Conflict and Coexistence in the Extractive Industries

A Chatham House Report

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1. The Chatham House Arbitration Database (CHAD)

Paul Stevens

Disputes between host governments and private international oil, gas and mineral companies[1] can have several outcomes. They can be settled between the parties informally, lead to international arbitration or result in outright nationalization. Only in the case of international arbitration or nationalization will there be a formal record of such disputes. Thus the Chatham House Arbitration Database (CHAD) cannot be regarded as covering all disputes.

This section first explains the nature and limitations of the data collected in CHAD, and explores basic patterns in the data. It then examines in greater detail in Section 1.2 the relationship between commodity prices and the number of arbitrations over time. Section 1.3 explores whether specific country characteristics (such as certain levels of income, levels of trade dependencies, or institutional quality) or company characteristics (such as the country of origin) can be related to arbitrations data – in other words, whether a specific type of country or company can be identified that is particularly prone to disputes.

This quantitative exploration of arbitration data yields a number of interesting correlations but few robust results that could help to predict where and when disputes between companies and governments in the extractives sector are likely to occur. The strongest results come from the correlations between high commodity prices and a higher incidence of arbitrations. However, common measures of countries' economic welfare, such as GDP per capita or other statistics such as trade balances or institutional indicators, offer few clear patterns.

1.1 Selection of dispute data

The initial source of the CHAD is the database of the International Centre for Settlement of Investment Disputes (ICSID), created in 1966 as part of the World Bank Group. In recent years there has been a growing perception that ICSID has become too partial towards private companies, leading more host governments to seek alternatives. A common alternative is the International Chamber of Commerce in various cities.

A major problem with gathering data on international arbitration cases is that often the details of cases are regarded as commercially sensitive and thus are withheld (for this and other challenges, see Box A1). This presents a serious challenge to the researcher attempting to accumulate a database. The CHAD is a collection of 182 cases concerning oil, gas, minerals and energy more generally.[2] The full database also includes the dates of the constitution and reconstitution of the arbitration panel, the decision, the status of the arbitration, comments and references to published decisions.

Box A1: The tip of the iceberg: challenges and pitfalls in measuring conflicts in extractive industries

Care must be taken in interpreting data on arbitrations, as several factors are likely to have contributed to the increasing number of arbitrations in recent years. A wave of privatizations in the extractive industries in the 1980s and 1990s and a rapid increase in foreign direct investment (FDI) have much increased the scope for conflict between governments and foreign companies. At the same time, international arbitration clauses in investment contracts have become commonplace, in contrast to many of the contracts governments abrogated in the 1970s that were colonial-era concessions with no mechanism for arbitration.[3] There has also been a dramatic increase in bilateral investment treaties (BITs), from fewer than 500 in 1990 to 2,500 at the end of 2005. BITs guarantee investors the option of recourse to international arbitration, even if it has not been stipulated under the original contract.

Disputes that end up in arbitration are likely to be only the tip of the iceberg of disputes in the extractives sector. Disagreements or even breaches of contract are more often addressed through bilateral negotiations or trusted intermediates than through arbitration. Indeed, the threat of arbitration is often employed as a bargaining tactic, signalling that one side sees a conflict as grave enough to involve lawyers and media headlines. The general view among many international lawyers is that resorting to arbitration indicates an irretrievable breakdown of the relationship between the parties.

In most cases, arbitration clauses offer limited protection for investors. Companies typically see arbitration as an option of last resort because the chances of obtaining financial compensation are usually slender[4] and because the process can jeopardize good relations with the host government. In scenarios where a powerful, agile and well-informed political elite controls resources, international arbitration is unlikely to yield results, as the holders of power are not necessarily subject to international regimes and initiatives. International arbitration in these contexts can at worst lead to a company being barred from the country in question.

In many cases, the potential losses from being cut out of current and future contracts outweigh the immediate cost of renegotiated contracts. Several examples from Africa illustrate this. After coming to power in Nigeria in 2007, President Yar'Adua immediately launched wide-ranging energy-sector reforms, including the renegotiation of deals signed under his predecessors in 1993 and 2000. The affected companies included Shell and ExxonMobil, which were ordered to pay a combined $1.9 billion in unpaid taxes in 2008.[5] Neither company resorted to international arbitration. Similarly in Chad, Chevron and Petronas, which had begun work there in 2003, were hit with bills for unpaid taxes, which they eventually decided to pay in 2006.

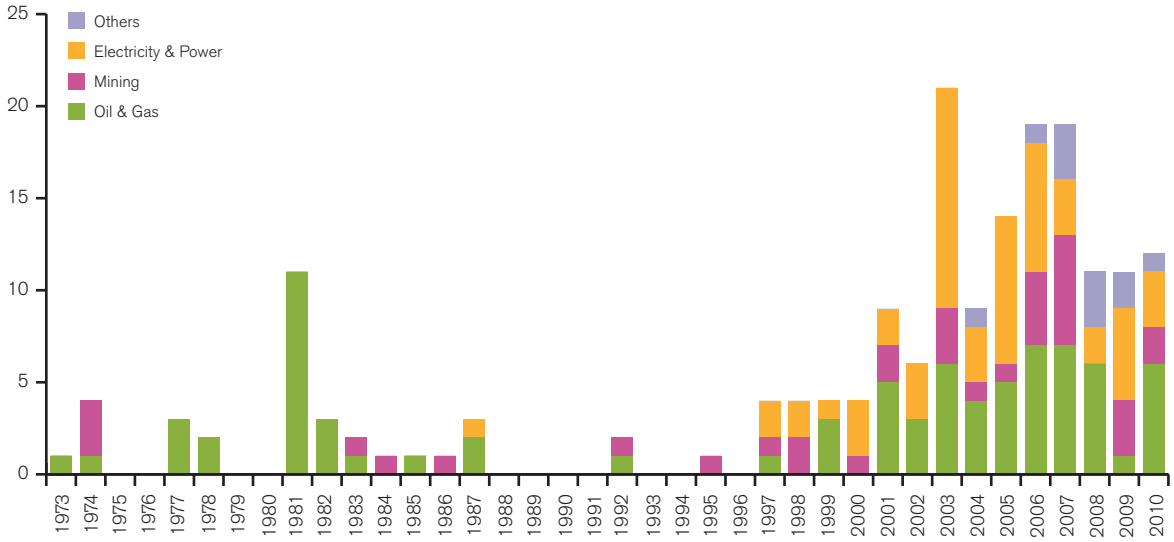
1.2 Characteristics of disputes that end up in arbitration

The 182 arbitration cases of the Chatham House database cover the period from October 1973 to October 2010. The incidence of disputes is shown in Figure A1.

Over this period, 77 disputes concerned oil and/or gas, 35 were about mining and metals, 49 related to electricity and power and 21 were a miscellaneous collection involving synthetic fuels, energy, hydroelectricity and hydrocarbons. As can be seen in Figure A1, there has been a dramatic increase in the number of arbitration cases in recent years.

This increase has been caused by a number of factors. The first is the price level. Figure A2 shows the historical relationship between the frequency of arbitrations and the price of crude oil, but this simple relationship is misleading. A time lag between price increases and disputes would be expected, i.e. a higher price this year leads to higher incidences of arbitration in future years. Figure A3 shows the impact on the correlation between prices and arbitration if such time lags of various lengths are used. For different sets of arbitration data (differently coloured lines), it shows the strength of the correlation between prices and arbitrations (on the vertical axis), using no lag, or a lag of one, two, or three years respectively (on the horizontal axis). The correlation for the mining cases relates to the prices of iron ore and copper; all other correlations use crude oil as proxy for commodity prices. The figure shows that the strongest relationship between prices and arbitrations (a correlation coefficient of 0.82) is found for the full sample (the blue line), using a two-year lagged price of oil.

Figure A1: Frequency of disputes by year and sector, 1973–2007

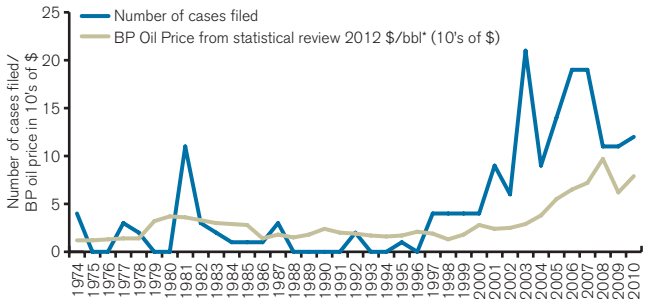


Source: Chatham House Arbitration Database.

Other influences on the number of arbitration cases are price expectations and perceptions of resource scarcity, with the latter tending to drive the former. A possible measure of oil price expectations is the long-term 'forward curve' on the New York Mercantile Exchange (NYMEX). This depicts the price at which contracts for future delivery (e.g. in two or five years' time) can be signed today, and can be interpreted as traders' views of the long-term price of oil (if traders expect prices to rise in the future, they will sell deliveries in, say, two years' time at a higher price than deliveries in three months). Between 1988 and 2002, the 'back end' of the futures curve (i.e. the price for contracts for deliveries several years in the future) remained stubbornly within the range of $18–20 per barrel. But as can be seen in Figure A4, this back end began rising after 2002. This reflected a number of factors, prominent among them being a growing concern for increasing scarcity of global oil supplies, driven by increasingly popular 'peak oil' arguments.

