a two-year delay.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2

TRANSPARENCY OF FRENCH EXTRACTIVE COMPANIES: MORE PROGRESS NEEDED

Analysis of the first disclosures of payments to governments by Areva, EDF, Engie, Eramet, Maurel & Prom and Total makes it possible to determine whether these companies are in compliance with French law and to identify the gaps and limitations in their disclosures. Here follows an overview of the first payment to government data published by French extractive companies.

Overall, companies do comply with the disclosure requirements ...

Of the companies studied, only Maurel & Prom does not disclose all the information required by law, in particular the government entities that receive the payments. However, it should be noted that the company was not required to report for 2015, as it had 329 employees at the end of this year. Only companies with more than 5,000 employees were required to report their payments to foreign governments in the first year that France's law came into force.

... but their statements make it difficult to effectively analyse the payments made

While this is an important step forward in terms of transparency, the disclosures of payments to governments by the six companies studied enable for the moment **only a partial understanding of the financial flows** to the government authorities of the countries in which the companies operate. Our report identifies various gaps: difficulties in accessing the information, lack of contextual explanation and clarification, inconsistencies, interpretation of legislative provisions, etc. It also sets out the potential improvements that could lead to greater transparency in the extractive sector.

Access to information: an issue to revisit

While the French government assumed that the disclosure requirement would apply to "about thirty companies" in the financial year 2015, only 12 reports on payments to governments were identified in France by members of PWYP, and it is impossible to know whether these 12 constitute all or only some of the companies subject to the French reporting obligation.

All payment disclosures from the companies studied in our report were published online in accordance with the legislation. However, they are not always easily accessible.

> *The search tool of the Eramet website does not allow users to find the disclosure data of the company using the keywords "payments" or "governments".*

In addition, all companies have published their document in "pdf" format, which, unlike open data formats, encapsulates data and does not allow direct manipulation (calculations, data sorting, aggregations, etc.). It is therefore necessary to manually retrieve the data and to clean it, which is a long and tedious process during which mistakes could be made.

Without context, numbers mean nothing

Like the Directives, French law does not ask for background information on the extractive projects subject to the transparency requirement. Only EDF provides context for a better understanding of its activities. However, raw data only allows for a limited understanding of the payments and leaves many questions unanswered. Some projects are missing from the disclosures of the six companies studied, without any explanation regarding their exclusion.

> *The Engie website mentions projects in Indonesia and the Philippines that are not reported on in the company's disclosures.*

In the absence of contextual information, it is difficult to determine whether these projects were excluded from the disclosures because their payments were below the statutory 100,000 euros threshold or because these projects were deliberately omitted by the companies.

Questionnaires therefore had to be sent to each company in order to understand and analyse their disclosures.

> *The questionnaire addressed to Total contained no fewer than 67 questions covering barely one third of its disclosures. This number illustrates how difficult it is to understand the data reported by the company if it is not linked to its activities in the various countries.*

Four companies replied to the questionnaire that was sent to them: Areva, Engie, Eramet and Total. Their answers, along with the information and comments that accompanied EDF's numerical table, illustrate that greater contextual information about payments can address lingering questions. Information regarding the history and evolution of the presence of companies in the countries concerned, the existing partnerships, details regarding the payment categories used, the projects, etc. are necessary for a better understanding of the payment disclosures.

Finally, additional information such as profits, revenues, the list of subsidiaries and the number of employees in all the countries where the company is present (known as "public country-by-country reporting") is also necessary. This information would make it possible to analyse more precisely whether extractive companies pay their fair share of taxes in their countries of activity or if they artificially shift their profits to tax havens in order to reduce their tax contributions. This step is essential to assess to what extent the extractive activity benefits the development of producing countries.

The great mystery of currency conversion

French law defines a threshold of 100,000 euros for payments to be disclosed. In the absence of further clarification, it is logical to expect that the currency used in the company statements will be the euro. Yet this is not always the case.

> *Total publishes its payments in dollars, and Areva in local currencies. In both cases, it is necessary to convert the amounts into euro in order for the amounts to be compared within the same statement (in the case of Areva) or with the statements of the other companies.*

Even when companies disclose their payments in euro, they do not specify the exchange rates used to convert their payments from other currencies (nor the sources they used for reference), which makes it difficult to cross-check them.

Finally, these rates are likely to vary from one company to another; therefore the euro valuation of payments is also different. For this reason, 100,000 euros disclosed by Engie is quite likely not the same as the 100,000 euros disclosed by EDF.

▸ Unknown payments

Some payments to governments are made in kind (in barrels of oil, for example). Although the Directives require companies to disclose these payments in kind both in terms of volume and in monetary value, French law does not include this obligation. This has created a loophole that companies can use in order not to reveal:

• the volumes paid in kind to the governments;

To the extent that Total does not indicate either the corresponding volumes or the price references used for their valuation, it is difficult to verify the correlation between the statements of the company and those of the government authorities that received the payments.

• the raw materials associated with these payments;

> *EDF uses a unit which is the barrel of oil equivalent (boe), which makes it impossible to know the type of raw materials that it makes payments with (oil or gas), since the payments for these two raw materials are not reported separately.*

Again, it is not possible to verify the consistency between EDF's statements and those of the recipient authorities when the latter publish their receipt of payments in kind in other units (e.g., in m3 for gas, or metric tonnes for liquefied gas).

To be or not to be (the one who discloses), that is the question

The law states that companies must report payments for each project. The rule is clear when a sole company is involved in a project. On the other hand, things get complicated when a company operates a project through a partnership or a joint venture. As no precise requirement has been provided by law (neither in the Accounting Directive nor in the Transparency Directive), companies have a margin for manoeuvring when assessing how payments are to be reported in the context of a partnership or joint venture.

Analysis of the disclosures reveals various rationales used by the companies:

> *Areva discloses all the payments relating to the projects it operates. The company includes the amount of payments made by its partners. The amount disclosed does not correspond to what the company actually paid for its own share in the partnership or joint venture.*

> *Total declares the payments that it actually pays, in proportion to its participation in a joint venture, and for all its projects, whether or not the company is acting as an operator.*

> *On the other hand, Engie deems that it does not need to declare any payments if it does not have the status of an operator, even if it holds an interest in a project, and irrespective of whether its payments exceed the threshold of 100,000 euros.*

The current ambiguity resulting from these differences in interpretation of the law makes it impossible to obtain a complete and coherent view of the reality of the financial flows in cases of partnerships and joint ventures, and certain payments in excess of 100,000 euros are therefore presumed to be absent from the disclosures.

Projects with shifting boundaries

In order to improve the transparency of financial flows in each country of production, payments to governments must be disclosed for each project. However, the definition of the term "project" leaves room to manoeuvre, allowing companies to aggregate geographically separate sites or different projects, which in turn can ultimately undermine the visibility of financial flows.

> *In New Caledonia, Eramet aggregates as a single project payments relating to about ten mines scattered throughout the territory*[8].

> *Areva has consolidated under one contract the activities of its two mines in Kazakhstan, despite their distance of nearly 100 km apart*[9].

In addition, some companies have published payments at company level, not on a per project basis, an option that is allowed (in respect of obligations imposed at entity level) under the Accounting and Transparency Directives. The companies have in fact created a category of "not attributed to projects". Disclosing **at company level does not allow for cross-checking or tracking of revenue streams.**

> *For its payments in Gabon, Total uses a "fields in a non-allocated concession" category which includes more than 40% of all payments made in the country*[10].

In the cases cited above, the possibilities for analysing the corresponding payments are undermined.

Payment categories: each does as it pleases

French law requires companies to report their payments according to seven payment categories, without giving a precise definition of those categories. This can be explained by the fact that payments can be understood differently depending on the legal and fiscal regime of the countries in which the companies have extractive activities. As a result, each company has its own reference system to categorize its payments in order to match each specific national tax system using the seven categories mentioned in the law.

> *For Total, which uses United States and Canadian accounting standards as a reference, a royalty fee is not necessarily the same as for Engie, which used the guidelines developed in the United Kingdom by professional associations in the oil and mining sectors.*

> *According to the companies, a royalty fee can be allocated to the category "taxes", in accordance with the benchmark used and the tax system of the country*

In particular, the "taxes" category often turns out to be a sort of aggregated category, containing all the amounts that could not be allocated elsewhere. In addition, some companies have created an "other" or "miscellaneous" category[17], which is not provided for in the law and which prevents data users from identifying the nature of the payments made.

The heterogeneity of the statements and the absence of a precise definition of the payment categories make it difficult to compare the payments of different companies regarding taxes or royalties, making it akin to comparing apples to pears.

- The identity of the government recipients is not clear

The companies break down their payments by recipient government authority: ministry, region, municipality, public body, etc. But the disclosures do not allow, with the exception of the data from Areva, users to identify the recipient authorities by project. As it stands, the amounts per project are in one table, and the amounts per authority in another, with no possibility of linking the two tables. However, only by connecting these two pieces of information is it possible to trace financial flows and enable local civil society to ask for accountability.

If, in the case of a certain project, payments were made by a company but it is not clear who the recipient was, possibilities of cross-checking and cross-referencing are limited. Furthermore, some recipient authorities sometimes appear to be mentioned in different ways depending on the reporting company. Companies also sometimes use generic names to indicate recipient authorities rather than their official names.

> *Total mentions "Brunei government" to indicate the authority that received the payment. However, this wording is too vague to accurately identify the recipient (e.g., Ministry of Finance).*

3

TOTAL IN ANGOLA: PARTIAL TRANSPARENCY RAISES QUESTIONS

With its recent presidential election apointing a new leader, Angola is at a crossroads. With a fragile economy, the country continues to suffer from the «resource curse". It remains one of the poorest countries on the planet whilst being the leading oil producer on the African continent[14], a resource exploited by the French company Total, among others. This paradox raises questions about the management of revenues resulting from the exploitation of the country's natural resources. In this context, Total published its payments to the Angolan government for the first time.

OIL GOVERNANCE: LONG-AWAITED TRANSPARENCY

For many years, the Open Society Initiative of Southern Africa (OSISA), which promotes democracy, transparency and human rights in the management of oil revenues in ten southern Africa countries, has been reporting endemic corruption in the Angolan oil sector[25]. Similar criticisms have also been made by other NGOs, such as Human Rights Watch[26], some US authorities[27], and the International Monetary Fund (IMF), which lamented a loss of 4.2 billion euros in public funds between 2007 and 2010, potentially linked to a misappropriation by Sonangol, the national oil company[28].

The role of Sonangol

Angola's oil sector is regulated by a 2004 law which affirms the inalienable public ownership of oil fields by the Angolan State and makes Sonangol, the national oil company, the holder of all land rights[29]. As the "exclusive concession holder" of the State, Sonangol is responsible for all hydrocarbon activities in the country. It can conduct these activities independently or in partnership with other companies. Any company that wishes to carry out oil activities in the country (apart from prospecting permits) must partner with Sonangol.

These accusations led the Angolan government to take steps to improve transparency in oil-related revenue streams. For several years, the Oil Ministry and Finance Ministry have been publishing disaggregated information per block regarding the tax payments received by the Angolan government. This information includes the barrels paid pursuant to Profit Oil[30], as well as the applicable selling price[31]. Despite these commendable efforts[32], Angola has not yet joined the Extractive Industries Transparency Initiative (EITI) and remains 164th (out of 174 countries) in Transparency International's Corruption Perception Index[33].

Furthermore, recent studies conducted by civil society have shown that **the official data regarding the revenues received by the Angolan State is incomplete and sometimes inconsistent between the various government agencies**[34]. Disclosure of payments made by Total to the Angolan State now at last makes a new analysis possible in order to clarify how much Angola receives in return for the extraction of its oil.

This study shows how the receipts of Profit Oil reported by the Angolan authorities in 2015 on Block 17 – the largest payment received by Angola – differ by more than USD 100 million from companies' payments based on the payment reported by Total.

TOTAL IN ANGOLA - AN ONGOING STORY

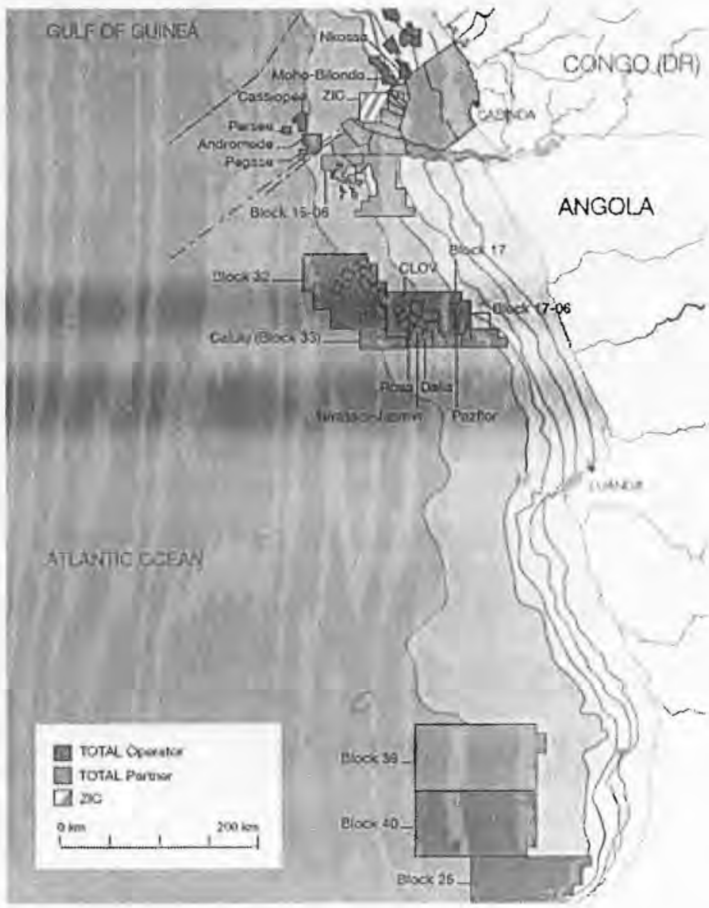
After a decade of economic upturn[15] following the end of Angola's civil war, the dramatic decline in economic growth in recent years has led to a recession in a country where more than a third of the population lives below the poverty line[16] and only 40% of inhabitants have access to electricity[17].

With production of 1.8 million barrels per day (bpd), which accounts for 95% of exports and 80% of the country's income[18], the Angolan population should be able to benefit from the exploitation of the country's natural resources.

But that is not the case. Primarily destined for the Chinese (60%), European (22%) and American (14%) markets[19], Angolan oil mainly comes from offshore sites. The largest site in Angola is Block 17, located 150 km off the coast. It accounts for about 35% of the country's production[20]. Although operations started in the 1970s, it was only since the 1990s and following the discovery in deep waters of the Girassol field (which is located in Block 17[21]), that oil and gas production took off in Angola. It more than tripled between 1994 and 2014[22].

Claiming to be "the most efficient oil major in 2016[23]", Total holds a special place in Angola as the country's largest oil producer[24]. Total discovered the Girassol field in the 1990s and is currently operating Block 17 in partnership with Exxon Mobil, Statoil and BP. Angola is the second largest oil source for the French multinational and the new agreements signed in 2015 between Total and Angola suggest that its involvement will continue in the years to come.

Figure 1. Total projects in Angola
Source : Total SA – Financial Transparency 2015, Example of Total in Angola



Profit Oil: a guide

Profit Oil corresponds to the number of barrels, or their valuation, to be shared between extractive companies and the host government. It can be in kind or in cash.

In the case of Block 17, there is a breakdown between Total and its partners (BP, Statoil and Exxon) and Sonangol, the concession holder of the operating site, once these companies have recovered the Cost Oil (the share of oil intended to cover their costs of exploration or investment in the production site from the beginning). Profit Oil is paid in kind.

Once recovered by Sonangol, the Profit Oil is transferred to the Angolan Ministry of Finance after a charge has been deducted to cover the operating costs of Sonangol.

Figure 2. The distribution of oil produced and the revenues generated between operating companies and the concession holder of Block 17 (source : BASIC)

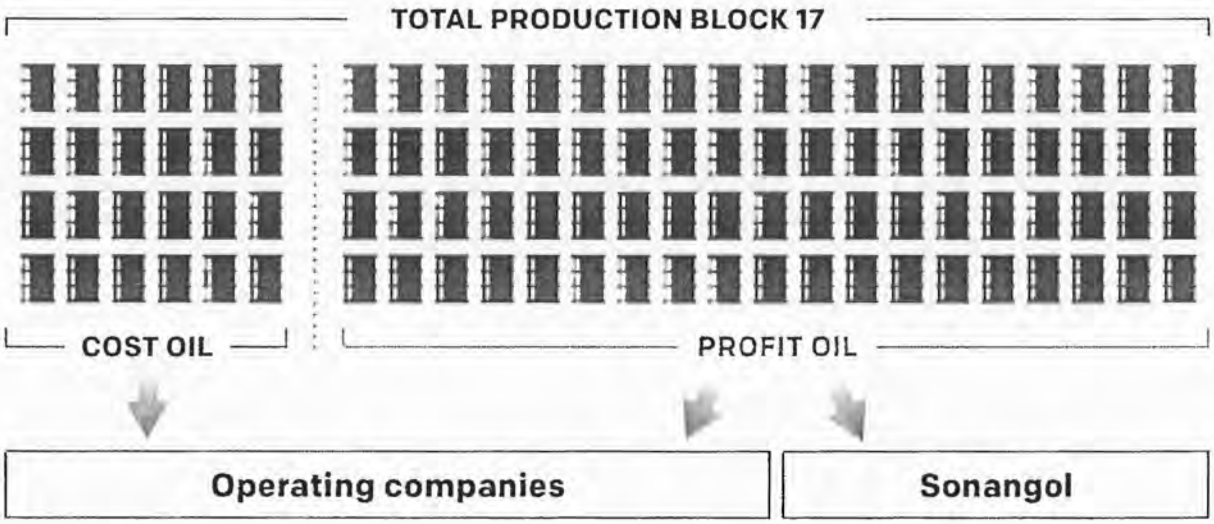
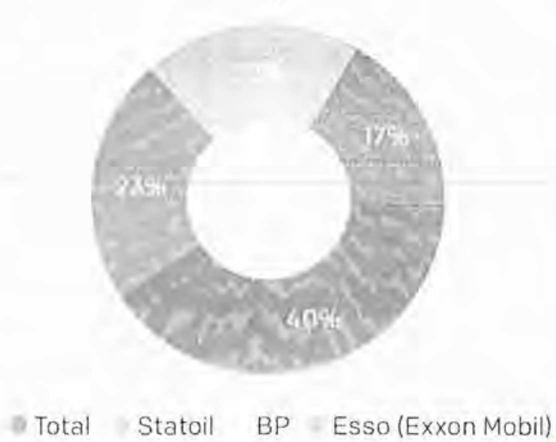


Figure 3. Participation in block 17 (source : BASIC).



PROFIT OIL : DIFFERENT TOTALS

In 2015, the Angolan authorities disclosed revenues of more than USD 3.7 billion (USD 3,729,572,262) as Profit Oil from Block 17[35].