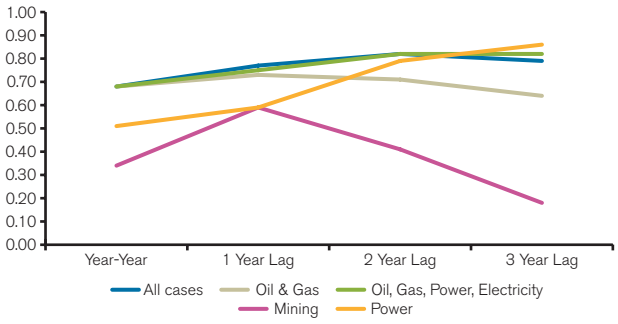
The rise in price expectations coincided with the rising number of arbitrations and a spreading view that 'oil in the ground was worth more than money in the bank'. This led many producing governments to decide not to promote an expansion of oil-producing capacity, thus reducing their need to attract foreign companies. And it encouraged host governments to be more aggressive in their relations with international companies.

Figure A2: Frequency of disputes vs crude oil prices



Sources: Dispute: CHAD; oil prices BP, 2010.

Figure A3: Time lag between price changes and arbitrations

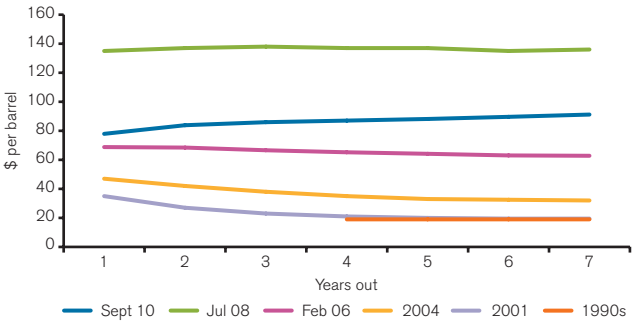


Source: CHAD.

Institutional changes may also have played a role in the historical pattern of arbitrations. Two factors may have contributed to an increase in the number of arbitrations since the late 1990s. First, many of the agreements that now came under pressure contained clauses allowing for the option of international arbitration. Second, there had been a dramatic increase in the number of bilateral investment treaties. BITs grant a number of guarantees for a company's or consortium's investments in the territory of another state. They typically include fair and equitable treatment, protection from expropriation, free transfer of available money and full protection and security. If the investing company feels that these guarantees are being ignored, it can choose to go to international arbitration, usually under the ICSID. Figure A5 shows the number of BITs concluded between 1959 and 2005.

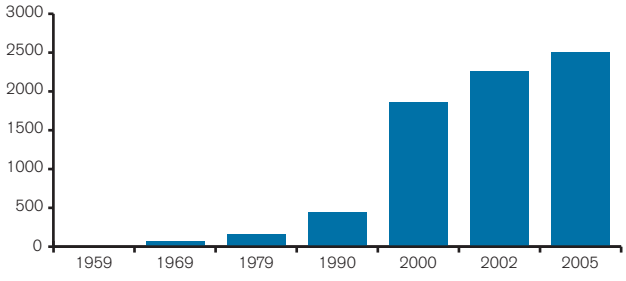
In recent years, the number of BITs has been growing more slowly, reflecting increasing criticism, as noted, that they are too favourable to companies. Between 2000 and 2006, the majority of mineral arbitration cases were based on BITs.

Figure A4: Forward curves for oil prices



Source: NYMEX

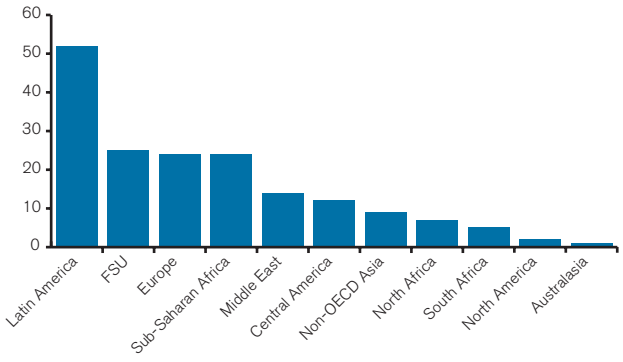
Figure A5: Bilateral investment treaties concluded, 1959–2005



Source: CHAD

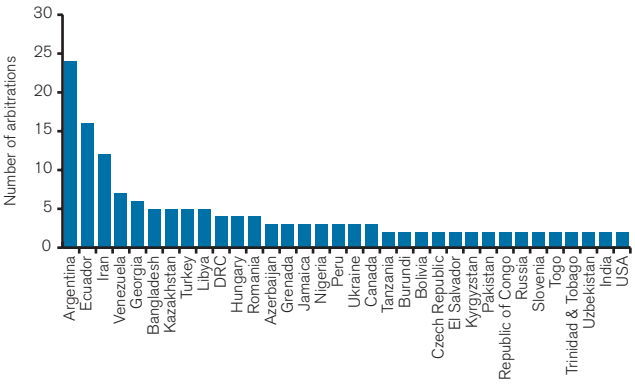
The geographical distribution of arbitrations can also be important. Action by one state may put neighbours under popular pressure to follow suit. Figure A6 shows the number of arbitration cases and their regional distribution. To some extent, the results are distorted by the fact that between 1959 and 2005, Argentina had a record 24 cases. Of these, 18 were initiated in the period 2002–04; there was a peak of 11 in 2003.[6]

Figure A6: Geographical distribution of arbitration cases



Source: CHAD

Figure A7: Number of arbitration cases by country



Source: CHAD

1.3 Characteristics of the parties involved in arbitrations

1.3.1 Governments

The CHAD enables the identification of governments involved in arbitrations since 1973. Figure A7 lists countries involved in more than one arbitration case. Table A1 lists those governments involved in only one case.

Table A1: Governments involved in only one arbitration case

Algeria	Guatemala	New Zealand
Armenia	Guinea	Nicaragua
Bulgaria	Iceland	Niger
Burkina Faso	Indonesia	Panama
Cambodia	Jordan	Papua New Guinea
Central African Republic	Kuwait	Poland
Egypt	Latvia	Qatar
Gambia	Macedonia	South Africa
Germany	Mali	Sri Lanka
Ghana	Mauritius	Turkmenistan
Greece	Mongolia	

Source: CHAD

To identify the types of governments that might be most likely to get embroiled in disputes, the governments in CHAD were organized in three different categories, according to the number of disputes in which they have been involved (one or two, three to five, or more than five).

Additionally, 'control groups' of countries were drawn up, consisting of countries that are dependent on fuel and mineral exports but for some reason have not become embroiled in extractives-sector arbitrations. These are countries where mineral and fossil fuel rents are likely to be significant, and it could be worthwhile for governments to attempt to put pressure on companies or challenge revenue sharing agreements. Depending on their level of dependence on fuel and minerals exports, these countries were grouped in three control groups (more than 15, 30 and 60 per cent share respectively in total merchandise exports in any year since 1970). Together with the three groups that have become involved in arbitrations, this yields six groups of countries (listed in Table A2) whose characteristics can be assessed to identify dispute-prone countries.[7]

Table A2: Groupings of countries for the empirical analysis

Group	Number of arbitrations	Percentage of fuels/minerals in exports	Number of countries
1	More than 5	Not relevant	6
2	3-5	Not relevant	13
3	1-2	Not relevant	48
4	None	60-100	36
5	None	30-59	27
6	None	15-29	39

Next, data on a set of 14 individual indicators from the World Bank Development Indicators were compiled for each of the six groups, attempting to capture four sets of broad characteristics: the type of the economy, the standard of living, the trading position, and the institutional quality of the country. These 14 indicators are listed in Table A3. Where the available data allows, it an attempt was made to distinguish between four different periods: the 1970s, the 1980s, the 1990s and the 2000s. The reasoning is that over 40 years, countries' characteristics will inevitably change. As many of the institutional measures – such as ease of doing business, level of corruption and level of economic freedom – have only been collected relatively recently, changes cannot be observed over any significant time period.

In a final step, data for each indicator were averaged across each individual group in order to enable comparison of the characteristics of the groups of countries that became embroiled in arbitrations, relative to those groups that have managed to avoid them.[8]

Table A3: Indicators used to identify characteristics of arbitration-prone countries

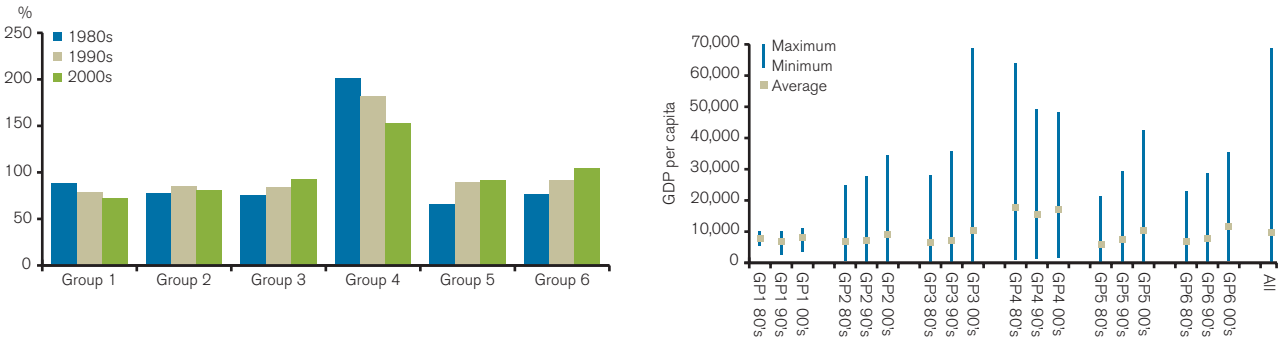
Category	Indicators
Type of economy	GDP per capita based upon constant $2005 PPP
	Agriculture's share of GDP
	Gross fixed capital formation (% GDP)
	Foreign direct investment (% GDP)
Standard of living	Life expectancy
	Infant mortality rate (under 5)
	Literacy rates
Trading position	Merchandise exports (% GDP)
	Current account balance (% GDP)
Institutional quality	Membership of OECD
	Membership of WTO
	Ease of doing business
	Level of corruption
	Level of economic freedom

The results of this analysis are discussed in the four following sections. They show two figures for each of the 14 indicators examined. The first shows the average value of the indicator per group (represented by a brown square). Where available, these are shown for each decade individually. The blue lines represent the range of the results from the country with the highest indicator value to the country with the lowest indicator value in the group. In the second chart, the average of all six groups for each decade is taken as a reference point, and the average of the individual groups is compared with this overall average (100% represents the per decade average across all groups).

Type of economy

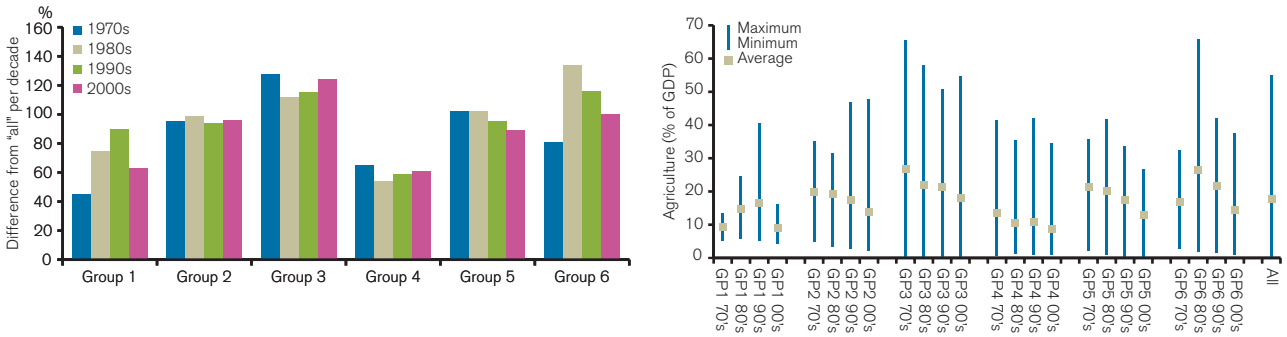
'Type of economy' refers to the level of per capita income, the structure of the economy as measured by the proportion of agriculture in the GDP and levels of investment. As unilateral changes imposed on agreements by host governments will damage a country's reputation, poorer countries might be expected to show a greater tendency to engage in disputes with companies, as the potential prize would be a greater gain to the GDP than in the case of a richer country. Figure A8 reveals that Group 4 countries, with high levels of exports of fuel and ores and metals and with a much higher income than those countries resorting to arbitrations (i.e. groups 1, 2 and 3), appear to avoid arbitration proceedings altogether. Also, in the first decade of this century, poorer countries (i.e. Group 1 countries) resorted to a large number of arbitrations. Otherwise there are no obvious patterns arising from differences in per capita incomes.

Figure A8: GDP per capita income PPP (constant 2005 international $)



The share of agriculture in a country's GDP can be regarded as an indicator of development, with more advanced countries having a smaller share. Figure A9 suggests that Group 1 countries, which resort to a large number of arbitration cases, appear to show a reversal of the development process in the period up to 2000 – the share of agriculture in their GDP grew – compared with all other groups apart from Group 6 in the 1970s.

Figure A9: Agriculture as share of GDP (%)



As for investment, Group 1 countries appear, at least up to 2000, to have a worsening record on investment as measured by gross fixed capital formation (Figure A10). This would be logical if their record of disputes acted as a deterrent to further investment. However, Figure A11 shows a slightly different story for the level of foreign direct investment (FDI): it might be expected to decline if a country gained a reputation as an unreliable subject for investment. Thus countries in Groups 1, 2 and 3 all show higher FDI levels after stagnation in the 1970s and 1980s, which in turn could be explained by the debt crises of those two decades. It also appears that of those countries involved in arbitration, i.e. Groups 1 and 2, more involvement led to below-average FDI relative to that for other groups.

Figure A10: Gross fixed capital formation

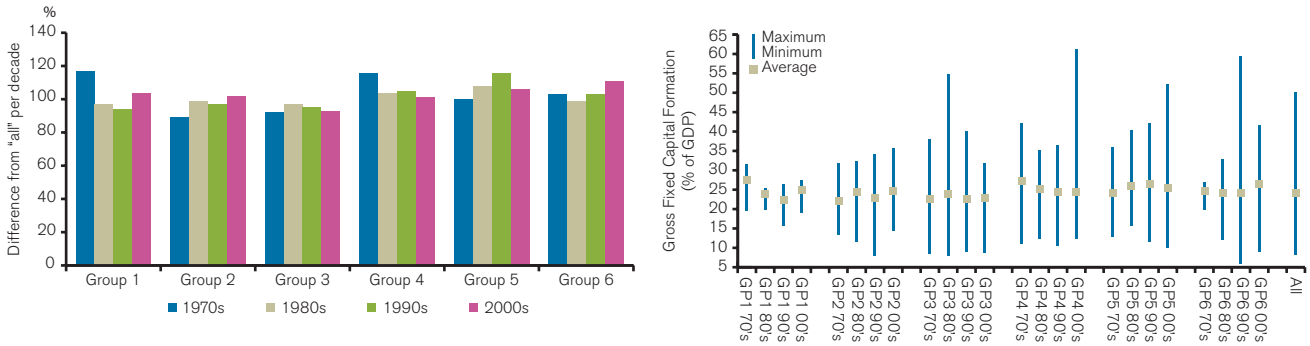
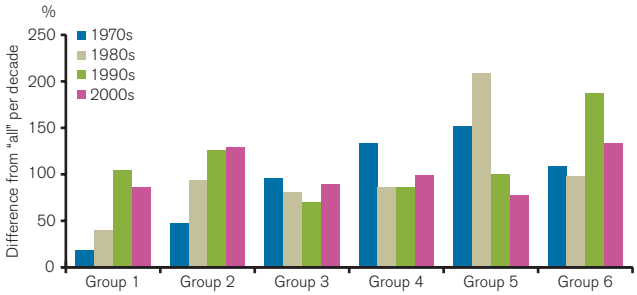
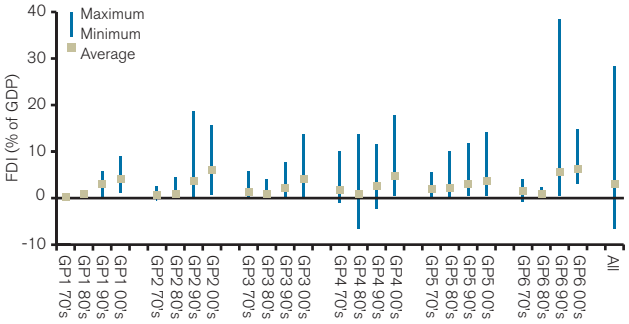


Figure A11: Foreign direct investment (FDI)

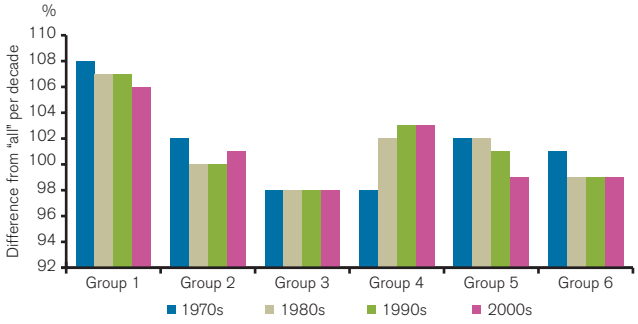




Standard of living

Three variables have been chosen to reflect living standards: life expectancy, infant mortality and literacy rates. All three variables are included in the Physical Quality of Life Index used by the Overseas Development Council since the 1970s. The standard of living is one of the few indicators showing unequivocal evidence of specific patterns. Group 1 countries appear to have enjoyed a higher living standard that the other five groups: they have longer life expectancy, lower infant mortality and higher literacy rates (see Figures A12 to A14).