Two of the joint venture partners operating Block 17 have not disclosed their payments to the Angolan government. Without the statements of Exxon and BP[36], it is impossible to trace the payments made by each company paying Profit Oil for Block 17 and to know if the total sum corresponds to the amount reported by the Angolan authorities. Despite this, the existing statements of Total serve as a starting point for tracing the whole Profit Oil paid for Block 17.

Total states in its payments to governments disclosures that it paid USD 1.5 billion (USD 1,535,173,000) in Profit Oil in relation to Block 17. At a meeting with the authors of this report, the company's management confirmed that the Profit Oil it paid on Block 17 corresponded to the percentage held by Total in the joint venture operating the block, i.e. 40%. However, the amount reported by Total does not correspond to 40% of the amount reported by the Angolan authorities. Had this been the case, the Profit Oil received by Angola would amount to USD 3.8 billion (USD 3,837,932,500), which means that there is a discrepancy of USD 108,360,238.

Illustration 4. USD100 million gap between Profit Oil disclosed by Angolan authorities and data based on Total disclosure (Source : BASIC)

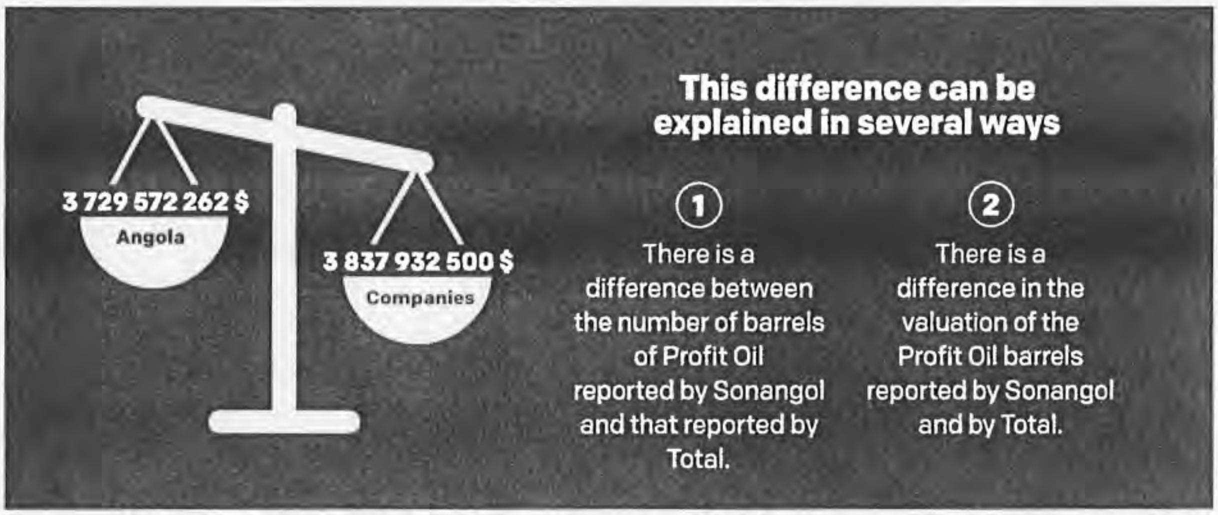


Figure 5. The two possible explanations for the difference in valuation of Profit Oil between Total and Sonangol (source : BASIC)

PROFIT OIL: WHO BENEFITS FROM THE AMBIGUITY?

Theory I: The differences in Profit Oil stem from a difference between the number of oil barrels reported by Sonangol and those accounted for by Total.

In its 2015 financial report, **Sonangol stated that it had received 70,269,382 barrels of Profit Oil for Block 17**[37]. According to the information from the Angolan authorities, Total's share would therefore be expected to be 28,107,753 barrels, corresponding to its share in Block 17 (40% of total barrels paid).

In its payments to governments disclosures, Total publishes only the valuation of its payments in kind without providing the number of barrels. This obligation under the Directives has not been properly transposed into French law. It is therefore impossible to compare the volumes declared by Total and those disclosed by the Angolan authorities directly. In order to make such a comparison, the reference price published by the Angolan Ministry of Finance must be used to value the Profit Oil paid to Sonangol relating to Block 17[38].

Using this information, we can estimate the number of barrels of Profit Oil paid by Total at 29,573,743 barrels[39]. **This would mean a difference of 1,465,990 barrels according to the data published in Sonangol's financial report**. So how can the difference between the number of barrels in the statements of the Angolan authorities and the estimates derived from the data of Total be explained?

One explanation could be a difference in the definition of Profit Oil used by Sonangol and by Total. Analysis of Total's disclosures highlighted that the French company used US accounting rules to define its payment categories, while the Angolan authorities may use a different reference. This way, when Sonangol receives various kinds of payments from Total, it may account for certain payments under Profit Oil, while Total does not.

Another possibility could be an under-reporting of the number of barrels received by the Angolan authorities. Sonangol may have received more barrels as Profit Oil than officially declared; some could then have been diverted, although it is impossible to trace the destination or use of those barrels. Officially, Sonangol collects a portion of Profit Oil paid by the companies to maintain its operations. The margin is reported annually by Sonangol and is limited by law to a maximum of 7% of the overall payments[40]. The difference in reported barrels could thus result from a greater share being collected by Sonangol than what it has officially disclosed.

Theory II: The difference in Profit Oil stems from different valuations of the barrels of oil from Block 17.

In 2015, the reference price published by the Angolan authorities to value a barrel of crude paid as Profit Oil for Block 17 was USD 51.91[41].

Without the disclosure by Total of the number of barrels associated with the valuation of the Profit Oil payment for Block 17, and without knowing the Profit Oil valuation method, it is impossible to directly calculate Total's price per barrel. To confirm the valuation per barrel, it is necessary to cross-reference the information with other data.

Total holds its 40% stake in Block 17 via two subsidiaries. One subsidiary, Total E&P Angola, registered in France, manages 35% of the 40% stake of Total in Block 17. Its activity is limited to managing and selling oil from Block 17[42]. The accounts of the subsidiary are held at the French company registry and accessible for a small fee. Use of the information disclosed in these accounts and Sonangol's filings makes it possible to calculate the price per barrel of Block 17 Profit Oil at USD 49[43], giving a valuation difference of USD 2.91 per barrel.

How to explain the fact that Total values the barrels at a lower price than Sonangol does for the same Profit Oil from the same well? The accounts provided by Total E&P Angola indicate that the sole activity of the subsidiary consists of the sale of oil from Block 17. All of the sales by this subsidiary were made to another subsidiary of Total, TOTSA Trading, the international trading platform of the group located in Switzerland[44], a country known for its "advantageous" taxation for multinational companies[45]. By applying a selling price between its two subsidiaries that is below that set by the Ministry of Finance, Total could reduce its taxable profit in Angola and reduce its tax payments. If Total E&P Angola were to value the barrels at the Ministry of Finance's reference price of USD 51.91 per barrel instead of USD 49, the subsidiary would earn 186 million euros in additional revenue[46]. The tax rate on oil revenues in Angola (50%) would result in **USD 93.4 million (USD 93,388,342) in additional taxes in Angola**.

CONCLUSION

The first disclosures of payments to governments by Total has revealed differences between the information published by the company and that of the Angolan government. In particular, a gap of more than USD 100 million was recorded between Sonangol's reported Profit Oil regarding Block 17 and calculations based on Total's statements. This can be explained either by a difference in the number of reported oil barrels, or by a different valuation of the price per oil barrel. To confirm or invalidate one of these theories, Total would have to publish the number of Profit Oil barrels regarding Block 17 that the company actually paid - a requirement set out in the Accounting and Transparency Directives which has not been transposed into French law. The French company should also indicate its method of valuing Profit Oil for each payment in kind and publish the amount of its profits made in Angola. The disclosure of such information would make it possible to confirm or invalidate each of the two theories by removing the ambiguity around the valuing of payments between companies and the authorities. The reported gap of more than USD 100 million is questionable and could be all the more condemnable if it were the result of illicit practices in a country where nearly one-third of the population lives below the poverty line.

Recommendations

FOR THE FRENCH GOVERNMENT:

1. Modify Article L.225-102-3 of the Code du Commerce to incorporate an obligation to disclose payments in kind, value and volume as required by the European Transparency and Accounting Directives.

FOR TOTAL:

1. Publish the volumes relating to the company's payments in kind.
2. Publish the method used to value each payment in kind.
3. Proactively publish a country-by-country report such as required of banks by the EU Capital Requirements Directive IV.

4

AREVA : TRANSPARENCY IN A MINEFIELD

More than 75% of the electricity currently[47] produced in France is of nuclear origin. Uranium extracted by Areva is an essential component of nuclear fuel production. It comes from a handful of producing countries, most notably Kazakhstan, Canada and Niger. Nigerien uranium accounts for nearly 30% of the uranium produced by Areva, the French state-owned company and one of the leaders in the nuclear market. If the opaqueness that surrounds the extraction of uranium is gradually dissipating, the issue of Areva's fair contribution to the Nigerien budget in return for uranium extraction still remains.

THE OXFAM-ROTAB CAMPAIGN: "NIGER - WHO PROFITS FROM THE URANIUM?"

In 2013, Oxfam and ROTAB (Réseau des Organisations pour la Transparence et l'Analyse Budgétaire/Publish What You Pay Niger) launched a campaign "Niger: who profits from the uranium?" to denounce the lack of contribution from Areva to the Nigerien budget in return for the exploitation of uranium in its territory and to demand the renegotiation of the mining contracts. In France, nearly one in five light bulbs is lit by Nigerien uranium[48], while in Niger almost 90% of the population does not have access to electricity[49]. In particular, Areva used to pay Niger a royalty fee that is lower than the applicable rate under the country's 2006 Mining Code[50].

Thanks to the mobilization of citizens in Niger, France and all over the world, Areva was finally forced to agree to apply the legal royalty regime regarding its uranium contracts with the Nigerien government[51] in 2014.

Royalty fee: company payment in return for the right to exploit natural resources.

Two years later, the company – more than 85% owned by the French government – disclosed the amounts it pays to the Nigerien government for the first time, as a result of the new European reporting requirements[52].

Despite the negotiations, our calculations show that Areva seems far from contributing its fair share. While Nigerien uranium accounts for nearly 30% of the French company's production[53], Niger receives only 7% of Areva's payments to producing countries[54]. Analysis of the data published by Areva for Niger highlights two factors that might have allowed the French company to reduce its payments in Niger:

Lowering the extraction price[55] of the uranium:
The renegotiation of the contracts resulted in a reduced extracting price, which in turn resulted in a decline in profitability of the mine. This decline in profitability has a twofold effect. When profitability declines, the extractive revenues also decline and, with them, the amount of royalty fees paid. Furthermore, since the Nigerien royalty rate is calculated based on the profitability of the mines, the decrease in profitability also results in the application of the lowest rate (5.5%, compared to 9% or 12% if the mine were more profitable).

If the extraction price had not decreased, the amount in royalty fees paid would have increased by nearly 15 million euros in 2015.

Under-valuing the exported uranium:
In 2015, Areva's Nigerien subsidiary may have sold uranium to its parent company at a price that is significantly undervalued compared to the prices otherwise charged by other players in Niger. The same metric tonne of uranium, coming from the same mines, would be valued at 11,500 euros more if it were not exported by Areva. The price of uranium exported by the French company may barely cover its acquisition cost, which would allow Areva not to pay any taxes on its profits in Niger.

Areva's uranium exports, valued at the prices charged by other players in Niger, could have yielded between 10 and 30 million euros in additional tax for the government in 2015, i.e. between 8% and 18% of the health budget of Niger for that same year, in a country where life expectancy barely exceeds 60 years[56].

FROM THE MINES OF NIGER TO FRANCE: FROM EXTRACTION TO EXPORT

Areva operates two active uranium mines in Niger, Somair and Cominak, with minority partners[57]. Somair is the largest uranium mine in Niger and one of the five largest uranium mines in the world in terms of production volume[58]. As operator, Areva holds almost 64% of the shares in the Somair mine in association with Sopamin, a company controlled by the Nigerien government, which holds the remaining 36%[59].

When extracted from Nigerien mines, the uranium is not directly owned by Areva. In order to obtain the uranium, Areva and Sopamin must buy it back at the mine in proportion to their shares for a contractually agreed extraction price. The Areva Mines Niger[60] subsidiary buys the uranium and then sells it back to the Areva parent company. The French multinational also buys uranium from Sopamin.

Like many mineral-rich countries, Niger imposes royalty fees on the extraction of its natural resources[61]. Profits from the extraction of these resources are also taxed according to the national tax regime[62], similar to other company profits.

Extraction price: price at which Areva buys uranium from Nigerien mines. It is set by contract. When it is extracted from the Nigerien mines, the uranium is not directly owned by Areva, which must buy it back at the mine in order to formally take possession of it.

Figure 6. Overview of the chain of uranium ownership mined at the Somair mine

NEW ROYALTY FEES: AREVA'S PROFITABLE NEGOTIATIONS

In 2014, under pressure from civil society, Areva and Niger signed a Strategic Partnership Agreement (SPA)[63], which amended Areva's royalty obligation[64]. The rates are now based on the profitability of the mine. Therefore, according to the profitability of the project, the royalties that the company will have to pay to Niger will be 5.5%, 9% or 12% (see table). Previously, the royalty fee paid by Areva was set at 5.5%, regardless of the profitability of the mines.

At the time of the conclusion of this Agreement, French and Nigerian civil society welcomed the inclusion of the new royalty rates in the text. The Agreement, however, states in its second part that the uranium extraction price will be indexed to market prices. What may seem like minor details actually matter considerably: if market prices fall, the price of extraction also decreases and this will inevitably cause a decrease in the profitability of the mines, and thus of the royalties due. Since 2014, the indexation of market prices has thus reduced the amount of royalties paid by the French company.

With a profitability level of 2.5% for Somair in 2015, Areva paid royalties of 5.5% of the revenue generated by the mine, approximately 10.8 million euros. This is **5 million euros less than the royalties the company paid in 2013 for a roughly equivalent production volume**[65]. To hope to see the application of a 9% royalty fee, the profitability of Somair would therefore need to be eight times greater.

This reduction in the mine's profitability was made possible by a combination of two factors: a reduction in the uranium extraction price and an increase in production costs.

How to check the amount of Areva's royalties in Niger? The example of Somair

Areva's payments to governments disclosures enable us to verify that the amount of royalty fees paid to Niger is indeed as stated by Areva. We can calculate the extraction price of uranium in Niger for 2015 from the royalties paid relating to Somair and compare this extraction price with the formula provided by Areva in the Strategic Partnership Agreement (SPA) and thus verify the amount of royalties paid by Areva.

The new formula for calculating the extraction price described in the SPA, and the uranium production volume of the mine as reported by Areva, can be used to calculate the extractive income from Somair and then to determine if the amount of royalties paid by Areva corresponds to the 5.5% rate.

In 2015, with a price of 78.38 euros per kilo of uranium, and production of 2,509 metric tonnes of uranium, mining revenues from Somair would amount to approximately 196,658,000 euros. The royaltyies paid are therefore approximately 10,816,200 euros, which corresponds to the amount reported by Areva in CFA francs (Central African francs) in its disclosures of payments to governments.

Figure 2. Applicable royalties according to the Nigerien Mining Code

Mining Code	Profitability less than 20%	Profitability between 20% and 50%	Profitability more than 50%
Royalty rate	5.5%	9%	12%

The royalty rate is expressed as a percentage of the market value of the uranium mined (i.e. the extraction price multiplied by the volume of production). The profitability is the net margin of the mine.

AREVA: A FAIR PRICE?

While the Strategic Partnership Agreement involved a change in the royalty regime, Areva succeeded in obtaining an indexation of the extraction price of uranium to market prices, but not just any market price. The new pricing formula is based on several market prices, including spot market prices, or short-term market prices, that are historically lower than others[66] and reduce the extraction price at which Areva and Sopamin buy uranium.

Therefore, since the signing of the SPA and the indexation, the extraction prices have been decreasing. Whereas in 2013 the extraction price of a kilo of uranium was **73,000 CFA francs (about 111 euros[67]), it was less than 52,000 CFA franc (or 78.38 euros) in 2015**.

Indexing the extraction price of uranium to so-called spot market prices is surprising, since Areva does not operate on spot contracts. The uranium purchased at extraction price is resold by Areva Mines Niger to the parent company. In reality, Areva has sold uranium to itself since the beginning of operations at the Somair mine, at that time by the predecessor of Areva, the company Cogema. This has therefore little to do with a short-term contractual commitment.

Even after being processed, Areva's uranium is mainly sold to long-term trading partners, most notably EDF, with which Areva has a contract to supply 35,000 metric tonnes of uranium until 2030[68]. Nigerien uranium, which accounts for nearly 30% of Areva's annual production, is therefore a strategic raw commodity, the sale of which is used to honour long-term contracts.

The reduction in extraction prices due to indexation therefore resulted in a decline in the profitability of the mine, thus reducing the amount of royalty fees paid and de facto locking the applicable royalty rate at the lowest level.

The decrease in extraction prices, however, would not be the only factor diminishing the profitability of the mine; the increase in production costs would be another.

Profitability: profitability is the net extractive margin and is calculated by dividing the operating results of a mine by its operating revenues.

MINING AT ANY COST ALLOWED?

During the 2014 negotiations, Areva and Niger also agreed on the need to reduce production costs, while safeguarding employment to preserve the profitability of Nigerien mines[69]. Since the costs of producing uranium are not made public, it is impossible to know exactly if they have increased since the SPA was signed. But the signs are not reassuring.

In 2014, an internal audit of Somair, which was leaked to the press, showed that the production costs of the mine had more than doubled between 2006 and 2011[70], without any correlation with production levels. The Nigerien government still refuses to make the complete audit public. According to Areva, this increase is due to new investments. Without the entire audit, it is not possible to verify the company's assertions.

If the rise in production costs reduces the profitability of the Nigerian mines, does it benefit Areva? The company could in fact benefit indirectly from this increase in costs. How? Areva is organized vertically: the company operates mines, transports uranium and converts it into nuclear fuel. It has subsidiaries specialized in logistics, marketing, transport[71], etc. For all these services, Areva could charge higher prices to the mines it operates. The increase in costs for the mine could thus represent an increase in profits for other Areva subsidiaries. The opaqueness surrounding the structuring of Areva's activities in Niger does not currently make it possible to answer this question properly.

To cope with rising costs, Areva needed in any case to break one of its commitments. In 2015, the French company laid off several hundred Nigerien workers[72], justifying this in terms of a decline in the profitability of the mines. This decline was in particular due to the indexation of prices that the company itself had negotiated.