Figure A12: Life expectancy



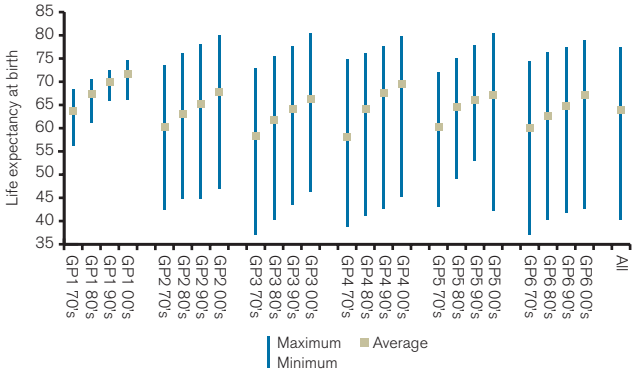
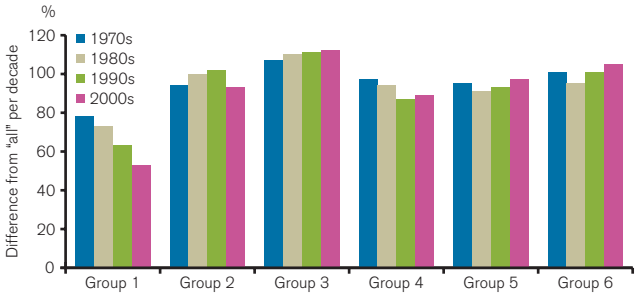


Figure A13: Mortality rates



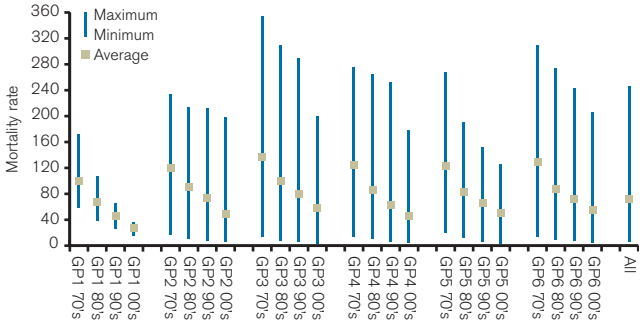
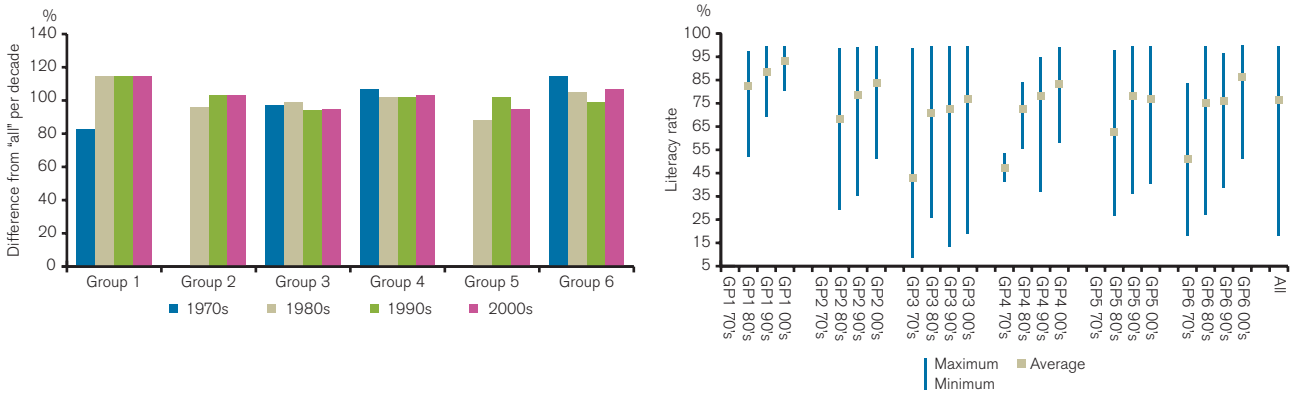


Figure A14: Literacy rates



Why there might be a link between higher living standards and a tendency to resort to more rather than less arbitration is not entirely obvious. One explanation is that governments in countries with higher living standards might come under greater pressure to observe the interests of their citizens and that those interests might be seen as inimical to foreign companies in the oil, gas and mineral sectors.

Trading position

Trading position refers to the relative openness of an economy to international trade and is measured by the level of exports and current account balance relative to GDP, as shown in Figure A15 and Figure A16.

Figure A15: Exports of goods and services

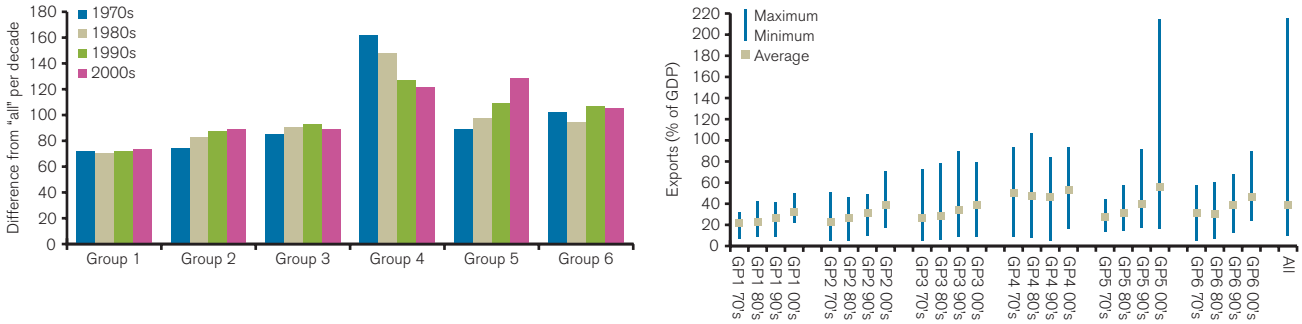
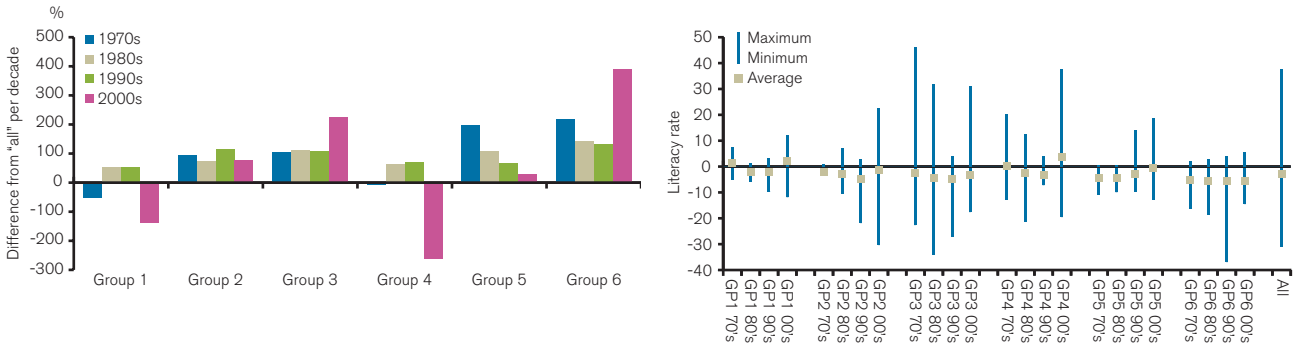


Figure A16: Current account balance



It might be expected that the more open to trade a country is, the less likely its government would be to engage in disputes with trading partners. Figure A15 suggests that countries in Groups 1, 2 and 3 involved in arbitration cases do have a lower level of exports relative to Groups those in Groups 4, 5 and 6, which have avoided arbitrations. Apart from this, there is no obvious pattern.

Institutional quality

Reliable indicators measuring the institutional quality of countries are difficult to obtain. A possible proxy of institutional quality is whether a government is a member of the OECD and the WTO. The fluctuating membership percentages across the groups are shown in Figure A17 and Figure A18. The expectation is that membership in both organizations might be a proxy of better institutional quality and correlate with a lower incidence of disputes. Low membership rates in the first group (the one embroiled in most disputes) provide some support for this, but the pattern across the other groups appears less clear.

Figure A17: OECD membership

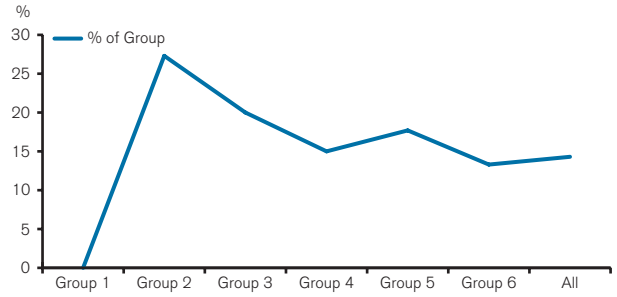
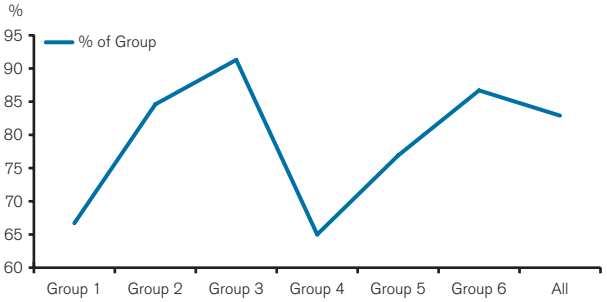


Figure A18: WTO membership



Three other indicators have been considered to capture institutional quality: ease of doing business, the level of corruption and the level of economic freedom. The results are presented in Figure A19, Figure A20 and Figure A21. Interestingly, and almost certainly counter-intuitively, Group 1 countries tend to score highest for ease of doing business, but they have the least economic freedom and are also perceived to be more corrupt than those in the other groups. However, it is important to note that these qualitative indices are created by different groups and for different reasons. There appears to be no substitute for careful analysis of individual countries.

Figure A19: Ease of doing business

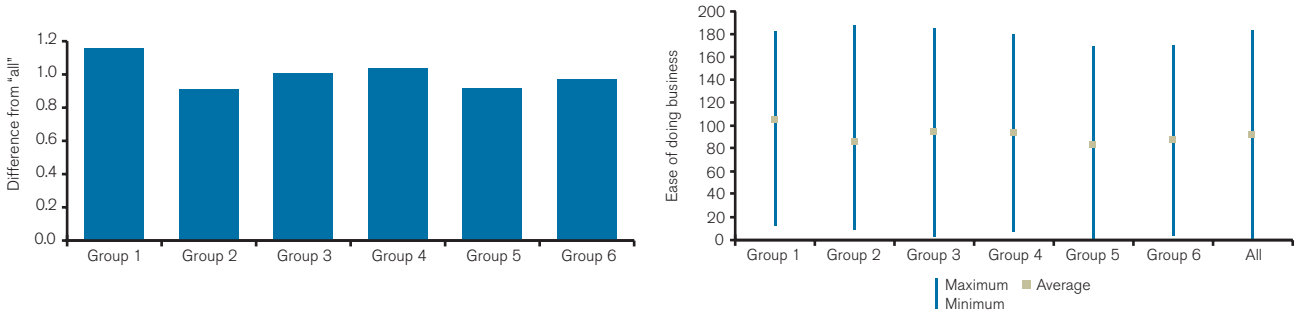


Figure A20: Corruption Perception Index

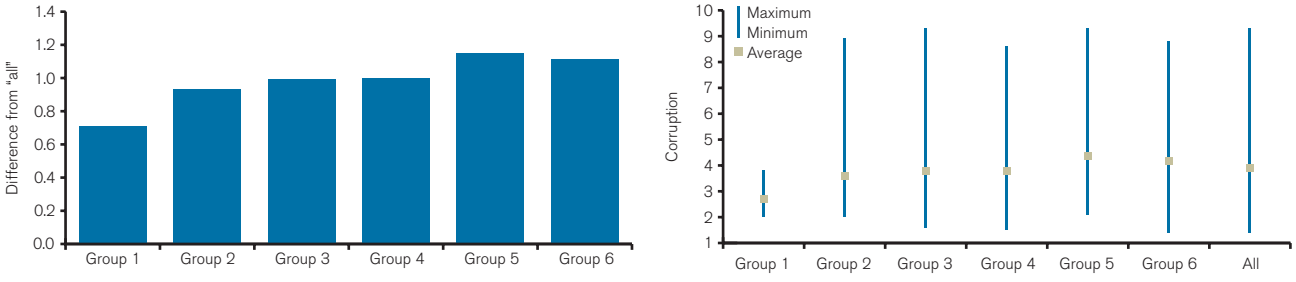
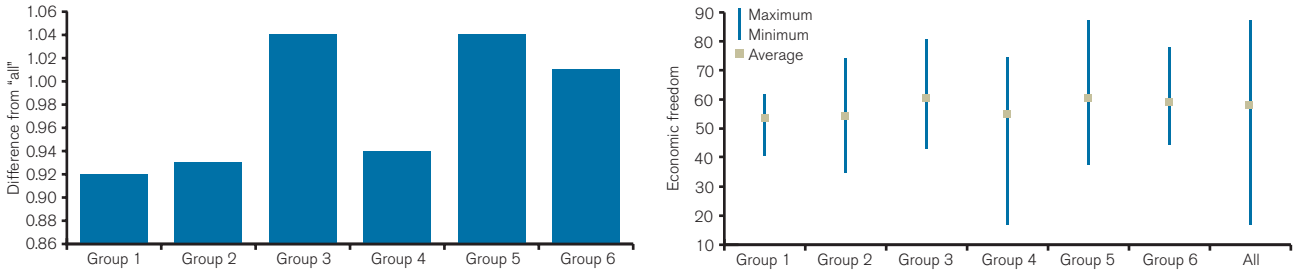


Figure A21: Index of Economic Freedom

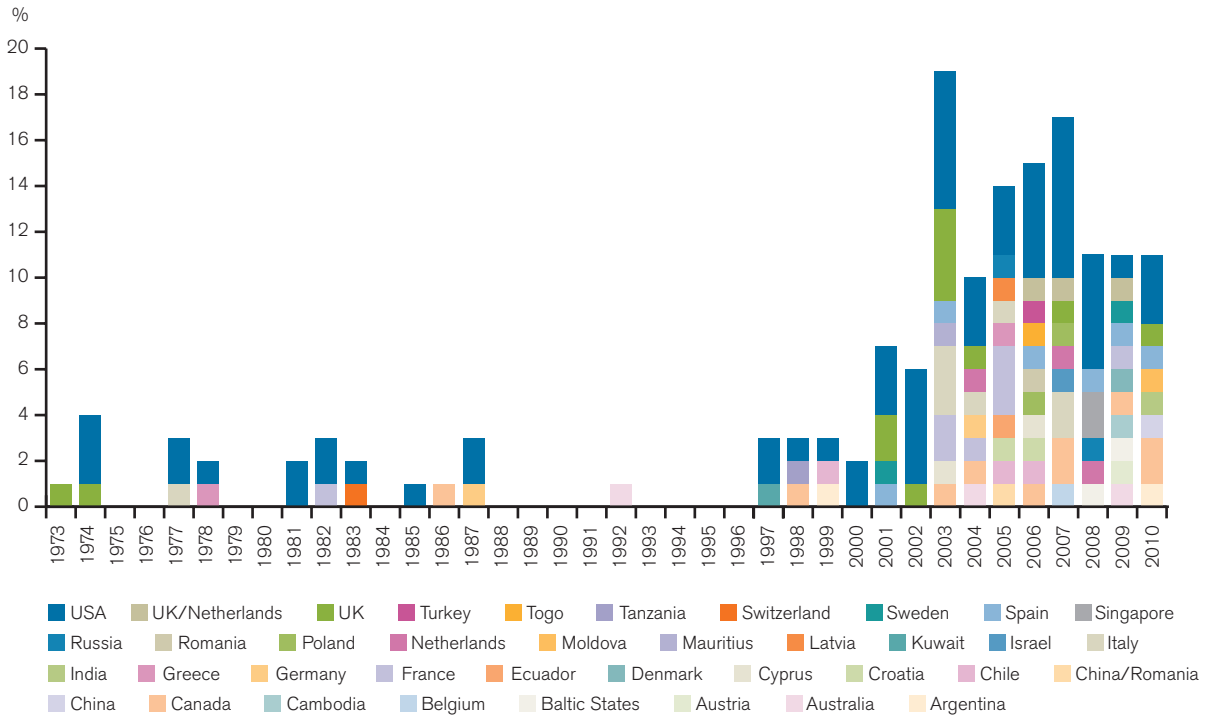


1.3.2 Companies

In the same way that governments can be identified from the CHAD, so too can the companies involved in arbitration cases. The typical companies involved in international oil, gas and mineral activities are large multinationals with many affiliates operating in different countries. For this reason, determining the characteristics of companies is often difficult. Furthermore, companies, unlike countries, often simply disappear; and trying to establish their characteristics long after they have dissolved can be complex and time-consuming.