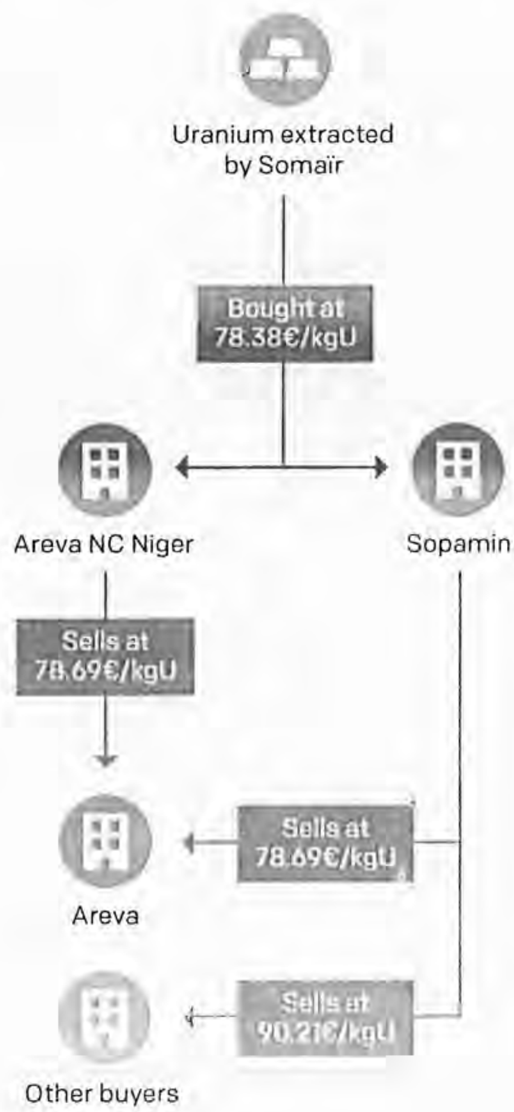
This combination of higher production costs and lower extraction prices could explain the very low profitability of the mines and thus the reduction in the applicable royalty fees. If the extraction price in 2013 had been maintained at 73,000 CFA francs (compared to the current price of less than 52,000 CFA francs), the applicable royalty rate for the year 2015 would have been 9%. The royalties paid would have been 25 million euros, nearly 15 million euros more than the current payment.

AREVA'S EXPORT PRICES WELL BELOW THOSE OF COMPETITORS

After being bought by Areva Mines Niger at extraction price, the uranium is sold to Areva in France for a price that beats all competition.

The UN Statistics Division and Nigerien Customs both publish information on the volumes and value of Nigerien uranium exports, which makes it possible to obtain an export price[73]. By comparing the extraction prices and the export prices to France, we can calculate that, for 2015, the margin generated by the sale of uranium from Areva Mines Niger to Areva Mines France is on average 31 cents per kilo (on an average sale of 78.69 euros per kilo of uranium). This margin is intended to cover transport costs, which are high due to the safety measures surrounding the transport of *yellow cake*[74], as well as a profit to remunerate the employees of Areva Mines Niger. However, the same kilo of uranium from the same mines yields a margin of 11.8 euros per kilo (on a sales price higher than 90.2 euros per kilo of uranium) when it is not sold to Areva. The price of the kilo of uranium sold to Areva therefore seems undervalued compared to the prices charged to other companies.

Illustration 7. Export Price of Nigerien Uranium



Export of uranium: whoever loses, wins

In 2015, the uranium exported from Niger came only from the two mines operated by Areva, both subject to the SPA between Areva and Niger, which establishes a single extraction price. This implies that uranium should have been sold at the same price to all partners in both mines. However, exports to France (i.e. Areva's purchases) are on average 11,500 euros cheaper per metric tonne than exports to the rest of the world. They are also well below average uranium prices for 2015. How can this be explained? Two reasons can be given.

The first reason is Areva's purchase cost. A lower selling price for a producing country as big as Niger offers a significant competitive advantage. Not only is Areva buying uranium from its Nigerien subsidiary at an unbeatable price, but it passes this purchase price on to other suppliers, as indicated by the UN data.

The second reason relates to income tax. The export price of uranium to France leaves a very small profit margin (31 cents per kilo) to cover the transport costs and to pay the employees of Areva Mines Niger. This very low profit margin also allows Areva not to pay income tax for its Nigerien subsidiary[76]. When contacted, the company defended itself for not paying taxes, and explained that it took advantage of a tax credit resulting from prepaid taxes in 2014[77]. In other words, Areva claims to have paid too much tax in 2014 in relation to its profits, and that the surplus paid in 2014 covered the total amount of taxes due in 2015.

But how much in taxes did Areva's Nigerien subsidiary pay in 2014? According to data from the Nigerien government[78], in 2014 Areva Mines Niger did not pay income tax, apart from a pre-payment, equivalent to less than 38,000 euros[79]. For the years 2014 and 2015 combined, Areva could have therefore paid less than 38,000 euros in taxes. It is unclear today whether the 2015 payments have exhausted the 2014 tax credit or whether the pre-payment will also cover the taxes due in 2016. This data tends in any case to demonstrate the limited profits of Areva's subsidiary in Niger. Are these profits limited by the underpricing of uranium exported to France?

TANGIBLE LOSSES FOR THE NIGERIEN GOVERNMENT

While Niger is still struggling to raise funds to finance essential services such as access to health or education, the potential underpricing of uranium exported by Areva represents significant potential losses. Since these losses are difficult to quantify with precision, we have identified two possible scenarios based on a comparison of the extraction price and the export prices of 2015, taking into account Areva's economic model:

Scenario 1: If Areva values its uranium at the same price as other Nigerien uranium exporters (90.2 euros per kilo in 2015), the profit of Areva Mines Niger would amount to more than 39 million euros in 2015[80] and the taxes that Areva would have to pay would be around 11.75 million euros.

Scenario 2: If Areva values its uranium on the basis of long-term market prices that would reflect its activity correctly (109 euros per kilo in 2015), then the profit of Areva Mines Niger would amount to more than 101 million euros in 2015[81] and the taxes that Areva would have to pay would be around 30.5 million euros.

These potential tax losses represent between 8% and 18% of the health budget of Niger in 2015, in a country where life expectancy is just over 60 years.

CONCLUSION

Three years after the renewal of Areva's contracts in Niger, the contracts regulating Areva's activities have still not been made public despite a Constitutional mandate. Disclosure of the SPA, as well as the first set of data published by the French nuclear giant to fulfill its European obligations, make it possible to reach a partial assessment of the outcome of the negotiations.

The change in the royalty regime, one of the main demands of the Nigerien public, unfortunately did not have the expected results. The parallel negotiations on the indexation of the extraction price have frozen profitability, preventing the application of higher royalty rates and de facto decreasing the amount of royalty fees to be paid. Without this modification of the extraction price, the royalties paid could have increased by 15 million euros in 2015. The formula for the extraction price introduced for the financial years 2015 and 2016 should be reviewed every two years, giving Niger an opportunity to readjust the formula in accordance with Areva's economic model.

Moreover, this analysis also shows that Areva's uranium exports could be underpriced, which would allow the company not to pay any income tax. This underpricing would represent estimated losses of between 10 and 30 million euros. It is up to Areva to price sales between its subsidiaries on an arm's length basis[82], reflecting both the market value of the goods and the business model of the company.

Recommendations

FOR THE GOVERNMENT OF NIGER:

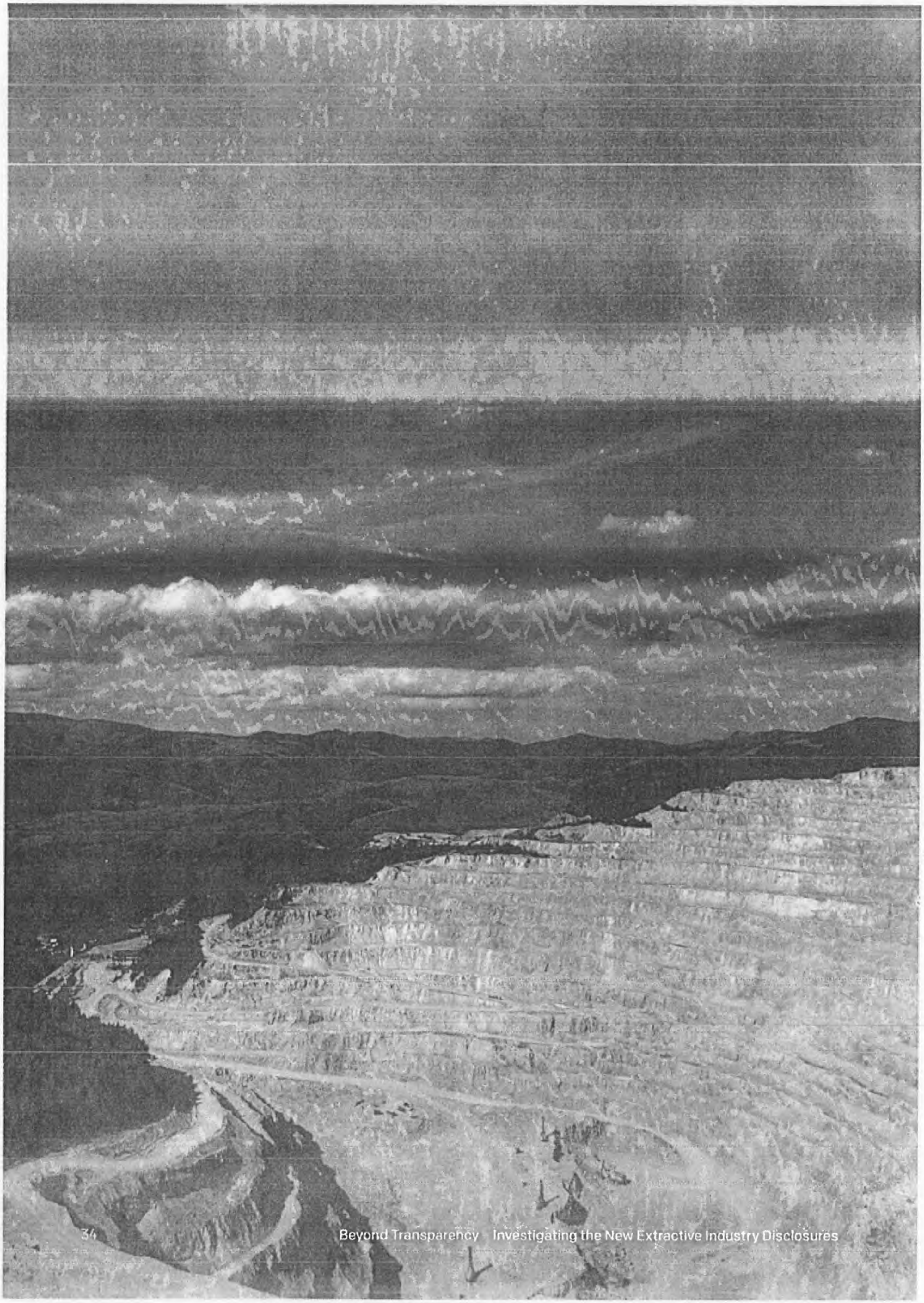
1. The contracts regulating the extraction activities of Areva in Niger must be made public in accordance with the provisions of the Constitution.
2. The renegotiation of the extractive price of uranium must take into account Areva's economic model.
3. The audits of the mines operated by Areva must also be made public so that citizens get a clear idea of how the mines are governed.

FOR AREVA:

1. Areva should renegotiate a uranium extraction price that corresponds to its economic model.
2. Areva should sell uranium from its Nigerien subsidiary at an arm's length price, in accordance with OECD principles.
3. Areva should proactively publish a country-by-country report in order to complete the disclosure of information on its activities in the countries where it operates.

FOR THE FRENCH GOVERNMENT, MAJORITY SHAREHOLDER IN THE COMPANY:

1. As the majority shareholder in Areva, the French government must ensure that Areva adheres to the highest standards of transparency and dialogue with civil society. In particular, the French government must require Areva to publish all contracts relating to its mining activities in Niger.
2. The French government must commission a public audit of the extractive activities of Areva in order to account for the potential overcharging by the French company of its own subsidiaries operating its mines.



5 GENERAL RECOMMENDATIONS

The first mandatory disclosures by Areva, EDF, Engie, Eramet, Maurel & Prom and Total improve our understanding of the companies' activities and their contributions in the countries where they operate. Yet fully understanding this data is difficult.

The difficulty of accessing this data, the lack of context of the data, the lack of information on the exchange rates used, the insufficient precision of the criteria defining the different categories of projects and recipient entities, etc. are all elements that do not currently allow the public to have a complete understanding of the disclosures published by the French extractive companies.

As the cases of Total in Angola and Areva in Niger show, French extractive companies still appear to benefit from the exploitation and extraction of natural resources at the expense of the development of the countries in which they operate.

[illegible]

FOR THE EUROPEAN UNION

1 Access to data:

a. Require Member States to create a centralized, public and free registry of company reports on payments to governments;

b. Require companies to publish reports in both pdf and in an open data format.

2 Putting the information into context:

a. Require companies to publish the following information for each project: project status (exploration, development, exploitation), partners, start date, production volumes, contextual information about payments linked to infrastructure;

b. Require companies to include and name projects where payments are of less than 100,000 euros;

c. Require companies to report per country for all countries where they are present without exception, including the following information: revenues, number of employees, physical assets, sales, profits, a complete list of subsidiaries and the nature of the activity of each subsidiary.

3 Improving the reporting requirement for each project:

a. Require companies to declare the amounts paid in both their original currencies and in euro, indicating precisely the rate and the reference system used for currency conversions;

b. Require companies to indicate the source used for defining each payment category;

c. Differentiate the nature of payments by commodity and provide the method that companies must use to value these payments;

d. Require companies to publish the payments in proportion to their participation in projects regardless of their status as operator or non-operator;

e. Clarify the concept of "project"; only projects that are integrated both operationally and geographically and with similar terms can be combined;

f. Specify that companies disclose the official name of each authority that received a payment.

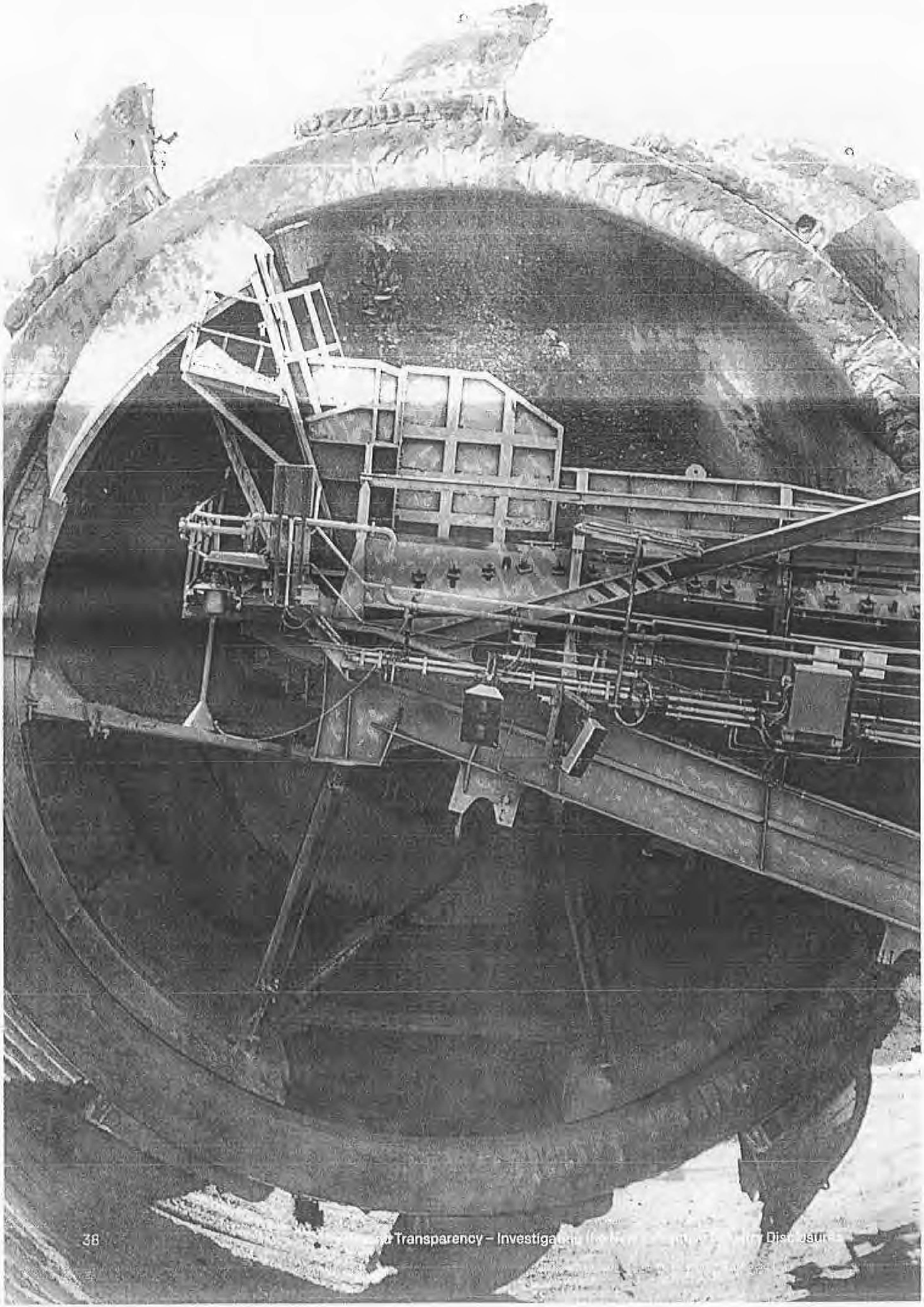
FOR THE FRENCH GOVERNMENT

The French government should support the recommendations set out above at a European level.

Given the loopholes in the transposition of the European Directives into French law, as highlighted in our analysis, the French government must **reinstate the obligation to disclose payments in** kind by both value and volume as required by the Directives, and should:

> **a.** Consolidate all reports in a centralized, public and free registry and request disclosure of reports on payments to governments in both pdf and an open data format (open data format reporting is required in the United Kingdom for UK-registered extractive companies and will be required for publicly listed non-UK-registered extractive companies when reporting on financial years that start on or after August 1, 2016);
>
> **b.** Raise the upper limit of the current fine of 3,750 euros to make the penalties more dissuasive, as specified in the Directives.

These improvements would allow **for a better understanding of the activities of the** companies concerned **regarding their obligation to report per** project and thus meet the **objective of transparency** in the extractive sector.



6 GLOSSARY

GLOSSARY

Several of these definitions are taken or adapted from
OpenOil (2012), Oil contracts: how to read and understand them [33]

Barrels Of Oil Equivalent (Boe)
Way of measuring energy production or consumption across different energy sources. Other hydrocarbons like natural gas and coal and occasionally even renewables are measured by the amount of energy they produce compared to a barrel of oil.

Barrels Per Day (Bpd)
The standard way of measuring oil production. A barrel is about 42 US gallons or 158 litres, though the exact number varies according to crude oil grades. The world currently consumes around 90 million barrels of oil a day, a quarter of it in the United States.

Block
Method used to designate an area of land into workable areas for separate consortia or companies to operate in. One block can contain several oil fields.

Concession
A lease agreement by which an oil company can enjoy the exclusive right to produce oil in any given area, as ownership of the oil is transferred from the natural owner, such as the state or landowner, to the lease holder at the wellhead.

Crude Oil
A fossil fuel formed from organic material over millions of years and extracted directly from the rocks where it is found, which can be further processed into various fuels and petrochemical products for consumers. Natural gas is often found dissolved in the oil.

Joint venture
Two or more companies share the management of a project, as well as any profits and losses.

Natural gas
Mainly methane. It occurs naturally and is used as a fuel.

Natural resource curse
The theory that natural resource wealth can paradoxically lead to negative development outcomes in producing countries due to the weakening of government institutions, the neglect of other key sectors of the economy, corruption, high inequality of income and/or pollution. Sometimes called the "paradox of plenty".

Offshore
Term for oil and gas deposits and installations at sea.

Onshore
Term for oil and gas deposits and installations located on land.

OPEC
The Organization of Petroleum Exporting Countries was established in 1961 and has 12 member states that agree on a common quota for the production and sale of oil.

Operator
The company partnering in a joint venture that has decision-making authority at the operational level for the extractive project. It is also the company that will meet the financial obligations of the joint venture on behalf of the other partners; to latter contributing their share in proportion to the percentage they hold in the joint venture.

Petroleum
The technical term to denote both crude oil and petroleum products produced by refining.

Production sharing agreement (PSA)
An agreement which regulates the sharing of production between the host government and the oil company, after deduction of the Cost Oil (which allows the company to recover the costs it has borne). The company generally pays the share due to the government in the form of royalties and income tax.

Profit Oil
The portion of revenues divided up between participating parties and a host government in a production sharing agreement, once the operator has recovered its investment by deducting Cost Oil production

Reserves
The quantities of oil and gas whose extraction is profitable under the prevailing economic conditions. A series of definitions has been established by the American Society of Petroleum Engineers. Reserves are divided into subcategories: proved reserves, probable reserves and possible reserves.

Royalty fee
Payment by a company in return for the right to extract natural resources.

Service contract
An agreement whereby a foreign oil company is contracted to produce a country's oil reserves on a simple fee basis. The state maintains sole rights over the reserves, and the contractor is compensated by a fee per barrel, plus cost recovery.

Signature bonus
Lump sum of money paid up front by companies to governments upon signing an exploration contract, production sharing agreement or concession agreement.

Transparency in the extractive industries
Improved access to information such as data on revenues, prices and contractual conditions for better management of natural resources and to prevent illegal practices such as corruption or tax evasion. The concept of transparency gained prominence in the 1990s as governance issues dominated the development debate. Since 2003, the Extractive Industries Transparency Initiative (EITI) has promoted transparency in the extractive sector.

ENDNOTES

FRENCH EXTRACTIVE COMPANIES PUBLISH THEIR PAYMENTS TO GOVERNMENTS FOR THE FIRST TIME: WHAT ARE THE IMPLICATIONS?

1. Oil exports have increased by 25% in value since 2005 and amounted to US$1,440 billion in 2015. At the same time, gas exports increased by 75% to US$260 billion by 2015. [illegible] (accessed April 2, 2017)

2. These flows were estimated in 2013 at 75 billion euros for the countries in sub-Saharan Africa alone. See Global Financial Integrity (2015), Illicit Financial Flows from Developing Countries: 2004-2013, p vii, http://www.gfintegrity.org/wp-content/uploads/2015/12/IFF-Update_2015-Final-1.pdf (accessed April 2, 2017).

3. Publish What You Pay (PWYP), Extractive Industry Transparency Initiative, http://www.publishwhatyoupay.org/our-work/eiti/ (accessed April 2, 2017).

4. It should be noted that these Directives also apply to logging companies.

5. Légifrance (2014), Law number 2014-1662 of December 30, 2014 encompassing various provisions for adapting the legislation to European Union law regarding economic and financial matters, which incorporates a new article in the commercial code (article L. 225-102-3 of the commercial code).

6. Ibid.

7. These are the six largest companies among the 12 French companies in the mining, oil and gas sectors whose disclosures were identified.

TRANSPARENCY OF FRENCH EXTRACTIVE COMPANIES: MORE PROGRESS NEEDED

8. Thio, Kouaoua, Népoui-Kopéto, Tiébaghi, Poro, Pinpin, Etoile du Nord, Tontouta-Opoué and Poum. See Nickel Mines & Factories Company, http://www.sln.nc/mines [illegible] (accessed April 2, 2017).

9. Muyunkum and Tortkuduk. See Mining Atlas Kazakhstan, https://mining-atlas.com/operation/Tortkuduk-[illegible]-Mine.php (accessed April 2, 2017).

10. Total does not provide any explanation regarding this point in its disclosures. In response to our questions, the company told us that it has reported payments from each of the major fields in Gabon - which together account for 80% of production - and that all other payments have been allocated to "unallocated concession field" (the majority of these payments relate to non-attributable income taxes).

11. The categories "royalty fees" and "taxes" can sometimes be substituted, whereas in most countries of production, a royalty fee refers to a monetary payment calculated on the basis of revenues in return for an exploitation right, some other countries use that term to indicate a payment based on profits which is considered to be a tax.

12. Areva created a different category for payments in Kazakhstan and Niger. When questioned, the company did not detail what this category encompasses.

TOTAL IN ANGOLA: PARTIAL TRANSPARENCY RAISES QUESTIONS

13. Le Monde (2017) Angola : le parti au pouvoir remporte les élections générales (Angola: Party In Power Wins General Elections) http://www.lemonde.fr/afrique/article/2017/08/24/angola-le-parti-au-pouvoir-remporte-les-elections-generales_5176172_3212.html#6LgcxVp1dAHzuyxw.99 Accessed August 25th 2017

14. Jeune Afrique (2016), Pétrole: en 2016 l'Angola éclipse le Nigéria (Petrol: in 2016, Angola eclipses Nigeria), http://www.jeuneafrique.com/388371/economie/petrole-2016-langola-a-eclipse-nigeria (accessed April 2, 2017).

15. Le Monde (2016), L'Angola chute après des années de prospérité (Angola plummets after years of prosperity), http://www.lemonde.fr/afrique/article/2016/07/15/l-angola-chute-apres-des-annees-[illegible]_4970232_3212.html (accessed April 2, 2017).

16. US Energy Information Administration (2016), Country Analysis Brief: Angola, May 2016, p. 2, https://www.eia.gov/beta/international/analysis_includes/countries_long/Angola/angola.pdf (accessed April 2, 2017).

17. Ibid.

18. International Monetary Fund (2015), Angola - Country Report No 15/302, p. 6. [illegible] (accessed April 2, 2017)

19. US Energy Information Administration (2016), op. cit., p

20. EMIS Insight (2014), Oil and Gas Angola, November 2014, p 18, [illegible] (accessed April 2, 2017)

21. As shown on the map above, Block 17 consists of five fields: Girassol (the most important), Pazflor, Dalia, CLOV and Rosa.

22. EMIS Insight (2014), op. cit., p. 16.

23. Le Monde (2017), Total affiche de bons résultats dans un environnement dégradé (Total shows good results in a deteriorating environment), http://www.lemonde.fr/economie/article/2017/02/09/total-affiche-de-bons-resultats-dans-un-environnement-degrade_5077005_3234.html (accessed April 2, 2017).

24. EMIS Insight (2014), op. cit., p. 18.

25. See in particular OSISA and Global Witness (2012), Oil Revenues in Angola: much more information but not enough transparency, http://www.osisa.org/other/economic-justice/angola/oil-revenues-angola-much-more-information-not-enough-transparency (accessed April 2, 2017).

26. Human Rights Watch (2004), Some Transparency, No Accountability: the Use of Oil Revenue in Angola and Its Impact on Human Rights, https://www.hrw.org/report/2004/01/12/some-transparency-no-accountability/use-oil-revenue-angola-and-its-impact-human (accessed April 2, 2017).

27. US State Department (2010), Angola, [illegible] (accessed April 2, 2017)

28. International Monetary Fund (2012), Angola - Country Report No. 12/103, p. 39, https://www.imf.org/external/pubs/ft/scr/2012/[illegible].pdf (accessed April 2, 2017)

29. Miranda, Correia, Amendoeira & Associados, Sociedade de advogados, English translation of the 2004 Petroleum Activities Law, [illegible] (accessed April 2, 2017)

30. Sonangol (2016), Relatorio e Contas 2015 Consolidado (Consolidated Report and Accounts 2015), p. 30

31. [illegible] Relat[illegible]20Contas/Documents/relatorio_contas_2015.pdf (accessed April 2, 2017).

32. Ministerio das Finanças (2017), Avaliação do Comportamento da Receita Petrolífera (Evaluation of Management of Oil Revenue), http://www.minfin.gov.ao/PortalMinfin/faces/materiasderealce/publicacoes (accessed April 2, 2017).

33. L. Mouan (2015), Governing Angola's oil sector: The illusion of revenue transparency?, Unpublished thesis, Coventry University, UK, https://curve.coventry.ac.uk/open/file/44d3c08f-2d59-4d1a-3ffa-7e9aa18a7232/1/mouancomb.pdf (accessed April 2, 2017).

34. OSISA and Global Witness (2011), op. cit.

35. Based on data disclosed by the Angolan Ministry of Finance and taking into account the margin withheld by Sonangol: see the note on methodology. See Ministério das Finanças (2015), Avaliaçao do Comportamento de Receita Petrolifeira Annual 2015 (Evaluation of Management of Oil Revenue 2015), p. 12, http://www.minfin.gov.ao/PortalMinfin/faces/materiasderealce/publicacoes# (accessed April 2, 2017).

36. In 2016, US company Exxon (or ExxonMobil) was not listed or registered in a country requiring the disclosure of payments to governments. UK company BP (formerly British Petroleum) only reports payments made when it is acting as an operator. Norwegian company Statoil disclosed the share of Profit Oil it paid to Angola.

37. Sonangol (2016), op. cit., p. 30.

38. Since 2004, the Angolan authorities have required Sonangol and the operating companies to report quarterly to the Finance Ministry and the Oil Ministry both an ex ante estimate and an ex post realization of the price of oil from each block. This information allows the two ministries together to calculate a market price for the barrels extracted from the corresponding sites, which serves as a reference for the valuation of Profit Oil paid by Sonangol. Since mid-2015, only the Ministry of Finance has published this reference price on its website (the most recent publication by the Oil Ministry was in the first half of 2015).

39. The volume is calculated by dividing the Profit Oil reported by Total by the reference price published by the Angolan Ministry of Finance.

40. This rate is calculated based on the fiscal reference price per barrel of oil set by the Angolan government on a quarterly basis. In 2015, the rate was set at 6.72% of the Profit Oil amount realized by Sonangol.

41. The Angolan Ministry of Finance publishes a list of prices per block. For a more detailed calculation, see note on methodology in Ministerio das Finanças (2017), Exportações e Receitas de Petróleo Consolidado (Consolidated Exports and Oil Revenues), http://www.minfin.gov.ao/PortalMinfin/faces/economianacional/petroleo;jsessionid=VspJSK-QUwzQidvqlnn3zRymllu_

42. Total E&P Angola, Annual Report – Year 2015, Registry of the Commercial Court of Nanterre: Registration No. 37426, September 28, 2016.

43. The accounts of Total E&P Angola detail revenues from the sale of oil from Block 17 totalling 2.8 billion euros (USD 3.1 billion). The Sonangol accounts provide information to calculate the number of barrels sold by Total E&P Angola, i.e. 64,228,070 barrels. The price per barrel obtained is therefore USD 49 per barrel.

44. Ibid.

45. Public Eye, Matières premières (Raw materials), [illegible] (accessed April 2, 2017).

46. Total's revenues are obtained by multiplying the number of barrels (64,228,070) by the price per barrel of USD 51.91, which would amount to USD 3.33 billion in revenues. Given that Total's reported revenues are USD 3.15 billion, the estimated income difference amounts to USD 186 million.

AREVA: TRANSPARENCY IN A MINEFIELD

47. RTE (2015), Electricity balance 2015, http://www.rte-france.com/sites/default/files/pictures/actu/rte_be_2015_interactif.pdf, p. 13 (accessed April 2, 2017).

48. Estimate from Oxfam France and ROTAB (2013), Niger: à qui profite l'uranium ? (Niger: who benefits from the uranium?), https://www.oxfam.org/sites/www.oxfam.org/files/niger_renegociations_areva_note_oxfam-rotab.pdf, adjusted according to the latest public statements from Areva. See also Le Nouvel Observateur (2014), Nouvel accord entre Areva et le Niger sur l'uranium (New agreement between Areva and Niger on uranium), May 28, http://tempsreel.nouvelobs.com/economie/20140528.REU4920/un-accord-areva-niger-sera-signe-dans-la-journee.html (accessed April 2, 2017).

49. Oxfam France and ROTAB (2013), op. cit., p. 1.

50. For more information, see Oxfam France and ROTAB (2013), op. cit.

51. Oxfam France (2014), Première victoire sur Areva (First victory over Areva), http://www.oxfamfrance.org/actualites/areva-niger/premiere-victoire-sur-areva (accessed April 2, 2017).

52. Areva (2016), Rapport sur les paiements effectués au profit des gouvernements au titre de l'exercice 2015 (Report on payments to governments for the financial year 2015), http://www.areva.com/finance/liblocal/docs/2016/Rapport_paiements_gouvernements_2015.pdf (accessed April 2, 2017). Areva's disclosures comprise the following payment categories: production entitlements; taxes; royalties; dividends; bonuses; fees; payments for infrastructure improvements; and other payments.

53. Areva (2016), Rapport de Responsabilité Sociale 2015 d'Areva Mines (Social Responsibility Report 2015 of Areva Mines), p. 24, [illegible] areva [illegible] PLET-FR.pdf (accessed April 2, 2017).

54. For our calculations, see the French language version of this report: PWYP France, Oxfam France, ONE and Sherpa (2017), La transparence à l'état brut – Décryptage de la transparence des entreprises, April 2017, p. 18, https://www.oxfamfrance.org/sites/default/files/file_attachments/la_transaprence_a_letat_brut_one_oxfam_sherpa.pdf

55. Extraction price: sale price of the uranium from the mine to its shareholders. It is set by the latter.

56. Information on life expectancy from the World Bank. Information on Niger's health budget from Ministry of Public Health (2016), Annuaire des Statistiques Sanitaires du Niger 2015 (Niger Yearbook of Health Statistics 2015), p. 25, http://www.stat-niger.org/statistique/file/Annuaires_Statistiques/snis/Annuaire_Statistiques_2015_DS-MSP.pdf (accessed April 2, 2017).

57. This case study concentrates only on Somair. As a consequence of new international accounting rules, Areva does not consolidate the results of its other mine (Cominak), which means that there is no access to the information needed to cross-check the results.

58. Investing News Network (2016), Top Uranium Mines, http://investingnews.com/daily/resource-investing/energy-investing/uranium-investing/top-uranium-mines/ (accessed April 2, 2017).

59. Areva (2016), Rapport de Responsabilité Sociale 2015 (Social Responsibility Report 2015), op. cit., p. 13.

60. Areva Mines Niger is a subsidiary which consolidates the participation of Areva in the Nigerien mines Cominak and Somair.

61. Republic of Niger, Mining Code, Art. 84.

62. Republic of Niger, General Tax Code, Art. 27.

63. Republic of Niger (2014), Official Journal, Special No. 12, June 12, 2014.

64. This Agreement specifies that Areva will now be subject to the Mining Code of 2006.

65. In 2013, royalties paid relating to Somair were 15.3 million euros, for a production volume of 2,730 metric tonnes: EITI Niger (2015), EITI Report 2013, p. 90, http://www.itieniger.ne/images/DOC_SITE_ITIE/Rapport Definitif 2013_01-12-2015.pdf (accessed April 2, 2017).

66. For example, in 2014 the price for a pound of uranium on the spot market was USD 33.21 versus USD 46.46 on the long-term markets. The company Cameco, a competitor of Areva, publishes on its website the spot and long-term prices according to UxC and TradeTech that are also used by Areva: https://www.cameco.com/invest/markets/uranium-price (accessed April 2, 2017).

67. EITI Niger (2015), op. cit.

68. Areva (2012), Areva et EDF signent deux contrats significatifs pour la fourniture de plus de 30 000 tonnes d'uranium naturel (Areva and EDF sign two significant contracts for the supply of more than 30,000 tonnes of natural uranium), http://www.areva.com/FR/actualites-9532/areva-et-edf-signent-deux-contrats-significatifs-pour-la-fourniture-de-plus-de-30-000-tonnes-d-uranium-naturel.html (accessed April 2, 2017).

69. Republic of Niger (2014), Official Journal, Special No. 12, op. cit.

70. D. Flynn and G. De Clercq (2014), Atomic Split, Reuters special report, p. 4, http://graphics.thomsonreuters.com/14/01/NIGER-AREVA.pdf (accessed April 2, 2017).

71. Areva TN (2015), Press release, http://china.areva.com/home/liblocal/docs/China%20Offer/AREVA%20TN%20pres%202015%20(Compatibility%20Mode).pdf (accessed April 2, 2017).

72. Africa 7 (2015), Niger: Layoffs of hundreds of Areva employees http://www.afrique7.com/[illegible]/11293-niger-licenciement-de-[illegible]-demployes-dareva [illegible] (accessed April 2, 2017).

73. Data available on the UN databases Comtrade (https://[illegible]) and Trademap ([illegible]trademap[illegible]) (accessed April 2, 2017).

74. Yellow cake is defined by Areva as a solid uranium concentrate obtained after processing mined rock. It takes its name from its yellow colour and pasty texture.

75. According to customs data for 2015, more than 3,300 metric tonnes of uranium were exported to France. However, Areva's share in Niger for the year amounts to about 2,100 metric tonnes. The French company could have bought 1,200 metric tons from minority partners operating in Niger at an average price of 78.69 euros per kilo of uranium.

76. Areva (2016), Rapport sur les paiements effectués au profit des gouvernements au titre de l'exercice 2015 (Report on payments to governments for the financial year 2015), op. cit.

77. Areva's reply to our questionnaire sent on December 12, 2016.

78. The European Accounting and Transparency Directives only cover payments made since 2015. But Niger has been part of the EITI since 2006, which obligates the Nigerien government to disclose payments received from each extractive company within two **years. Payments in 2014 - including** Areva Mines Niger's taxes – **are** available in EITI Niger (2016), EITI Report 2014.

79. EITI Niger (2016), EITI Report 2014, p. 93.

80. This result is based on the margin of 11,800 euros per metric ton between the removal price and the export price, and 3,314 metric tons exported to France. For more information, see the note regarding methodology.

81. This figure is based on the margin of 30,700 euros per metric tonne between the extraction and the export price, and 3,314 metric tonnes exported to France.

82. According to the OECD, under the arm's length principle, the applicable price for transactions within the same group must be identical to the applicable price for two entities that do not belong to the same group: OCDE (2009), Principes de l'OCDE applicables en matière de prix de transfert à l'intention des entreprises multinationales et des administrations fiscales 2009, [illegible]

(accessed April 2, 2017); English language text (OECD 2010) at

enterprises-and-tax-administrations_20769717;jsessionid=2ct9jn69kuia6.x-oecd-live-03qsCJYnloRG-H3VEXohl4wYW75!-276812619# (accessed April 2, 2017).