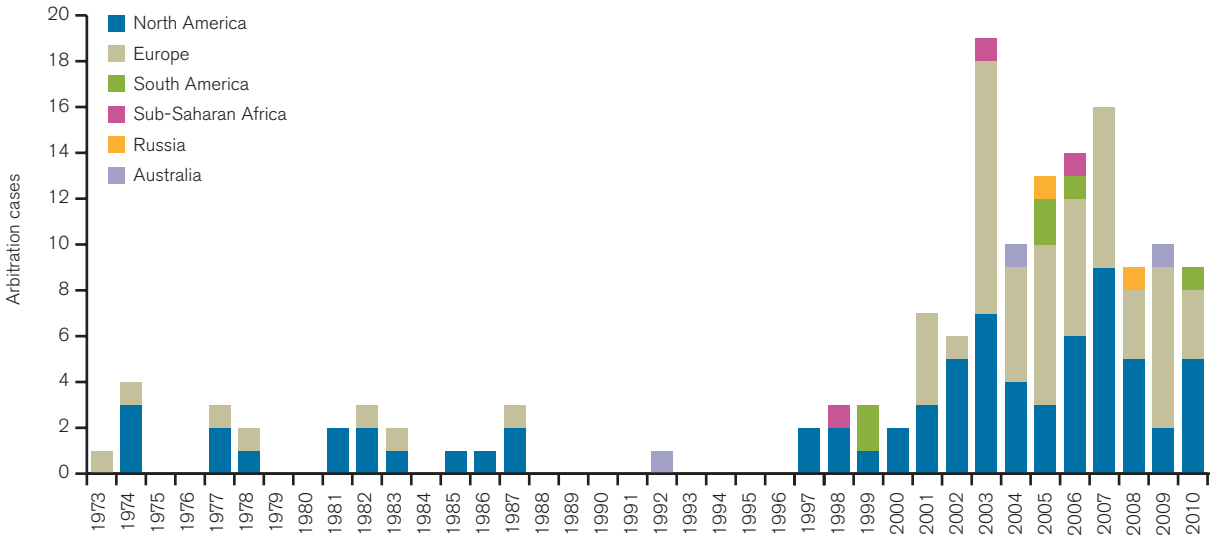
Figure A21 shows disputes over time, broken down by the home-region of the company involved in a dispute. North American and European companies tend to dominate the picture. Of 155 companies involved in arbitrations identified between 1973 and 2010, there were 61 from the US, 10 from Canada, 15 from the UK, 8 from France, 8 from Italy and 6 from Spain. These 6 countries account for 70 per cent of companies involved in arbitrations.

Figure A22: Disputes by regions of company origin, 1973–2010



Furthermore, as illustrated in Figure A22, the majority of companies operated in three or more countries, which is not surprising given that oil, gas and mineral companies follow the location of resources.

Figure A23: Disputes by regions of company origin, 1973–2010



It is fairly clear that the majority of companies involved in dispute arbitrations are relatively long-lived, privately owned multinationals listed on international stock exchanges. They operate in many countries and their host governments are former colonial powers. On balance, it looks as though the characteristics of governments are a far more important determinant of whether disputes arise than the characteristics of companies. But trying to generalize is extremely difficult. There is no magic formula that investing companies can apply to a specific country at a particular time to gauge whether or not their investment may become subject to a dispute in the future.

[1] Normally, if the company in dispute is of the same nationality as the government, the dispute can be resolved by reference to the national courts rather than to international arbitration.

[2] Tim Eaton and Beth Stevens created the CHAD during the latter half of 2010. The only other attempt at such a database of which we are aware is the pre-June 2006 'Cost Shifting in Investment Treaty Arbitration' (available from http://law.wlu.edu/faculty/page.asp?pageid=1185) created by Professor Susan Franck of Washington & Lee University.

[3] Stevens, P. (2008), 'National Oil Companies and International Oil Companies in the Middle East: Under the Shadow of Government and the Resource Nationalism Cycle', World Energy Law & Business, 1(1), pp. 5–30.

[4] The case of the US-Iranian Claims Tribunal was unusual in that both parties agreed in advance to deposit $500 million in an escrow account held by the Bank of Algeria and the Bank of England. This in effect guaranteed that both sides would receive compensation based upon the findings of the Tribunal.

[5] Amanze-Nwachuku, C. and Taiwo J. (2008), 'Nigeria: Yar'Adua Orders Shell, ExxonMobil, to Refund N263 Billion', This Day, 21 May, http://allafrica.com/stories/200805210008.html.

[6] In January 2002, Argentina defaulted in its international debt leading owing to a major economic crisis. In May 2003, Nestor Kirchner, frequently described as a 'left-wing Peronist' was elected president. A major debt restructuring followed, with a series of renegotiations of contracts with foreign companies and some nationalizations. Clearly such local conditions are extremely important in understanding the pattern of arbitrations.

[7] The original idea behind this attempt at quantification was to employ facet theory from forensic psychology, used for profiling criminals.

[8] It should be noted that frequent arbitration might lead countries to develop certain characteristics rather than vice versa. This 'chicken and egg' problem – did the characteristic lead to the disputes or did the disputes lead to the characteristic? – can be resolved only by detailed analysis of each country, its disputes and the outcome of those disputes.

2. Regional and country case studies

2.1 Asia and the Pacific

Gareth Price and Rosheen Kabraji, with William MacNamara (sections 2.1.3 and 2.1.4)

2.1.1 Indonesia

2.1.1.1 Oil and gas

The small number of oil disputes in Asia, excluding the Middle East, is partly a result of the relatively limited prevalence of oil in the region. Indonesia, India and Malaysia are Asia's only substantial oil producers. Unlike in the Middle East, most Asian oil is consumed domestically rather than exported – Indonesia is the only Asian member of OPEC, the Organization of the Petroleum Exporting Countries. Indonesia has experienced a range of oil and mining disputes that are clearly related to the political events. Following the resignation of President Suharto in 1998, a host of dubious contracts were re-examined. In Malaysia, higher levels of competence among state officials and the country's continued political stability have meant that it has effectively renegotiated contracts when needed. India, by contrast, nationalized its oil industry, but the timing of that process made it relatively uncontroversial.

Indonesia gained independence in 1949 after a bitter conflict with Dutch colonial forces. Relations remained strained as the Netherlands refused to hand over control of West Papua. In the 1950s, two companies produced most of Indonesia's oil: Royal Dutch Shell, which had been producing since the 1890s, and Caltex, a joint venture between Standard Oil and Texaco that launched operations just before the Second World War. In 1957, the government nationalized Royal Dutch Shell's assets but Caltex continued to operate.

In 1961, the Indonesian government passed an oil and mining law stating that oil and gas extraction was to be conducted only by the relevant state company. At that time, there were three state-owned companies but by 1968, they had been merged into one company, Pertamina. In 1971, the state articulated Pertamina's duties. They included licensing and contracting foreign operators, marketing oil and gas and supplying the domestic market with refined products.

Indonesia was one of the first countries to introduce production-sharing contracts, establishing contractual conditions that were among the toughest in the world. The government also gave immense power to Pertamina: it had responsibility for approving the costs associated with oil production. Pertamina's excessive bureaucracy and focus on rent-seeking made it inefficient and contributed to its failure to diversify into upstream operations in other countries.

The rise in oil prices in the 1970s led to a boom for Indonesia and its oil industry. Much of the greater income was used to fund a range of industrial projects. But President Suharto and his associates also increasingly used Pertamina as a cash cow, frequently handing out contracts to the president's family and friends. Despite the higher price of oil, Pertamina began defaulting on its debts.

Indonesia's oil production peaked in 1977 and declined in the 1980s. Pertamina's tough contracts, along with widespread corruption and lower global oil prices, discouraged exploration in the 1980s and 1990s. However, natural gas discoveries led it to shift into production of liquefied natural gas (LNG), and by 1988 Indonesia had become the world's largest exporter of LNG.

The fall of Suharto in 1998 was caused in part by the Asian financial crisis of the previous year. When Indonesia turned to the IMF for help, it became clear that reform of the oil sector, with its hefty subsidies and widespread corruption, was imperative. Under new oil and gas legislation in 2001, the government's share of oil revenue passed to the central bank rather than to Pertamina and the company lost its regulatory functions.

Caltex held a licence to produce oil in the Coastal Plains Pekanbaru (CPP) block in Sumatra that was due to expire in 2001. In 1997 the increasingly isolated (and nationalist) Suharto stated that when the licence expired, it should be taken over by Pertamina. After Suharto resigned, Pertamina came under harsh criticism and Caltex managed to have the former president's decision reviewed. The US-based company argued that it was the best equipped to install the new technology required by the project. The energy minister, Kuntoro Mangkusubroto, decided that Caltex and Pertamina should work together in the block.

Caltex also faced questions about its award of a contract in 1997 to a construction company linked to Suharto and the then head of Pertamina. The energy minister subjected the project to a special audit, as he sought to crack down on the power of the Suharto family in the oil industry and wanted to devolve mining powers to the provinces.