GLOSSARY

83. http://openoil.net/understanding-oil-contracts/

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From the Assistant Private Secretary

1 March 2017

Dear Mr Litvinoff

I am writing on behalf of the Prime Minister to thank you and the members of the Publish What You Pay anti-corruption coalition for your letter of 25 January, about payments to governments by oil, gas and mineral companies.

Improving transparency makes a critical contribution to fighting corruption, including through the support it provides to law enforcement.

I am sure you will be aware that the Congress has now voted in favour of repealing the regulation in the Dodd-Frank Act, requiring oil, gas and mineral companies that are publicly listed in the United States to publish their payments to governments.

The Government will continue to make the case for transparency, including with our partners in the United States. In doing so, we will build on our strong record of accomplishment in championing international action on transparency.

We promoted mandatory reporting by extractives companies as part of our 2013 G8 Presidency and were joined in the establishment of such rules by Canada, Norway and other members of the EU. The UK became an Extractive Industries Transparency Initiative (EITI) candidate country in 2014. We are on track to publish our second EITI report in April 2017, and we will undergo the EITI validation process next summer.

The Government remains committed to this, and will continue to work with other jurisdictions around the world to raise global standards of transparency in the oil, gas and mineral sectors.

Yours sincerely

CLAIRE BRADSHAW

Mr Miles Litvinoff

Publish What You Pay
United Kingdom

UK coalition members

ABColombia
Action Aid
Amnesty International UK
Burma Campaign
CAFOD
Campaign Against Arms Trade
CARE International UK
Christian Aid
Ecumenical Council for Corporate Responsibility
Engineers Against Poverty
Global Poverty Project
Global Witness
Natural Resource Governance Institute
The ONE Campaign
OpenCorporates
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Oxfam Great Britain
Peru Support Group
Progressio
Save the Children UK
Scottish Catholic International Aid Fund
Tearfund
Transparency International UK
United Nations Association of the UK
World Vision International

The Rt Hon Theresa May MP
The Prime Minister
10 Downing Street
London SW1A 2AA

25 January 2017

Dear Prime Minister

Threat to United States extractive industry mandatory reporting law

We write as UK members, the International Secretariat and other members of the global Publish What You Pay anti-corruption coalition, which has worked for many years for a more transparent and accountable extractives (oil, gas and mining) sector.

In light of your forthcoming visit to the United States, and your Government's strong anti-corruption commitments, we must alert you to a threat under the Congressional Review Act (CRA) to mandatory reporting in the United States. Certain US legislators are seeking to use the CRA to void the Cardin-Lugar anti-corruption rule (Dodd-Frank Act 2010, Section 1504), which requires oil, gas and mining companies publicly listed in the USA to publish their payments to governments.

The first year of mandatory extractive company reporting in the United Kingdom, under the Reports on Payments to Governments Regulations, and the Disclosure and Transparency Rules, has been a real success. Similar laws exist throughout the European Union and in Canada and Norway, as well as in the USA.

It would be a serious setback for global efforts to achieve greater transparency and accountability in the extractive industries – progress that the UK Government has championed – if mandatory reporting legislation in the US were to be rolled back.

We urge you and your officials on your forthcoming visit to do everything possible to persuade your US counterparts and American legislators to ensure that the Cardin-Lugar anti-corruption rule (Dodd-Frank Section 1504) remains intact.

For further information, please ask your office to contact Miles Litvinoff, Coordinator, Publish What You Pay UK (mlitvinoff@pwypuk.org; 01442 825060; 07984 720103).

Yours sincerely

Gillian Caldwell
Chief Executive Officer
Global Witness

Daniel Kaufmann
President and CEO
Natural Resource Governance Institute

Neil Thorns
Director of Advocacy
CAFOD

John Arnold
Executive Director
Ecumenical Council for Corporate Responsibility

Mona Thowsen
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Robert Barrington
Executive Director
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UK Director
The ONE Campaign

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Peru Support Group

Miles Litvinoff
Coordinator
Publish What You Pay UK

Press release / Oct. 15, 2017

SHELL EXECUTIVES CHARGED IN LEAD UP TO LANDMARK TRIAL OVER BILLION DOLLAR NIGERIAN BRIBERY SCHEME

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Senior Royal Dutch Shell executives have been charged in Italy for their role in a vast bribery scheme that deprived the Nigerian people of over a billion dollars, the Milan Public Prosecutor's Office confirmed on Friday. Those facing trial include Malcolm Brinded CBE, the second most powerful person in the company when the deal was struck (1). Shell itself is also facing bribery charges alongside the four named individuals.

This historic decision follows a dramatic U-turn in which it admitted that it knew its billion dollar payment would go to convicted money-launderer and former Nigerian oil minister, Dan Etete, in exchange for Nigerian oil block OPL 245 in 2011.

"This could be the biggest corporate bribery trial in history, and a watershed moment for the oil industry. The top brass of the UK's largest company is in the dock after it finally admitted dealing with a convicted money launderer. There can be no clearer sign that wholesale change is needed. Shell must first apologise to the Nigerian people, then take clear steps to reassure investors and the broader public that this won't happen again," said Barnaby Pace of Global Witness.

In April, Global Witness and Finance Uncovered revealed that Shell executives knew that $1.1bn they paid for OPL 245 would go to Dan Etete and were likely to be used in a vast bribery scheme. For years, Shell has claimed that it only paid the Nigerian Government. But after our investigations Shell shifted this position and acknowledged it had dealt with Etete, via his front company

Malabu. Dan Etete was convicted of money laundering in France in 2007. Etete had awarded his own company the OPL 245 oil block while oil minister during the rule of former dictator Sani Abacha.

In December, the Milan Public Prosecutor alleged that $520 million from the deal was converted into cash and intended to be paid to the then Nigerian President Goodluck Jonathan, members of the government and other Nigerian government officials.

Now, Italian authorities have brought bribery charges against Malcolm Brinded, then Head of Upstream, alongside three others (2). According to the Shell Foundation, Brinded has stepped down from his role as Chairman of the Board of Trustees due to the legal action in Italy. Brinded remains a trustee of the Foundation as well as retained positions as Chair of Engineering UK and President of the Energy Institute.

In September 2017 BHP Billiton announced that Malcolm Brinded will not return to the BHP Billiton board due to judicial inquiries over the OPL 245 deal. In 2002, Brinded was awarded the CBE for services to the U.K. Oil and Gas Industry. These individual charges are in addition to existing charges brought against Shell, Italian oil major Eni, Eni's CEO, former CEO and Chief Operations Officer, middlemen and several Nigerian officials.

"Shell's current CEO Ben van Beurden has described the emails we leaked as "pub talk", but most pub chats don't end up in criminal proceedings. Mr van Beurden has had four years as CEO to address a scandal that now threatens to engulf his company, but has done next to nothing. He should draw a line under the case by admitting the company's guilt, removing Mr Brinded from his position, and setting out his plan for overhauling the company's anti-bribery efforts for the future," said Pace.

"These charges are a clear signal that it is no longer business as usual for oil companies in Nigeria. It's now time for the Dutch and British authorities to follow Italy's lead and hold their biggest company to account," said Olanrewaju Suraju, of Human and Environmental Development Agenda of Nigeria.

/ ENDS

INVESTOR BRIEFING
APRIL 2017

global witness

Shell, Eni & company executives face corruption charges: Key issues for investors

INTRODUCTION

On 8 February 2017, Italian prosecutors requested that Shell, Eni and several Eni senior executives including the current CEO Claudio Descalzi, be tried for alleged international corruption offences over the 2011 purchase of the Nigerian OPL 245 oil block.[1] Shell, Eni and Mr. Descalzi have all denied the charges. The oil block could, if estimates prove accurate, increase Shell's proven global oil reserves by a third, and add two thirds to Eni's.[2] A preliminary hearing will take place on 20 April 2017.

The prosecutors also confirmed that they will separately seek charges at a future date against four senior Shell executives including the current Shell Foundation Chairman Malcolm Brinded, who at the time of the deal was Shell's head of Global Exploration and Production.[3]

These developments were followed by reports in early March of charges being filed by Nigerian authorities against Eni and Shell relating to the purchase of OPL 245.[4]

As well as raising specific issues for Eni and Shell, this matter highlights the risks to companies and shareholders more broadly from a lack of transparency around company payments to governments and the ultimate beneficial ownership of companies, as well as the need for more robust corporate anti-corruption policies and practices.

In this context, investors should be troubled by the voiding on 14 February, following intense and prolonged oil industry lobbying, of an SEC rule (known as the Cardin-Lugar rule).[5] This rule would have required oil and gas and mining companies to disclose in detail the payments they make to foreign governments. Had such a rule been in place in 2011, it likely would have prevented the circumstances which have led to Eni and Shell facing corruption charges. Investors should expect and counter extractive industry lobbying to undermine the corresponding EU, Norwegian and Canadian legislation following the US reversal.

This briefing outlines the recent legal developments in Italy. It provides background on the OPL 245 deal which has led to the Italian charges, as well as ongoing investigations in Nigeria and the Netherlands. We suggest questions investors should ask Shell and Eni. The briefing also outlines the relevant legislative transparency protections and why investors should work to counter efforts to dismantle such regulations.

MAJOR RISKS FOR INVESTORS

- Potential loss of oil block key to Shell's and Eni's future reserves
- Potential convictions for corruption
- Inadequate anti-bribery & corruption policies & board oversight
- Repeal of anti-corruption regulations at the request of extractive industries.

ITALIAN CORRUPTION CHARGES

Charges are being sought by the Milan prosecutor against 11 individuals, including Eni's current CEO, Claudio Descalzi and his predecessor Paolo Scaroni. The prosecutor has also requested that Shell and Eni in their corporate capacities stand trial. The prosecutor claims that $1.1 bn of the money paid by Shell and Eni to a Nigerian government escrow account was, with the knowledge of those charged, transferred to a company controlled by a former oil minister and then used to pay bribes to then Nigerian President Goodluck Jonathan, Oil Minister Diezani Alison-Madueke and Attorney General Mohammed Adoke. The prosecutor further alleges that money was also channeled to Eni and Shell executives with $50million in cash delivered to the home of Eni's current Chief Operations Officer.

The preliminary hearing is scheduled for 20 April,[6] at which a judge will decide whether to accept the prosecutor's requests. If the judge approves the charges, a trial will likely start later this year and may last for around 1 year. The separate request for charges against 4 Shell personnel is likely to be made within weeks. If all parties are tried, all charges may be heard together.

In response Eni commented that *"Eni is entirely free of any involvement in the alleged corrupt conduct subject to investigation. The Board of Directors also confirms its total confidence that the company's CEO, Claudio Descalzi, was not involved in any way in the conduct under investigation, and maintains their upmost support for him as CEO."*[7]

Eni's 2017 AGM at which Descalzi will seek re-election is scheduled for 13 April, 1 week before the preliminary hearing. Investors should not vote for his re-appointment in the current circumstances. Moreover, investors should withhold support on relevant board reappointments until questions over the involvement of senior management in corruption and the adequacy of the board's oversight have been satisfactorily answered.

Shell's response stated: *"Based on our review of the Prosecutor's file and our understanding of the facts, we don't believe a request for indictment is justified and we are confident that this will be determined in the next stages of the proceedings. We continue to take this matter seriously and co-operate with the authorities."*[8]

THE ALLEGED CORRUPT PURCHASE OF OPL 245

In 2011, Nigerian subsidiaries of Shell and Eni paid US$1.3bn for OPL 245.[9] $1.1bn was paid by the companies to an account created at JP Morgan in London by Nigerian government officials with a separate agreement to transfer it to Malabu Oil and Gas (Malabu), a company widely believed at the time of the payments to be controlled by convicted money-launderer and former oil minister Chief Dan Etete. In July 2013, a British High Court ruled that Etete was indeed the owner of Malabu.[10] As Etete had awarded the oil block to Malabu whilst oil minister, he had effectively given himself one of the most lucrative oil blocks in Nigeria.

Shell and Eni deny paying any money to Malabu and claim to have paid the money to the Nigerian Government. However, High Court proceedings in London and other evidence seen by Global Witness reveal that, in reality, Shell and Eni were aware and in agreement that the deal was for the benefit of Malabu, knew that Etete was the owner of Malabu, and had even met with Etete face-to-face on several occasions.

According to the Wall Street Journal,
"Italian magistrates have maintained that Mr. Descalzi, then the head of exploration, and Paolo Scaroni, Eni's CEO at the time, knew the government escrow account was a stopover for the money before it moved onto an account controlled by Mr. Etete and was eventually paid as kickbacks."[11]

Due diligence reports commissioned by Eni during the negotiation process prove that the company knew about Etete's involvement from the early stages. A 2007 report states that Malabu is *"controlled by the former petroleum minister, Dan Etete. The company was awarded OPL 245 by the Abacha administration, while Etete was still petroleum minister"*,[12] while the 2010 report is even more explicit: *"whatever the formal ownership structure of Malabu, all of the sources to whom we have spoken are united in the opinion that Dan Etete is the owner of the company"*.[13]

However, Eni continues to deny any knowledge of Etete's involvement. In response to a question from Global Witness at its 2014 Annual General Meeting

Eni, in its written answer, replied that *"no clear evidence was found during the preliminary audits conducted by the Eni legal department under the anti-corruption procedures, particularly in relation to his [Etete's] connection with the company"*. In light of the due diligence reports' explicit references to Chief Etete, it was put to Eni that they had lied to their investors about their knowledge of Etete's involvement in Malabu. Eni did not respond.

There is evidence that Shell managers were in direct contact with Etete during the negotiation of the deal and worked with others at Shell's headquarters in the Hague to decide how much to offer him. A meeting with Etete is referred to in an email from Shell's John Copleston read out in 2013 court hearings in London: *"Our initial response is that it will remain very difficult to meet Chief's expectations in terms of the cash Shell is able to put up front on the table [...] Peter has to talk to The Hague and we will come back with a figure [...] As always, the issue will be the extent to which the Chief is ready to be sensible ... Meanwhile we are getting along very well personally – lunch and lots of iced champagne – and this time round we are at least negotiating face to face"*.[14]

Global Witness believes that "Peter" could have been Peter Robinson, Shell's Vice President for Commercial Sub Saharan Africa, who took part in the negotiations for Shell. His superior at the time was Malcolm Brinded, Shell's Head of Upstream. Robinson, Brinded and Copleston are among the Shell executives facing a separate charge request from the Milan prosecutor.

In 2015 Eni commissioned an external audit of the case from Pepper Hamilton, a U.S. law firm, which it has shared with investigators and it claims did not find evidence of illegal conduct. However, Eni would not originally disclose publicly the name of the law firm, and has still not released the terms of reference or detailed findings of the investigation. However, in response to questions from shareholders Eni has admitted that the investigation did not include interviews with any of the Eni staff under investigation. Eni has self-reported the OPL 245 deal to the U.S. authorities for review under the Foreign and Corrupt Practices Act.[15] No information has been provided by Shell as to whether it has commissioned an independent review of its involvement in the deal or whether it has self-reported the deal to the U.S. authorities.

Documents seen by Global Witness indicate that over US$801 million of the money transferred to Malabu was later transferred to a further five shell companies with hidden owners, raising concerns as to who truly benefitted from this deal. Etete told a UK court in 2013 that he received $250m in total for his role in the deal.[16] The ultimate recipients of the rest of the money are not yet known.

THE CASE FOR MANDATORY TRANSPARENCY

Global Witness and others - including investors - have long called for laws requiring extractive companies to disclose their payments to governments on a project level basis. Had such laws been in place at the time, the OPL 245 scandal would almost certainly not have happened.

Absent transparency rules, the corrupt money trail only came to light because a middleman who had acted for Malabu in negotiations with Eni, sued Malabu in UK commercial court for fees he claimed he was owed for his cut of the sale of OPL 245. These cases put previously secret information into the public domain, revealing how Eni and Shell had acquired OPL 245 from Malabu and Etete, and, also confirmed that Etete was a beneficial owner of Malabu.

Had Shell and Eni, been required to publish details of this deal would they have gone ahead with the deal as concluded? If the Nigerian government had known their payment to Malabu would have been so easy to track, they too may have thought twice.

TRANSPARENCY RULES UNDER THREAT

The US first passed the Dodd-Frank Act in 2010, Section 1504 of which requires companies to report payments to governments for oil, gas and minerals. The SEC then set about drafting a rule that would detail the requirements for companies, and implement the law.

In 2013, the EU passed similar legislation, the Accounting and Transparency Directives,[17] which requires the disclosure of project-by-project payments to governments by extractive companies. The UK and French implementing laws came into effect in 2015, with over 100 oil and mining companies publishing details of approximately $150 bn in payments to governments around the world for that year. Disclosing companies include Shell, BP, Total, Rio Tinto, and BHP Billiton. Statoil reports under a corresponding Norwegian law.

In 2014 Canada followed suit with the Extractive Sector Transparency Measures Act which came into force on June 1, 2015.[18]

In 2012, the American Petroleum Institute (API), an influential US oil industry lobby group whose members include Shell and a number of other big oil companies, brought a case against the the SEC's regulation implementing Section 1504 (the "Cardin-Lugar Rule"). This delayed implementation of the US legislation and meant that the US now lagged behind the EU as the leader on extractive industries transparency. The oil industries' intensive lobbying against the Cardin-Lugar Rule stands in marked contrast to their public claims to support transparency.

In 2016, the SEC finalised the Cardin-Lugar Rule allowing a 2 year phase-in period. To address company concerns regarding host country prohibitions on required disclosures, the rule provided for applications for exemptive relief on a case-by-by case basis. The rule was publicly welcomed by investors with $5.6 trillion in assets under management.[19]

However, in early 2017 in its first act, the newly elected US Congress voted to rescind the Cardin-Lugar Rule and President Trump signed this into law on 14th February. Section 1504 remains in place but these developments mean that for the moment there is no mechanism to implement it.

The dismantling of this transparency provision has drawn criticism from investors.[20] It is likely, based on their lobbying via trade associations in the US, that extractive companies will now seek to undermine the corresponding EU, Norwegian and Canadian laws. Investors should confirm their support for such laws and push for US listed companies to make such disclosures as would have been required under the Cardin-Lugar Rule. Claims made by the API that publishing project-level payments will harm companies' competitiveness have been refuted, as companies reporting under the European laws have continued to win extractive licenses around the world.

EXTRACTIVES INDUSTRY TRANSPARENCY INITIATIVE

Founded in 2002 the EITI is a voluntary scheme implemented in over 51 countries for extractive companies to declare what they pay to governments, and for governments to declare what they receive. Once adopted by a country the reporting requirements within the EITI become mandatory for relevant companies. The EITI standard requires project level payment disclosures thereby aligning with Section 1504 and EU law.[21] However not all EITI countries were implementing the project level disclosure standard. The EITI board recently reaffirmed this requirement and set an implementation deadline of December 2018. By 1 January 2020, all countries must ensure that privately held companies disclose their beneficial owners as part of their EITI reports.

FOLLOW THE MONEY - BENEFICIAL OWNERS

The OPL 245 deal also would not have taken place had Etete not been able to hide his ownership of Malabu. The UK, Norway and Ukraine are creating the world's first public registries of beneficial ownership, so that investors, taxpayers and other interested parties can see who really owns and gains from companies. The EU has also recently agreed that all Member States will have to create national registries and that members of the public will have access providing that they can pass a "legitimate interest" test. The OPL 245 deal demonstrates the need for the similar laws to be passed in other countries including the US so that criminals – including corrupt officials – cannot disguise their identities to carry out corrupt dealings. As of September 2016, institutional investors managing over $740m in assets have sent letters to the U.S Congress calling for an end to shell company secrecy.[22]

RECOMMENDATIONS FOR INVESTORS:

- Encourage extractive companies to disclose payments to governments on a project by project basis regardless of the revocation of the Cardin-Lugar rule in the United States.

- Publicly express support for EU and other international transparency legislation.

- Express to companies their view that shareholder capital should not be expended, either directly or via trade association membership, think-tank contributions or other third party lobbying activity, on efforts to repeal, challenge or weaken any such legislation.

- Support payment transparency on a project by project basis globally through the EITI. Investors can write to the investor representative on the international board Mr Sasja Beslik.

- Support collaborative investor efforts in support of beneficial ownership transparency for U.S. companies.

CONCLUSION

As Shell and Eni face corruption charges, ongoing investigations, and the possible loss of a valuable asset as a result of a 2011 deal, the laws enacted since then to prevent opaque money trails from companies to governments and onwards to corrupt officials are under threat. Buoyed by their successful lobbying efforts in the U.S., extractive companies will likely turn their sights on corresponding legislation elsewhere. Given the risks highlighted by Shell's and Eni's current predicaments, investors should continue to demand company disclosures of payments to governments, push-back on industry efforts to dismantle such risk-mitigation laws, and voice their support for such measures. For Shell and Eni shareholders, many crucial questions remain unanswered in relation to what the companies knew and when they knew it about the money trail for their purchase of OPL 245. As the case moves its way through the courts, shareholders must challenge the companies on the steps they have taken to address the corporate failings and allegedly criminal actions of senior managers to prevent any similar incidents.

QUESTIONS FOR SHELL

- What provisions has Shell made for potential financial impacts of the corruption allegations relating to the OPL 245 deal?

- What level of oversight is being exercised by the Board of Directors over the ongoing investigations and legal developments relating to the OPL 245 deal?

- Has the Board of Directors commissioned an independent investigation of the company's involvement in the OPL 245 deal?

> If so, will Shell disclose the terms of reference and the detailed findings of such an investigation for shareholders to assess?

> If not, why not given the seriousness of the allegations arising and the failings they suggest exist within the company's anti-corruption policies?

- Has Shell reviewed its anti-corruption procedures since the OPL 245 deal? If so, have any steps been identified and/or taken to address the concerns highlighted by the OPL 245 deal?

- Has the Nomination and Succession Committee of the board considered recommending an appointee with specific expertise related to anti-corruption, given the risks it poses to the industry?

- Has Shell self-reported the OPL 245 deal to regulators? If not, does Shell plan to do so?

- If Shell executives are tried in Italy or elsewhere in relation to corruption, what action does the Board of Directors plan to take e.g. termination of employment, and/or remuneration claw-backs?

QUESTIONS FOR ENI

- What provisions has Eni made for potential financial impacts of the corruption allegations relating to the OPL 245 deal?

- What actions has Eni taken to review its anti-corruption procedures in response to allegations of corruption in the OPL 245 deal as well as allegations of corruption in Iraq, Kuwait, Libya, Brazil and Algeria? If Eni intends to update its anti-corruption procedures what is the timeline for doing so?

- If current Eni executives are tried in Italy or elsewhere in relation to corruption, what action does the Board of Directors plan to take e.g. termination of employment, and/or remuneration claw-backs?

- In relation to Eni's investigation of the OPL 245 deal:

> Will Eni disclose the terms of reference and the detailed findings of the Pepper Hamilton investigation commissioned by the Eni Board for shareholders to assess?

> Why were senior executives who are now facing charges in Italy not even interviewed as part of the company's internal investigation? These executives include CEO Claudio Descalzi and COO Roberto Casula.

> What steps (if any) have been taken to examine the actions of current CEO Claudio Descalzi and current COO Roberto Casula in the OPL 245 deal?

> Why were the relevant executives not suspended during the investigation?

> In contrast, why was Independent Board Member Karina Litvack, an expert on corporate governance, removed from her position on the company's risk and control committee?

- Did the former Independent Board Member Luigi Zingales resign over concerns regarding corruption at Eni as has been reported?

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PUBLISH WHAT YOU PAY

Case Study
Is the United States getting a good deal on its natural resources? A taxing question.

Is the United States getting a good deal on its natural resources? A taxing question

JANA MORGAN

—

PWYP US

CONTEXT

This case study began with a not-so-simple question: Is the United States getting a good deal for the depletion of its natural resources?

Publish What You Pay - United States (PWYP-US) has worked for 13 years to open the books of oil, gas and mining companies to create a more open and accountable extractives sector. More than a decade into this effort, many of the world's largest oil, gas and mining companies now disclose their project-level payments to governments, either voluntarily or in compliance with legal requirements. Yet, a few major US oil companies - namely ExxonMobil, Chevron and ConocoPhillips - remain strongly opposed to these simple financial disclosures.

Like the citizens in resource-rich countries around the world, citizens of the United States also need to know if they are getting a good deal on their natural resources. Thoroughly answering this question, however, is incredibly complex and involves the careful analysis of contracts, as well as relevant tax and royalty regimes governing the extractives sector. As a starting point, this case study focuses on how much some of the largest extractives companies paid in taxes to the US federal government in 2015.

USING THE DATA

The 2015 state and federal tax payments made by nine major extractives companies operating in the United States were compiled and analyzed using the financial disclosures made by companies in compliance with transparency laws in the European Union and Norway, as well as voluntary disclosures.

Table 1
Nine major extractives companies operating in the United States and where they disclose taxes (as of February 2017)

COMPANY NAME	JURISDICTION
BHP Billiton	Australia (voluntary)
British Petroleum	United Kingdom (UK disclosure)
Chevron	USA (refused to disclose to USEITI)
Conocophillips	USA (refused to disclose to USEITI)
ExxonMobil	USA (refused to disclose to USEITI)
Rio Tinto	Brazil (UK disclosure)
Shell	Netherlands (UK disclosure)
Statoil	Norway (Norway disclosure)
Total	France (US 20-F Form)

The UK disclosures available in .csv format on the UK Companies House website were the easiest to access and sort. The 2015 payment reports by BHP Billiton and Statoil were only available in .pdf format on the companies' own websites, so Tabula was used to scrape and organize the data. Total disclosed in compliance with the EU Directives in France, but the data was accessed using their 20-F disclosure to the SEC.

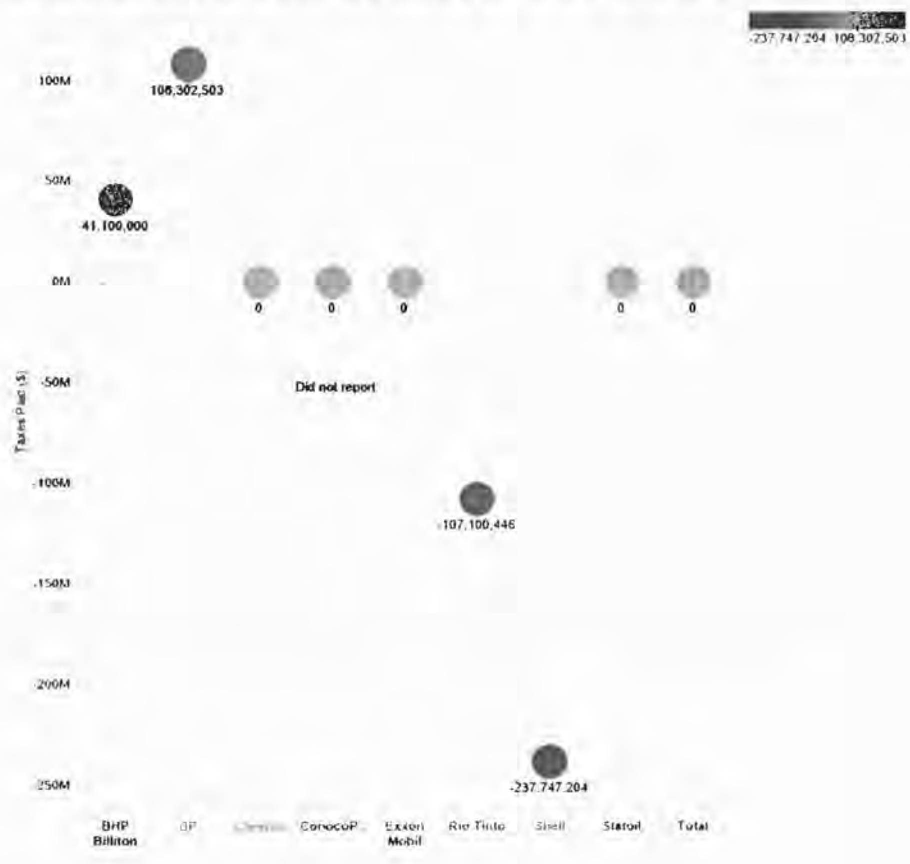
What is the EITI
The EITI is a framework to promote and facilitate revenue transparency by governments and companies. When a country signs up to EITI, they commit to publishing what they receive from extractive companies, and extractive companies within their jurisdiction have to publish what they pay.

It is important to note that there is no U.S. tax data available for ExxonMobil, Chevron or ConocoPhillips under any of the relevant payment disclosure regimes.

These companies sit on the governing bodies of transparency initiatives, like the Extractive Industries Transparency Initiative (EITI), yet have refused to comply with the most basic requirement of the EITI standard in the US: to disclose their federal income tax payments to the US government. This reluctance is especially puzzling given that these companies have disclosed tax payments through the EITI in other countries.

While these companies are required to make some tax disclosures in their reports to the Securities and Exchange Commission (SEC), there is an important difference between these SEC disclosures and those required through the EITI and mandatory disclosure laws. The SEC requires tax payments to be disclosed in the year when the obligation is accrued, whereas EITI and mandatory disclosure laws require disclosure of the actual payments that are made to the government. This is a significant difference that results in discrepancies between tax obligations that are accrued in one year but whose payment is allowed to be delayed until much later, especially under the US corporate income tax regime that permits multinational corporations to defer US taxes on their offshore income.

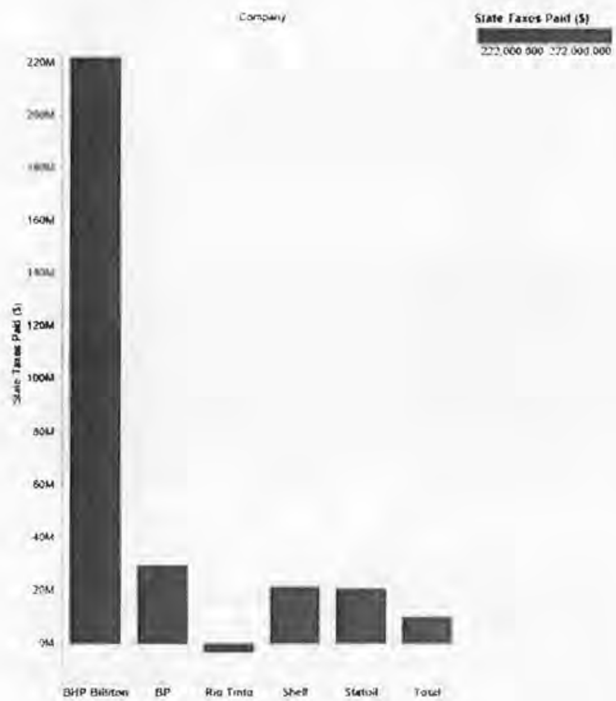
Graph 1
Federal Taxes 2015



Therefore, the disclosures made to the SEC do not provide an accurate tally of the taxes a company in fact paid to the US government.

"TAXES, AFTER ALL, ARE DUES THAT WE PAY FOR THE PRIVILEGES OF MEMBERSHIP IN AN ORGANIZED SOCIETY."
FRANKLIN D. ROOSEVELT

Graph 2
State Taxes Paid 2015



So while there is some data available about taxes paid by US-listed companies through their SEC disclosures, it is not comparable to the tax information disclosed by companies in compliance with mandatory disclosure laws or EITI. Despite this, it is important to include them in the analysis as they are major American companies, profiting substantially from US natural resources, and should thus be eager to disclose the contributions they make to federal coffers.

DISCOVERY

Compiling and visualizing the data using Tableau Public, raised more questions than answers. Of the six companies that disclosed federal tax data, two listed tax payments in the negative hundreds of millions of dollars, two listed tax payments as zero, and two disclosed positive amounts.

Why was there such a wide distribution in the taxes paid by some companies? Some possible explanations:

- Shell, which had a negative tax payment, reported large losses in 2015 due to the global drop in oil prices, which likely influenced its federal tax burden. It will be important to follow up with Shell to gain further insight, and to compare 2015 tax data with the 2016 data when it is released.
- Total and Statoil US federal tax payments were each $0, but they did pay taxes to state governments. To understand why these companies have paid tax on state land, but not federal, further inquiry is required.
- This analysis looks at both mining and oil/gas companies, yet these industries are subject to different fiscal regimes. To asses if the US is getting a good deal on its natural resources, these industries must be analyzed separately.
- The US government provides massive tax subsidies to the oil, gas and mining sectors. Fossil fuel companies get over $4 billion a year in tax subsidies, which could help explain the low tax figures.

Section 1504
Section 1504 requires any oil, gas or mining company filing an annual report with the SEC to disclose their project-level payments to host governments each year. It covers companies listed on US stock exchanges.

Of course, taxes alone cannot tell the complete story of company contributions to state and federal governments; one must also analyze other types of payments including royalties, bonuses, and fees. This is proving difficult to do in the United States because consistent payment information at the project-level is either unavailable or limited, in part because a few regressive companies, such as ExxonMobil and Chevron, and their lobbyists are fighting against legal requirements like the Cardin-Lugar Provision (Section 1504) of the Dodd-Frank Act.

For the companies unwilling to disclose their US tax payments through the USEITI, it is important to ask what exactly is motivating them to refuse.

CONCLUSION

While the question, "Is the United States getting a good deal on its natural resources?" cannot yet be answered, this case study presents an excellent springboard for further analysis. It also highlights the importance of having access to complete, comparable and machine-readable data. And for those companies that refuse to provide their tax data through USEITI - Chevron, ExxonMobil and ConocoPhillips - it is impossible to even begin this analysis.

In fact, research by Taxpayers for Common Sense has shown that these three companies pay a much lower effective tax rate than they claim because of overly generous provisions in the US tax code that allow for subsidies and deferral of tax payments.

While not necessarily doing anything illegal, companies with savvy accountants can take advantage of favorable tax laws, including the many subsidies available to oil, gas and mining companies in the United States, to ensure that their tax bills are minimal - or even nothing at all. The Obama administration and the G20 committed to eliminating fossil fuel subsidies, but weren't able to get far due to Congressional gridlock.

As a continuation of this case study, company tax payment data for 2016 will be compiled, explanations from companies about these tax bills will be sought, and further analysis of US tax subsidies will be conducted. To follow along as we continue to explore tax and other extractives data, please visit PWYP-US at Extract-A-Fact.

This case study is part of Publish What You Pay's Data Extractors programme, a global initiative which trains PWYP members and activists from across our network to use extractives data.

Thank you to the Omidyar Network [illegible] generous contributions, [illegible] have helped [illegible] this programme happen. Thank you also to Open Oil, who have helped run the Data Extractors programme, for contributing their skills and expertise.

WORK WITH US TO UNCOVER THE STORIES HIDDEN BEHIND EXTRACTIVES DATA!

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Publish What You Pay
United States

Oil, Gas, and Mining Company Support for Transparency
September 2017

Oil, gas, and mining companies are now reporting project-level payments to governments in over thirty countries in compliance with disclosure laws modeled on Section 1504 of the Dodd-Frank Act. No negative impacts have been reported by companies – in fact, many oil and mining majors have spoken out about the benefits of transparency to citizens in resource rich countries and investors.

BHP Billiton

On the business case for transparency
"I think it's very easy to answer the question of what the business case is, you've only got to look at the realities of being the largest natural resources company in the world, and what that entails, to understand how important transparency is. Quite simply, for a company like ours, public acceptance and trust is at the forefront."

"It's not a 'nice to have' for BHP, it's an absolute imperative to our business."

On project by project reporting
"When you start to get granular it starts to become a lot more useful."

- **Geoff Healy, Chief External Affairs (September 2017)**[1]

"To be meaningful, information and data should be disclosed in a format that is accessible and easy to understand. To this end, **we support the establishment of a globally consistent regulatory disclosure framework**, including equivalency provisions between jurisdictions. This would create a consistent basis for companies to disclose payments to governments, minimise compliance costs and make it easier for stakeholders to compare information between jurisdictions, sectors and companies. We remain concerned that the number and variety of local disclosure initiatives introduced in recent years will result in unhelpful complexity and we will continue to engage with governments and regulators to move towards global consistency."

- **Economic Contribution Report 2017 (September 2017)**[2]

Shell

"Tax binds governments, communities and businesses together. Revenue transparency provides citizens with important information to hold their government representatives accountable and to advance good governance. Shell is committed to transparency as it builds trust. Trust is essential for a company that operates in our line of business, reflecting our core values of honesty, integrity and respect for people."

---

[1] Healy, Geoff. "Transparency, anti-corruption, and sustainable development: Is progress possible?" (September 18, 2017) Brookings Institution, Washington, DC. Available at: https://www.brookings.edu/events/transparency-anti-corruption-and-sustainable-development-is-progress-possible/

[2] BHP Economic Contribution Report 2017 (September 7, 2017) Available at: http://www.bhp.com/-/media/documents/investors/annual-reports/2017/bhpeconomiccontributionreport2017.pdf

"By fulfilling the mandatory disclosures in line with the new UK legislative requirements we demonstrate that extraction of natural resources can lead to the opportunity of government revenue, economic growth and social development."

- **Jessica Uhl, Chief Financial Officer (June 2017)**[3]

British Petroleum (BP)

"BP supports the concept of transparency in revenue flows from oil and gas activities in resource-rich countries. It helps citizens of affected countries access the information they need to hold governments to account for the way they use funds received through taxes and other agreements."

- **Report on Payments to Governments (June 2017)**[4]

Kosmos Energy

"Being transparent in everything we do requires courage; it takes true commitment, but is the right thing to do. We have set a standard for transparent behavior by publishing our host government contracts, along with payments to governments at the project level and in aggregate."

- **2016 Corporate Social Responsibility Report (July 2017)**[5]

Barrick Gold

"We believe that transparency— whether through disclosing payments to governments, reporting on our energy and water use, voluntarily opening ourselves to third-party scrutiny, or otherwise — is integral to being a true partner. As such, we support consistent global standards for payment transparency [...] transparency is a core value at Barrick that we strive to achieve in everything we do."