Following Suharto's departure, many contracts were rewritten in terms more favourable to the government. For example, Caltex faced demands to provide more employment to people living in and around the CPP block, located in the province of Riau. The citizens of Riau themselves were demanding greater autonomy if not outright independence, which exacerbated tensions in the region. Pertamina and Caltex had been about to agree to a 55:45 split in the joint venture but in 2000 the new president, Abdurrahman, allowed Riau to participate in the development of the block. Eventually an agreement was reached whereby Pertamina and Riau province's PT Bumi Siak Pusako formed a 50:50 joint venture to take over Caltex's CPP operations.[1]

2.1.1.2 Environmental issues

Environmental concerns about oil and gas operations in Indonesia have also triggered disputes. In 2006, Lapindo Brantas, an Indonesian oil and gas company, failed to use protective casing while drilling in East Java province. The drilling resulted in an eruption of mud that became the most significant man-made environmental disaster ever in Indonesia. Many homes and livelihoods were lost, and its effect on the local community can still be seen today.

The Indonesian government ordered Lapindo Brantas and its owners, including a government minister, to compensate the local people. Subsequently YLBHI, a legal aid foundation, filed a civil suit against Lapindo Brantas, the president of Indonesia and various ministers and local officials, claiming negligence on the part of the government. In 2009, the Supreme Court decided that the eruption was a natural disaster caused by an earthquake that occurred near Yogyakarta. One of the joint venture partners, MedcoEnergy, filed a separate case against Lapindo Brantas in New York, accusing it of breaching safety procedures against its advice. MedcoEnergy sought exemption from any subsequent compensation obligation, and won the case.

2.1.1.3 Change of ownership and non-development

Another example of an Indonesian dispute involved Esso, a subsidiary of Exxon, and Pertamina. In 1980, Esso and Pertamina entered a 50:50 joint-venture agreement to explore a gas field in the South China Sea over a 30-year period. In 1996, three years before Mobil merged with Exxon, Pertamina transferred 26 per cent of its interest to Mobil Natuna. However, the project did not develop and in 2005 the government terminated the agreement. ExxonMobil rejected the termination. In 2008 the government decided to grant the project to Pertamina, which required a foreign partner. Eight

companies, including ExxonMobil, submitted tenders. In December 2010, Pertamina announced that it had signed a partnership agreement with ExxonMobil.

ExxonMobil has also been a party in two other significant disputes in Indonesia, both involving protracted negotiations and threats of litigation but now resolved. In 1990 the Cepu block was granted to PT Humpuss Patragas, a company owned by President Suharto's youngest son, and Ampolex, an Australian company. In 1996 Mobil bought Ampolex and in 1998 it purchased Humpuss Patragas. This caused an outcry from activists, who wanted state-owned Pertamina to run the project. Following negotiations in 2006, ExxonMobil was appointed the operator in a 30-year joint venture with Pertamina following negotiations. Pertamina and ExxonMobil held a 45 per cent stake in the project; the remainder was held by the provinces of East Java and Central Java.

2.1.1.4 Mining

There were few overt disputes in the mining sector during the Suharto era, in good part because the system in place deterred foreign companies from operating in the country. Those that did managed disputes within the system. However, the shift towards greater transparency after the Suharto era, coupled with widespread allegations of corruption within the Suharto system, resulted in a number of disputes quickly arising after his departure.

Suharto had close links with James Moffett, the chairman of Freeport-McMoRan Copper & Gold. Indonesia is the site of Freeport's most important asset, the Grasberg open-pit mine, which contains the world's largest single deposits of copper and gold and is valued at $60 billion. The mine was developed under the Suharto regime. Between 1991 and 1997, Freeport offered $673 million worth of loan guarantees to several Indonesians closely linked to Suharto, one of whom helped to secure Freeport's mining licence.

It is widely believed that Freeport-McMoRan was able to maintain mining rights on favourable terms because various associates of Suharto held important stakes in the mine. In 1997, Freeport secured an agreement to expand its operations substantially, apparently after Suharto gave a handwritten note to Moffett supporting this. The company subsequently secured the necessary approvals; but after Suharto resigned, the energy minister, Kuntoro Mangkusubroto, delayed final approval, in part because of concerns about how Freeport had gained earlier approvals. Eventually Moffett held a meeting with the new president, Bacharuddin Jusuf Habibie, who then supported Freeport. Kuntoro later stated that he had planned to double Freeport's royalties before following the president's advice to help the company.

The broader question of the division of profits between government and investors remains unresolved in Indonesia. Some mining companies have cited 'resource nationalism' and corruption as major impediments to investment in the country. Despite this, higher commodity prices have encouraged increased exploration and investment in recent years.

In 2009, Indonesia passed a mining law under which wholly foreign-owned mining projects would gradually have to sell a 20 per cent stake to Indonesian companies. In June 2011, the minister for energy and mines announced that Indonesia would renegotiate contracts in order to secure greater mining revenues for the state.

A dispute over PT Kaltim Prima Coal (KPC) reflected the divisions between local government, on the one hand, and central government and foreign investors, on the other. Rio Tinto and BP, which owned KPC, secured a contract to mine coal in Sangatta in 1982 on the condition that the mine would subsequently revert to Indonesian control. However, the contract did not explain exactly how this would be accomplished, and few details were offered other than a provision stating that part of their shares would eventually be transferred to the 'government'.

In 1999, KPC offered 30 per cent of its shares to the central government for $175 million. The East Kalimantan regional government offered to match this offer. Nothing was heard about the matter until July of the following year, when the central government announced that the East Kalimantan administration should buy the KPC shares. Negotiations between KPC and the central government over the price continued until March 2002, when both parties settled on $822 million for 51 per cent ownership.

The introduction of regional autonomy in 2001 increased the powers of the East Kalimantan government, which took legal action against KPC's failure to release its shares. It sued the central government, BP Indonesia and Rio Tinto. Many assets were subsequently put under the Jakarta State Administrative Court's control, including projects owned by BP. It was only after the 100% valuation of the divestment shares by KPC and the central government less than a year later that the lawsuit was eventually dropped.[2]

Jakarta made several attempts to resolve the dispute by allocating shares to East Kalimantan, although the two governments had been in dispute over the proportion of shares to be divested. A contract of work eventually committed BP and Rio Tinto to divesting 51 per cent of their share in KPC to either the Indonesian government or Indonesian-owned enterprises. But by 2003, no suitable purchaser had been able to raise the finances to buy the shares. In mid-2003, the KPC shares were allocated to PT Bumi Resources for $500 million. Thus the East Kalimantan regional government still has no share in the mine.

2.1.2 Malaysia

The contrast between the mismanagement and corruption in mining at the Indonesian state-owned company Pertamina and the development of the Malaysian equivalent Petronas is marked. The only oil company operating in Malaysia at independence in 1963 was Royal Dutch Shell, which focused on Sarawak, a state on the island of Borneo. In the early years of independence, a number of foreign companies, including Continental, Esso and Mobil, began exploration in various sites. But only Esso remained in Malaysia by 1974, when the country's total output of crude oil was just 81,000 barrels per day.

The idea of establishing a state-run company had been put forward in 1971. The 1973 oil crisis demonstrated Malaysia's reliance on imported oil, leading to the establishment of Petronas in 1974. The nationalization of oil production was also in line with Malaysia's New Economic Policy, designed to improve the economic status of ethnic Malays relative to both foreign companies and Indian and Chinese Malaysians.

Petronas, which was modelled on Pertamina, had supervisory powers over foreign oil companies in addition to its own production capacity. It renegotiated the leases granted to Royal Dutch Shell and Esso, replacing them with production-sharing contracts. These came into effect in 1976, when Malaysia became a modest net exporter of oil.

At the same time, the Malaysian government renegotiated many of its contracts with various oil majors. This was done to protect Malaysian interests rather than the specific interests of individuals. However, Petronas still performs poorly with regard to transparency, and allegations of corruption are frequently made against it. Unlike Indonesia, the same coalition of political parties continues to govern Malaysia. Were it to fall, Petronas, and its contracts, could face the same challenges that Pertamina did following the departure of Suharto.

2.1.3 Mongolia

Mongolia's Oyu Tolgoi copper-gold project is one of the biggest new mining projects in the world in terms of reserves.[3] However, it has taken nearly 15 years for the actors involved to convert the deposit in the isolated southern Gobi Desert into a working mine. During this time, Oyu Tolgoi has become a flashpoint for political tensions in Mongolia.

The decade-long debate over appropriate returns to the state from Oyu Tolgoi underscores how tendencies that are often described as 'resource nationalism' can have both positive and negative effects on Mongolia's welfare. The state has secured

a share of project profits and equity that is higher than it would have been in the 1990s, when a more investor-friendly mining law was in place. However, the scrapping of that law and the work-in-progress approach to investment legislation has created a climate of uncertainty. As questions about the terms and tenure of investment remained unresolved, this dampened investor enthusiasm.

The protracted policy-making process has also delayed the project, deferring the day when Oyu Tolgoi transforms Mongolia's export earnings and tax base and becomes a real benefit for the small, largely poor population. 'First copper' was forecast as early as 2005 and then for 2009 and 2010. Instead, these years saw fiery disputes between mining companies and the government. Only in mid-2013 did the mine finally enter first commercial production. Mongolia has other copper mines, but the country has missed out on years of boom-time copper profits.