- **Response to inquiry from the Business & Human Rights Resource Centre (February 2017)**[6]

Newmont Mining

"Newmont believes that revenue transparency is essential to generating long-term value. Building broader awareness of how taxes and royalties are spent in-country – and how much is paid – can provide greater clarity around the economic and social benefits natural resource development can bring to local communities. In addition, reporting those revenues according to internationally accepted standards makes that information more credible and accessible to all stakeholders."

- **Response to inquiry from the Business & Human Rights Resource Centre (February 2017)**[7]

For more information visit www.pwypusa.org

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[3] Shell. "Revenues for Governments" (June 2017) Available at: http://www.shell.com/sustainability/transparency/revenues-for-governments.html

[4] BP p.l.c. Report on payments to governments, Year ended 31 December 2017. (June 2017) Available at: http://www.bp.com/content/dam/bp/en/corporate/pdf/sustainability-report/group-reports/bp-report-on-payments-to-governments-2016.pdf

[5] Kosmos Energy 2016 Corporate Social Responsibility Report (July 2017) Available at: http://www.kosmosenergy.com/responsibility/pdf/2016-CR-Report-Letter-to-Stakeholders.pdf

[6] The full statement is available at: https://business-humanrights.org/en/publish-what-you-pay-urges-oil-gas-mining-firms-to-support-us-law-on-disclosure-of-payments-to-govts-statements-of-support-by-8-firms#c151944

[7] Newmont. "The Importance and Value of Revenue Transparency" (February 2, 2017) Available at: http://ourvoice.newmont.com/2017/02/02/the-importance-and-value-of-revenue-transparency/

Publish What You Pay (PWYP) is a global civil society coalition with more than 600 members from over 60 countries who believe that the wealth generated by oil, gas and mining industries can be a pathway to poverty reduction, stable economic growth and development in resource-rich countries. In the U.S., PWYP comprises 39 members, including development, faith based, human rights, environmental, financial reform and anti-corruption organizations representing over 2.5 million constituents spread through every state in the nation

EXTRACT-A-FACT

Digging Deep into Oil, Gas, and Mining Data

www.ExtractAFact.org

Extract-A-Fact is a project of Publish What You Pay - United States (PWYP-US) and is born out of our commitment to empower citizens, activists and journalists to harness oil, gas, and mining data and use it as a tool to demand accountability from governments and extractive companies.

Riding on the wave of recently released payment data, Extract-A-Fact seeks to answer questions like:

Are citizens getting a good deal on their natural resources?

How much did Big Oil pay (or not pay) in taxes last year?

How do I make a map to show mining revenues owed vs. revenues paid to my community?

Extract-A-Fact provides training modules detailing useful and creative ways to find, analyze, and visualize extractives data, as well as blog posts from PWYP-US and our partners as we dig deeper into oil, gas, and mining sector data to answer questions critical to communities impacted by natural resources.

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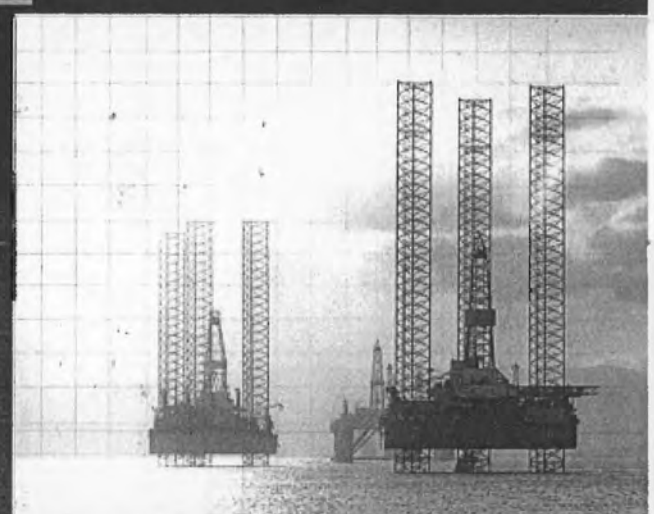
SHELL KNEW

Emails show senior executives at UK's biggest company knew it was party to a vast bribery scheme

APRIL 2017

[redacted]



[redacted]

SHELL KNEW

SHELL MISLED INVESTORS AND THE PUBLIC ABOUT MEGA-DEAL WITH CONVICTED MONEY-LAUNDERER

After 50 police raided Shell's headquarters in a bucolic suburb of The Hague, the oil major's CEO had some advice for a senior colleague—don't volunteer information.

In the joint raid in February 2016 Dutch and Italian police were looking for one thing: information on a $1.1 billion deal to acquire oil exploration rights for one of the most valuable oil blocks in Africa, thousands of miles away in Nigeria. Corruption allegations over the April 2011 deal have sparked law enforcement inquiries in six countries.

At the time, Shell said publicly that it took the allegations of bribery seriously and was cooperating with the authorities. "Shell attaches the greatest importance to business integrity," the company said in a statement. But that's not quite what the $235 billion oil giant's CEO Ben Van Beurden said in a phone call right after the raid.

"Don't volunteer any information that is not requested," Van Beurden told Simon Henry, Shell's CFO at the time, in a previously unreported call tapped by Dutch police. The two top Shell officials agreed that it was best not to tell shareholders about the raid. "The last thing you want of course is some sort of request to issue a stock exchange release," Van Beurden said. "There is nothing to be said other than that we are being asked to provide information."

Shell CEO Ben van Beurden referred to emails implicating Shell in a vast bribery scheme that robbed Nigeria of life-saving funds as "pub talk". Credit: Alamy

The amount paid for the oil block is one and a half times what the UN says is needed to respond to the current famine crisis - but the money was diverted into private pockets. Photo: Alamba/AP/REX/Shutterstock

New emails and documents seen by Global Witness and Finance Uncovered reveal that Shell had good reason to keep quiet.

"The companies conspired to hide the ex-minister's role

The Anglo-Dutch major and its Italian partner Eni knew the $1.1 billion would flow to a notorious former Nigerian oil minister who had been convicted in Paris for money-laundering. The companies conspired to hide the ex-minister's role, the material shows.

In its statements after the deal Shell would only admit to dealings with the Nigerian government and claimed ignorance of the money-launderer's role.

The new material shows that Shell was misleading shareholders and the public—and that it knew funds from the deal could flow to senior government officials, including the president (see box: Why we say "Shell executives knowingly participated in a bribery scheme").

A TROUBLED GIANT

Nigeria, Africa's most populous nation, produces over 1.5 million barrels of oil a day but corruption helps explain why a third of citizens live without running water and electricity. Right now, five million Nigerians face starvation in the north and 450,000 children are suffering acute malnutrition, according to the United Nations.

Shell and Eni paid $1.1 billion for the block, not including a $210 million signature bonus. The corrupt former oil minister, Dan Etete, took possession of the entire $1.1 billion—a sum equivalent to more than Nigeria's 2016 health care budget. Only a fraction of the money Shell and Eni paid went to the Nigerian state.

The country has always been important for Shell. Ann Pickard, its former Executive Vice President for Africa, told a senior US diplomat in Nigeria in 2009 that Shell "had seconded people to all the relevant ministries" in the country and that "Shell consequently had access to everything that was being done in those ministries".

WHY WE SAY "SHELL EXECUTIVES KNOWINGLY PARTICIPATED IN A BRIBERY SCHEME"

The emails leaked to Global Witness and Finance Uncovered show knowledge at the highest levels that Shell and Eni's $1.1 billion payment for OPL 245 would go to convicted money launderer Dan Etete, and that this money would flow onwards as bribes. Here's how we reached that conclusion.

In January 2011 - less than three months before the deal was finalised - Shell's head of exploration Malcolm Brinded told then CEO Peter Voser that the $1.1 billion "will be used by the FGN [Federal Government of Nigeria] to settle all claims from Malabu", Etete's company.

The previous year Shell executives had sent each other emails saying that Etete would spend much of his money on bribes. In July 2010 Senior Business Advisor Guy Colegate wrote to Shell Vice President for Commercial Sub-Saharan Africa Peter Robinson after a meeting with Etete in Paris. Colegate related that Nigerian president Goodluck Jonathan had just written a letter confirming Malabu's rights to OPL 245.

This letter was **"clearly an attempt to deliver significant revenues to GLJ [Goodluck Jonathan]** as part of any transaction" over OPL 245, he said. **"This is about personal gain and politics."**

In August 2010 Robinson sent exploration head Brinded a brief, saying "the President is motivated to see 245 closed quickly - driven by expectations about the proceeds that Malabu will receive and **political contributions that will flow as a consequence.**" The brief was also sent to three other Shell executives.

Even as far back as January 2009, Strategic Investment Advisor John Copleston wrote to Shell vice presidents Robinson and Ann Pickard, relaying a conversation with a source he described as "my Delta man": "He spoke to Mrs E this morning. She says E claims he will only get 300m we offering—**rest goes in paying people off.**" "E" is understood from other emails in the chain to be Etete.

The context was clear, as elections in April 2011 drew near. "In Abuja it is still a case of all politics and no government," Colegate wrote in a 29 March 2010 briefing to senior Shell executives. "Jockeying for ministerial position remains intense, with many aspirants offering substantial sums to purchase their way into office."

Colegate continued: "With an election only 10 months away **the need to build war chests for campaigning is strong.**"

So, to sum up:

Did Shell know it was a bribery scheme? Yes. And the emails show senior Shell executives were aware of this danger more than two years before the deal was signed.

Was it vast? Yes. Any scheme involving payments of hundreds of millions of dollars, with money flowing onwards to Nigeria's president, can fairly be characterised as vast.

Was Shell a party to it? Clearly yes. It was paying the $1.1 billion, along with Eni—Shell's then CEO Peter Voser even signed off on the OPL 245 deal.

Shell's annual reports have given scant details about the OPL 245 deal, despite the oil block's huge potential. But with nine billion barrels of "probable reserves" the block could increase Shell's global "proven oil reserves" – a key figure for shareholders – by a third.

The sale of the oil block was so clearly detrimental to the public interest that the most senior civil servant in Nigeria's petroleum department blasted it as "highly prejudicial" in a previously unreported letter. Nigeria was "throwing away an enormous amount of financial resources", said the official. The letter was sent on 1 April 2011, barely a fortnight before the deal was agreed.

To see the petroleum department's letter go to www.globalwitness.org/shellknew

"Prosecutors in Italy are demanding that Shell stand trial for bribery offences

Now prosecutors in Italy are demanding that Shell, Eni and some of their senior managers – along with Etete – stand trial for bribery offences. Nigerian authorities have charged the two oil majors, senior executives and Etete with "official corruption". The oil companies' ownership of OPL 245 is now in doubt.

Shell did not directly respond to Global Witness' request for comment. In an email to Finance Uncovered on 8 April 2017 Shell said: "we do not believe that there is a basis to prosecute Shell. Furthermore, we are not aware of any evidence to support a case against any former or current Shell employee." If it was ultimately proved that Etete's company made bribe payments relating to the OPL 245 deal "it is Shell's position that none of those payments were made with its knowledge, authorisation or on its behalf", the company said.

Eni told Global Witness that "None of the contracts relating to the 2011 transaction was executed secretly or designed to 'hide' any party's transaction." Global Witness had mischaracterised the structure of the OPL 245 deal and Eni's position would be fully set out in response to the Italian prosecution, the company said.

Both companies said they had commissioned separate, independent investigations. "No illegal conduct was identified," Eni has said, claiming that it "concluded the transaction with the Nigerian

Map showing block OPL 245 off the coast of Nigeria.

government, without the involvement of any intermediaries". Shell said it had shared key findings of its OPL 245 investigation with relevant authorities.

Etete, for his part, did not respond to emailed questions, but spoke out in a florid two-page newspaper ad earlier this year.

"People who live in the dark fringes of our national life have spread unfounded propaganda through their equally dark agents of misinformation," he said. It was entirely untrue to say that he took state funds "for himself and shared amongst his friends, associates and playmates".

To see Shell and Eni's latest replies go to www.globalwitness.org/shellknew

SHADY DEAL

OPL 245 was shady from the start.

In April 1998, when he was Nigeria's Minister of Petroleum, Dan Etete, awarded the block to Malabu, a company that he secretly owned along with Mohammed Sani Abacha, the son of Nigeria's venal dictator General Sani Abacha. Etete was essentially stealing a state asset.

Malabu had only been created five days earlier. It had no experience, no assets and little cash, and could only come up with a tenth of the $20 million payment required up front.

Just two months after the block was granted Abacha died in the arms of two prostitutes, bringing an end to a regime notorious for jailing and executing opponents, as well as for looting on a staggering scale (Transparency International estimates that

PASS THE PARCEL The saga of Nigeria's oil block OPL245

1998: Nigerian oil minister, Dan Etete, awards block to Malabu (a company he secretly owned), which pays only $2m of the required $20m signature bonus

2000: Shell executives say they will have to "find out from Etete who is holding shares on his behalf"

2001: Shell agrees in principle to buy 40% of block from Malabu. Government then revokes the licence altogether; Malabu launches court action

2002: Government awards 100% of block to Shell under a production-sharing agreement, for signature bonus of $210m

2006: Government reaches deal with Malabu, restoring its ownership of block for a signature bonus of $210m within 12 months. Shell launches legal challenges

1998 1999 2000 2001 2002 2003 2004 2005 2006 2007 2008 2009 2010 2011 2012 2013 2014 2015 2016 2017

2007: Etete convicted of money laundering by French court

2009: Etete's conviction upheld; he has meetings with Shell officials

2011: New deal struck, Shell and Eni pay government $1.1bn and the long overdue $210m signature bonus for full control of the block. Government pays Malabu $1.1bn. $520m allegedly converted to cash and distributed to Nigerian public officials. Malabu sued by two advisers

2012: Global Witness publishes first exposés on the story

2014: Nigerian House of Representatives votes to cancel the deal for OPL 245 and calls the deal "contrary to the laws of Nigeria". $190m from the deal frozen in UK and Switzerland

2015: New Nigerian government elected

2016: Milan Public Prosecutor concludes preliminary investigation; accuses Shell, Eni and senior executives of bribery

2017: Milan Public Prosecutor requests trial; Nigerian authorities charge Shell and Eni with official corruption and former Attorney General with money laundering

Abacha and his family stole between $2 billion and $5 billion from the state's coffers over less than five years). With the death of Abacha and his regime, Etete lost his job.

Despite the high corruption risks Shell agreed in 2001 to pay Malabu around $150 million for 40% of the exploration licence. It has said it did not know of the link with Etete, telling the Financial Times years later: "inspection of Malabu's company records as part of due diligence did not establish any connection between Dan Etete and Malabu".

"Shell knew full well who it was dealing with

But Shell did, in fact, know full well who it was dealing with. As far back as 2000, when Shell was first considering a deal over OPL 245, Shell executives discussed the names on the shareholders' register for Malabu, saying in one of the leaked emails that "we will have to find out from Etete who is holding shares on his behalf".

But before the deal was sealed the new government revoked Malabu's licence.

"Etete and Abacha had abused their positions in the past, while in office, to award themselves the OPL 245 at a ridiculously low price," a presidential spokesperson said of the decision.

Shell secured OPL 245 for itself soon afterwards but its success was short-lived. In 2006 the government once again awarded the block to Malabu, on condition that it pay a $210 million signature bonus within a year as a down payment. The allocations and revocations sparked court battles involving the two companies, embittered shareholders and the Nigerian government.

LIGHT IS THE BEST ANTIDOTE

Global Witness has long called for laws requiring oil companies to disclose their payments to governments on a project level basis. This would help to prevent companies from scheming with greedy government officials to get rich at the expense of ordinary people.

Over 30 major economies including the US, Canada, Norway, UK, and all 27 members of the European Union now have such laws. A transparency body covering 51 countries - the Extractive Industries Transparency Initiative (EITI) - tightened up its rules last month, requiring oil, gas and mining companies to also report such payments for each project they operate.

Had the US law, section 1504 of the Dodd-Frank Act, been in force when this deal took place, it is highly unlikely that the OPL 245 scandal would have happened. It's questionable whether Shell, knowing that its payment would be made public, would have gone ahead with a deal as it would have come to light that their payment was for a stolen state asset and would be transferred to the man who stole it.

In spite of the global trend towards transparency, oil companies like Shell are still fighting to keep secrets. Earlier this year their well-paid lobbyists won a big victory when the US Congress voted to overturn the implementation rule for Section 1504. This move sets the US in opposition to a broader global trend towards greater transparency and accountability in how oil, gas and mining revenues are managed. It will make it harder for the public to see what oil companies are paying for oil blocks —and easier for any dodgy deals to go undetected.

Shell and its oil industry peers can no longer masquerade as global leaders for sustainability, good practice and the protection of human rights, while entering into dodgy deals and lobbying to weaken transparency and accountability laws. Oil companies, their investors and governments should publicly support strong, project-by-project disclosure requirements through legally binding rules, including in the US, and during the forthcoming review of the EU Transparency and Accounting Directives, as well as through the EITI. These new developments in the OPL 245 scandal show clearly why robust payment transparency requirements must be established and maintained.

SHELL'S FRENEMY

Despite years of fighting in courtrooms, in mid-2007 Shell and Malabu were still flirting with each other in private, trying to find a price for partnering on the block.

The potential for further corruption was evident. In 2007, Etete was convicted *in absentia* of laundering $10 million obtained through bribery and eventually fined eight million euros. The judgment in the court case found that Etete used the money to buy a twin-engine speedboat, a chateau in northern France and to settle bills from The Ritz.

There were also specific warnings from Shell executives on the ground, which became more concrete as talks developed. In 2008, Simon Henry, Shell's chief financial officer for exploration and production at the time, and Malcolm Brinded, the head of exploration, were told by their most senior executive in Nigeria that the then oil minister "is involved (i.e. on the take)".

"Etete used the cash to buy a speedboat and a French chateau

Two Shell representatives, John Copleston and Guy Colegate, came to play a leading role in negotiations with Etete as the company inched towards a new deal. The Milan Public Prosecutor described them as having "previously worked for MI6" (in an email Copleston refers to his "two tours as UK Intelligence Rep in Nigeria").

The pair negotiated with Etete and relayed to Shell intelligence they gathered on the ground — including indications that bribes would flow from any payment. The new emails shed light on what Shell knew and on the thinking of its senior executives.

-----Original Message-----
From: Copleston, John SEPA-EPG-CI
Sent: maandag 5 januari 2009 17:16
To: [redacted] Colegate, Guy J SIEP-EPB-S
Subject: [redacted]

Saw my Delta man.
245. He spoke to Mrs E this morning. She says E claims he will only get 40m of the 300m we offering-rest goes in paying people off. Also says E [redacted]

Sent From my Blackberry

From:	"Colegate, Guy J SIEP-UIB/O/P" <SHELL/SI/RECIPIENTS/NLGCO1>
Sent:	7/16/2010 2:13:05 PM +0000
To:	"Robinson, Peter L SEPA-UIB/G" <Peter.L.Robinson@shell.com>;

"Copleston, John DC SEPA-UIB/G/SI" <John.Copleston@shell.com>

Subject:	Block

No pki- apologies its died.

Long meeting yesterday in Paris- salient points:
1) Etete claims he has and has shown (though not copied) a letter from President reiterating malabu's 100pc equity/contract "award"
2) This letter clearly an attempt to deliver significant revenues to GLJ as part of any transaction
3) Our source says this letter "has really damaged deal" as etete now "uncontrollable"- he stated deal was almost there on a proposed 50/50 split with RDS. I made no comment.
4) Italians look like they might abandon whole thing as they realise there will be no RDS agreement on this basis and the letter has torpedoed reasonable discussion with chief.

Emails exchanged between senior Shell staff show they knew its massive payment would go to convicted money launderer and former oil minister Dan Etete.

In January 2009 Copleston wrote to two of Shell's most senior Africa executives, relaying a conversation with "my Delta man", whom he did not identify further: "He spoke to Mrs E this morning. She says E claims he will only get 300m we offering—rest goes in paying people off." "E" is understood to be Etete.

"If he does turn his nose up at nearly $1.2 bill he is completely certifiable

In October 2009 Copleston and Shell's Vice President for Sub-Saharan Africa Peter Robinson met with Etete: "We are getting along very well personally – lunch and lots of iced champagne," Copleston wrote.

In March 2010 Peter Voser, Shell's CEO at the time, was told of Etete's involvement.

"Etete can smell the money," Colegate, Copleston's colleague on the ground, wrote in an email forwarded to Voser. "If at nearly 70 years old he does turn his nose up at nearly $1.2 bill he is completely certifiable," Colegate wrote in the email, referring to Etete. "But I think he knows it's his for the taking."

Voser was also kept abreast of negotiations on the ground by Brinded, the exploration and production chief. Sending a briefing on a draft deal for OPL 245, Brinded told Voser in an email in March 2010 that "your formal endorsement is appropriate given the history and the political/ business principles issues involved."

Former Nigerian oil minister and convicted money launderer Dan Etete received vast sums in the OPL 245 deal. Photo: Reuters/Alamy

POLITICS AND PERSONAL GAIN

At the time of the negotiations Nigeria was suffering a political vacuum. In late 2009 President Umaru Yar'Adua spent several months virtually incommunicado in a Saudi Arabian hospital, suffering from an unclear illness. After his death power fell to his vice president, Goodluck Jonathan—who hailed from the Niger Delta, Nigeria's most oil-rich region, directly north of the offshore OPL 245 block.

To remain in power though he had to win presidential elections scheduled for early 2011.

ACCOUNTABILITY FOR WRONGDOING

This case must be an important wake up call for an industry that has continued to treat corruption as a cost of doing business. The OPL 245 scandal is not an isolated case. The oil, gas and mining sector is the most corrupt on the planet, according to a study of hundreds of bribery cases by the Organisation for Economic Cooperation and Development (OECD). Half of these cases implicated senior management. The world can no longer stand back while multi-national oil companies rob countries of precious assets and fool their investors. We could save or improve countless lives across the world, and dramatically reduce the need for overseas aid if ordinary people benefit from how their natural resources are managed.

Those responsible for Shell's participation in this vast bribery scheme now face justice as legal action will shortly start in both Italy and Nigeria. The UK, US, Dutch, Nigerian, Italian and Swiss authorities should continue to cooperate to address the case and investigate for potential breaches by Shell and its executives of anti-bribery legislation.

Shell executives were told that money from the deal was likely to flow to some of the most powerful people in Nigeria - including the then president Goodluck Jonathan. Credit: Alamy

For Etete, the change at the top was useful—Jonathan was an old friend. According to one of Copleston's notes Jonathan used to tutor Etete's children.

"In Abuja it is still a case of all politics and no government," Colegate wrote in a 29 March 2010 briefing to senior Shell employees. "Jockeying for ministerial position remains intense, with many aspirants offering substantial sums to purchase their way into office."

"With an election only 10 months away the need to build war chests for campaigning is strong," he concluded.

Etete's position was insecure too. His own rights to OPL 245 were in doubt, not only because of the Shell lawsuits but also because his $210 million signature bonus was way overdue. His failure to pay meant his licence could be declared invalid.

Etete's friendship with President Jonathan came in handy. In July, according to another senior-level briefing from Colegate, Etete claimed the president wrote a letter confirming that Malabu still held the block. The letter risked weakening Shell's claim to the block in ongoing court battles—and strengthening Etete's hand in the parallel negotiations.

The letter was "clearly an attempt to deliver significant revenues to GLJ [Goodluck Jonathan] as part of any transaction", Colegate wrote to Robinson, the Shell vice president.

Neither Goodluck Jonathan nor the oil minister "understand our legal position", he added—"this is about personal gain and politics".

It was in 2010 that a new player entered the fray—Eni, the oil major 30 per cent owned by the Italian state. Shell and Eni soon started exploring how to work together, with talks taking place between exploration chief Brinded and his Eni counterpart.

Ahead of an August call between the two, Brinded was briefed by email from a colleague that "the President is motivated to see 245 closed quickly – driven by expectations about the proceeds that Malabu will receive and political contributions that will flow as a consequence".

SLEIGHT OF HAND

The suggestion that Etete planned to use the OPL 245 money for a bribery scheme didn't deter Shell. In November 2010 the Attorney General of Nigeria – Mohammed Adoke – took over brokering the deal, hosting direct negotiations over the following months in his office with Shell, Eni, Malabu and Nigerian government officials sitting around the same table.

The parties soon came to an agreement over the $1.1 billion Shell and Eni would pay to Malabu. "An absolute condition of this is that M [Malabu] are 100% out of the block!!" Brinded wrote. Shell would also pay the $210 million signature bonus to the Nigerian Government, he said.

Shell and Eni had a problem though. Striking a direct deal with Malabu could land them in difficulties, both legal and reputational.

So the oil companies, Etete and the Nigerian government agreed on an ingenious solution: the Nigerian state would act as middleman in the deal. Shell and Eni would pay their $1.1 billion into an account at JP Morgan in London set up by government officials, and the money would go straight out again to Etete.

"The oil majors, Etete and the government agreed a solution: Nigeria would act as middleman

"Eni will pay on behalf of itself and SNEPCo [a Shell subsidiary], an amount of $1.09 bln," Brinded informed Henry, Shell's CFO, and Peter Voser the company's CEO at the time. "This will be used by the FGN [Federal Government of Nigeria] to settle all claims from Malabu."

The sleight of hand served an important function: it allowed Shell and Eni to claim they did not pay Etete and that they bore no responsibility for what happened to the money after Nigeria received it. The deal also allowed Shell and Eni to side-step any legal disputes with Mohammed Abacha, the son of the former dictator, who was contesting the ownership of Malabu.

Shortly before midnight on April 14, 2011, after a hard day of negotiations, Shell vice president Robinson emailed a dozen colleagues. "Malabu initialed all agreements," he wrote. "Compliments to our legal team who have done a brilliant job."

> ***"Compliments to our legal team who have done a brilliant job.***

CAREFULLY CONSTRUCTED ANSWERS

When questioned about the deal by journalists and shareholders over the following years, Shell carefully constructed answers, designed to mislead.

In one of its first public comments on the matter, eight months after the deal was signed, Shell said that "any payments relating to the issuance of the licence in Nigeria were made only to the federal government of Nigeria."

"No payments were made by either Agip [Eni's subsidiary] or Shell to Malabu Oil and Gas." Eni has given similar explanations.

As the emails seen by Global Witness and Finance Uncovered show, these explanations may have been true on a very technical level but did not reflect the real nature of the deal.

The $1.1 billion deal was carried out despite a letter of protest sent by the most senior civil servant in the Ministry for Petroleum Resources to the Attorney General just days before the contracts were signed.

Granting OPL 245 to Shell and Eni as proposed "would be contrary to the prevalent practice in Nigeria", the letter said. "Oil Prospecting Licences are now granted on the basis of open and competitive licensing rounds". By agreeing to the proposal, the Nigerian government "would be throwing away an enormous amount of financial resources" and risked "opening itself up to scandal", it said.

Scandal is what it has got. The transaction has caught the attention of law enforcement in six countries: Italy, the Netherlands, the United Kingdom, the United States, Switzerland and, of course, Nigeria.

THE SHELL STARTS TO CRACK

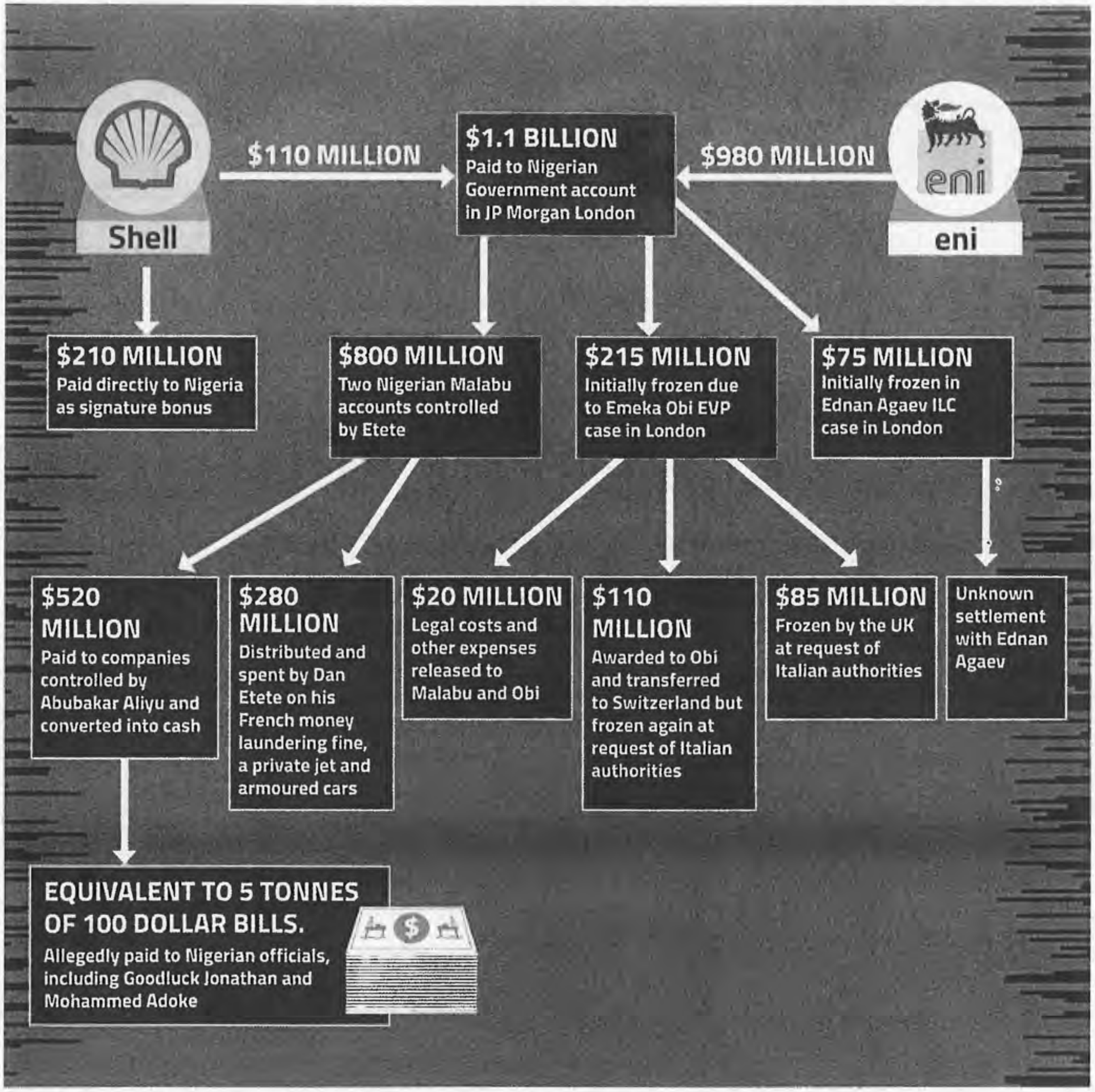
The lurid details of the deal could have remained secret were it not for court cases brought by two middlemen who helped broker the transaction.

One of the middlemen was Ednan Agaev, a former Russian diplomat taken on by Etete to deal with Shell and other potential partners. The other was Emeka Obi, a wheeler-dealer with connections to the Eni senior management.

MAJOR RISKS FOR INVESTORS

Shell's deception and hypocrisy also duped its investors, who include millions of people across the UK whose pensions are invested in the company. They should be deeply concerned about these revelations. In February 2016, Shell's headquarters were raided by 50 police in a joint Dutch-Italian investigation into the deal and corruption allegations over the deal have sparked law enforcement inquiries in six countries. The OPL 245 oil block holds an estimated 9.23 billion barrels of crude oil according to the findings of the Nigerian House of Representatives. If the estimates turn out to be correct, OPL 245 could increase Shell's proven global oil reserves by a third. The potential for Shell to lose this valuable block is therefore a huge risk to investors. Former executives could also face prosecution for corruption.

See our investor briefing online for further details.



Shell paid $1.1bn for rights to the OPL 245 block. Leaked emails show how money flowed to private hands when it should have benefited the Nigerian people.

Courts in Britain obliged the middlemen by freezing nearly $300 million. Obi eventually won $110 million in his case, while Agaev settled with Etete.

The judge presiding over Obi's case in 2012 at London's High Court clearly had issues with the deal. "The whole exercise is backed by murky instructions, I am not sure what I should do," said Justice Steel. "I have seen some odd cases in this Court over the years but even by those standards this is a striking one. I am troubled as to who I am involved with."

Obi's money was eventually transferred from London to Switzerland, where authorities froze the funds.

The details of Etete's direct negotiations with Shell and Eni, along with allegations of kickbacks and bribery, triggered the investigations that led to the joint Dutch-Italian police raid on Shell early last year. With investigators crawling all over its files, Shell risked the secrets behind its OPL 245 deal spilling out.

'REALLY UNHELPFUL EMAILS'

"Apparently there are some really unhelpful emails in there," Shell's Ben Van Beurden, the current CEO told Simon Henry, the CFO, in their phone call after the raid. Particularly from "the people we hired from MI6 who must have said things like 'I wonder who gets a payoff here and whatever.'"

Van Beurden, who was not in his post at the time of the OPL 245 deal, said the emails from the two ex-intelligence officials—Copleston and Colegate—were "judged to be 'pub talk'". And that an immediate public statement on the raid was unnecessary, as "there is nothing to be said other than we are being asked to provide information".

In 2015 Shell's Van Beurden told Global Witness that the oil company's payments were "morally OK" and "in accordance with the law of Nigeria and international practice". There was nothing "unclear or untransparent about it", he said.

Prosecutors in Italy and Nigeria beg to differ. They now allege the OPL 245 money was used for vast bribes, and have traced the money in granular detail.

FOLLOWING THE MONEY

In May 2011 Shell and Eni paid their $1.1 billion into the JP Morgan account in London, specially set up for the purpose.

The next hurdle was for the money to be moved into Malabu's private bank accounts, and to satisfy the compliance officers in charge of oversight at the banks' money-laundering risk units.

The first two attempts to send the money out of JP Morgan—first with a bank in Switzerland and then with a Lebanese bank – failed. Both banks refused the transfers: the Swiss because of Etete's criminal record, the Lebanese for "compliance reasons". Etete finally received the money in Malabu accounts at two Nigerian banks.

Within days $801 million was transferred to five Nigerian companies. They were all fronts, used to distribute the money further and disguise the origin. Banking and court documents show the companies were controlled by Etete and a key middleman, Abubakar Aliyu, dubbed by the Nigerian press "Mr Corruption".

The registered address for Imperial Union—one of the five beneficiaries—was the personal residence of Aliyu, a middleman whom the Milan public prosecutor has described as an "agent of Goodluck Jonathan," the Nigerian president at the time of the OPL 245 deal. Scores of people would gather at Aliyu's heavily guarded gates after prayers on Fridays, begging for alms.

Money received by Etete from Shell and Eni's deal funded lavish purchases including a $56m private jet, armoured Cadillacs, and luxury shotguns. Photos: Shutterstock

To justify one of the huge transfers Malabu presented First Bank of Nigeria in Abuja, Nigeria's capital, with an invoice—with scant detail and nice, round figures.

The $180 million invoice was dated 23 August 2011, and included "Equipment - $80 million" and "Construction and acquisition of site - $50 million". Malabu issued payment instructions to First Bank the same day. Etete later described these and other payments as "an investment on behalf of Malabu."

Nigeria's anti-corruption agency, the Economic and Financial Crimes Commission (EFCC), together with Italian and American law enforcement, traced the money flows. Aliyu told the EFCC that he received \$400 million from Malabu: \$50 million for his work on OPL 245, while the remaining \$350 million was used to buy properties, including a "shopping mall in Dubai" for Etete.

FIVE TONNES OF DOLLARS

The money trail uncovered by authorities did not look like a traditional investment pattern.

The Milan Public Prosecutor, in its December 2016 summary of findings, alleges that Aliyu in fact received \$520 million, which he turned into cash, mostly with local money changers. The cash— which would weigh five tonnes in \$100 bills—was "intended to be paid to President Jonathan, members of the government and other Nigerian government officials", namely: former Attorney General Adoke; a former oil minister (one of Etete's successors); and an ex-National Security Advisor. All these officials were in office during key stages of the OPL 245 manoeuvring.

In January of this year Jonathan released a statement, saying he "was not accused, indicted or charged for corruptly collecting any monies as kickbacks or bribes" in the OPL 245 affair and did not send Aliyu "to seek favour or collect any gratification on his behalf".

The EFCC has charged Mohammed Adoke, the Attorney General who brokered the OPL 245 deal, with receiving \$2.2 million in cash, laundering it through a money changer who converted the cash into Nigerian naira. Adoke has claimed that the charges were part of "orchestrated plans to bring me to public disrepute" and that he acted only in an official capacity regarding OPL 245, seeking to bring an end to court action by Shell that could have cost Nigeria \$2 billion in damages.

The former Nigerian Attorney General who had returned OPL 245 to Etete back in 2006—Bayo Ojo—also received \$10 million, according to authorities.

Etete said in court that he received \$250 million out of the deal, a fee he justified by saying "I put my blood, I put my life into this oil block". Eight million dollars of Etete's ill-gotten gains paid off his overdue fine from his French money laundering conviction.

The money also funded luxury goods including a \$56 million Bombardier private jet, three armoured Cadillacs and luxury shotguns to fuel his passion for big game hunting.

On April 20 this year a court in Milan will begin hearings on whether Shell, Eni and Etete will face trial for international bribery, along with Eni's current and former CEOs. Separate proceedings are being brought against Nigeria's Mr Corruption Aliyu Abubakar and four senior Shell employees from the time of the deal: Malcolm Brinded, Peter Robinson, John Copleston and Guy Colegate.

The companies risk losing the licence, not to mention public trust.

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Global Witness investigates and campaigns to change the system by exposing the economic networks behind conflict, corruption and environmental destruction.

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