Australia's BHP discovered the Oyu Tolgoi copper-gold deposit in 1998. By 2003, BHP had sold all titles to Ivanhoe Mines, a mining exploration company that since the mid-1990s had been the pioneer foreign investor in the Mongolian mining sector. Robert Friedland, the entrepreneur who established Ivanhoe, found the country attractive, in large part because of the 1997 Mongolian minerals law.

Like many mining codes written in the 1990s, Mongolia's was generous: the state did not require equity stakes in projects. When state companies did invest in projects, they received no special treatment under law. Licence-holders were granted virtual autonomy in their licence areas and were free to sell titles to third parties, as BHP did. Exploration permits were handed out on a first-come, first-served basis, favouring 'early believers' such as Ivanhoe.

But neither Ivanhoe nor other investors in Mongolia could have predicted the magnitude of China's boom, and in the years after 2000 Ivanhoe's geologists announced successive, increasingly optimistic assessments of the size and quality of the Oyu Tolgoi resource. By 2004, Oyu Tolgoi was starting to look like one of the great copper discoveries of the new century. Best of all, it was only a day's drive from China.

Mongolia's new-found resource wealth became a politically charged topic in the country's parliament and newspapers. Here was a poor country of under three million people that has lacked the leverage to challenge its neighbours Russia and China. The state's developmental needs were extensive and many citizens lived in pre-industrial, nomadic conditions. Would Mongolia get its fair share from the commodities boom? Should it ask for more from projects such as Oyu Tolgoi?

The answer to these questions came in 2006, when a new coalition government changed the mining laws. At the time, the country was engulfed by political turmoil. In April, demonstrators took to the streets of Ulan Bator, calling on the government to strike a better deal with Ivanhoe and generally to claim a fairer share of the riches. The demonstrators burned effigies of Friedland, the president and the prime minister.

Parliament hastily introduced a windfall profits tax in May 2006. Mining companies would pay 68 per cent of their profits to the state when the copper price exceeded $1.18 per pound. In October, it followed up with a new mining code. The 2006 code bore little resemblance to the investor-friendly framework of 1997. The state assumed the right to own stakes in 'mineral deposits of strategic importance' – up to 50 per cent equity in some projects and up to 34 per cent equity in others, depending on whether or not the government had funded exploration. The copper royalty rate doubled to five per cent. According to the law, at least 90 per cent of the workforce had to be Mongolian and at least 10 per cent of the equity in the project had to be listed on the Mongolian stock exchange.

However, the 2006 law was merely the starting point for another round of negotiations between government and investors. The problem for Ivanhoe was that it had already negotiated exhaustively over Oyu Tolgoi. For several years leading up to the surprise tax hikes of 2006, the company had sought an investment or 'stabilization' agreement. This agreement would have frozen tax rates on the project regardless of the prevailing fiscal regime, thus mitigating the risks to Ivanhoe's shareholders as they invested more than $1 billion in the copper mine.

Mongolia's overhaul of its 1997 mining code demonstrated why such investment agreements are so important to private investors. But Ivanhoe did not have one, and its share price fell. No one either inside or outside Mongolia seemed to know for certain how the windfall tax and the new participation schemes would work. If everything were implemented according to the letter of the law, Oyu Tolgoi and other projects could prove to be uneconomic for investors. In October 2006, Ivanhoe sold a minority stake to Rio Tinto, with Rio Tinto agreeing to double its stake after concluding an investment agreement with Mongolia.

The 2006 revisions cooled investment, as companies and the government clashed on what the new rules meant. In September, Centerra, the owner of Mongolia's biggest gold mine, said that it would delay developing a second mine until it understood the new provisions better. Two years later, an industry-friendly report was still contesting the basic tenets of the 2006 code. 'The 2006 changes to the Mineral Law have been an unmitigated setback for the development of commercial mining in Mongolia,' the report stated. 'The fiscal and regulatory regimes are now highly unattractive to international mining investors, both in terms of the policy settings themselves as well as the sovereign risk for investors in the light of the politicisation of the debate over the policy settings.'[4] Friedland had promised first copper from Oyu Tolgoi in 2005 and, later, in 2010. Both dates became unrealistic. By 2008, only a single shaft had been dug.

Ivanhoe and other mining companies claimed that the windfall tax would destroy mining investment in Mongolia. The country, too, was divided over the windfall tax. The government changed in 2008 after a violent election dominated by campaign pledges about how to manage the country's mineral wealth. According to Zorigt Dashdorj, a former minister of energy and natural resources, it took 'many years of intense debate', for parliament to repeal the tax in August 2009. 'The windfall tax meant that the [internal rate of return] was prohibitively low for companies.'[5]

The repeal of the windfall tax paved the way for Ivanhoe's long-sought investment agreement. The Oyu Tolgoi Investment Agreement, signed in October 2009, gave the government a 34 per cent stake. Rio Tinto poured money into Ivanhoe and Oyu Tolgoi over the next two years. Finally, as the mine neared completion in 2012, it took over Ivanhoe. But the tussle over the 2006 fiscal regime meant that Mongolia 'was not positioned to take full fiscal advantage of the most recent boom in copper prices', according to the World Bank.[6]

The Oyu Tolgoi Investment Agreement and rising minerals prices revived Mongolian mining. Any appearance of stability, however, was short-lived. In 2012, the parliament passed a law restricting foreign ownership of strategic assets, including mines, to 49 per cent unless a deal was approved by it, making it harder for foreign investors to buy or sell properties to other foreign companies. Just a year later, a new ruling coalition decided to scrap the contentious distinctions between private foreign and domestic companies to create greater stability for investors.

In many ways the most challenging aspect of Mongolia's natural resource legislation for foreign investors is its changing nature, not any particular statute. Perhaps because of the disproportionate political and economic importance of the resource-rent question in Mongolia, new laws are subject to pressure from both sides. They are often reduced or dropped when a new coalition comes to power.

The frequent changes in legislation have underlined the importance of investment agreements for foreign investors in Tavan Tolgoi, the coalfield equivalent of Oyu Tolgoi. In the June 2012 parliamentary elections, the coalition led by the Mongolian People's Revolutionary Party, campaigned on a platform calling for the renegotiation of the 2009 agreement. Rio Tinto's head of tax admitted that 'In the case of investment agreements, there's no doubt that at the time it is signed, both parties are satisfied. But the investment then continues over many years, and there's no assurance that the terms will not be changed.'

2.1.4 Pakistan

The Tethyan belt is a mineral-rich band that extends from Romania to the border of India. It crosses Iran, Afghanistan, Pakistan and other countries that have failed to attract international mining investment commensurate with their mineral wealth.

Pakistan could become a major producer of copper and gold if it starts to exploit its slice of the Tethyan belt, which passes through the far western autonomous province of Balochistan. Its aspiration is symbolized by Reko Diq, a copper-gold project in Balochistan, which has been developed since 2006. But in 2013, Reko Diq still had no mine as deepening disputes between the developers and the Pakistani government have been taken to international arbitration courts in Washington and Paris.

Reko Diq offers important lessons. The project shows how conflicting national agendas exist within a country, often catching mineral projects in their crossfire. Reko Diq has pitted the Balochistan regional government against the central Pakistan government, reviving old tensions between Balochi nationalism and Pakistan federalism. Many natives of Balochistan do not see themselves as part of Pakistan. Separatist movements such as the Balochistan Liberation Army have persisted for 60 years, contributing to insurgency, bloodshed and a widely acknowledged lack of trust between Islamabad and Quetta, the regional capital.

Local–federal disputes have centred on natural resources. The Tethyan belt has endowed Balochistan with the majority of Pakistan's known mineral wealth. The province is also the country's biggest source of natural gas. Balochi nationalists have claimed that the province is getting an unfair deal from its gas fields at Sui, which Pakistan has exploited since the 1950s. Nationalists have long demanded billions of dollars in compensation for the gas pumped from Balochistan to other parts of Pakistan. In recent years, separatist tribal groups in Balochistan have been blamed for sabotaging sections of the Sui gas pipeline.

In recognition of Balochistan's *de jure* autonomy within the federation, Pakistan's 1973 constitution granted the province the right to award mineral licences. In 2002, Balochistan issued a new mining code in an attempt to attract foreign investment. The Tethyan Copper Company (referred to below as 'Tethyan'), the developer of Reko Diq, said that it liked 'the sense of stability and security provided by the Balochistan Mineral Rules [2002]'.[7] In 2006, the Canadian gold mining company Barrick and Antofagasta, a Chilean copper mining company, bought Tethyan in order to develop Reko Diq as a 50:50 joint venture.

Both companies were regarded as extremely conservative investors. Their backing appeared to diminish the risks of building a mine in an insurgency-prone province of a politically unstable country. As insurance against contract renegotiations, Balochistan was cut into the project with a 25 per cent equity stake.

Disputes over Reko Diq became public in 2009 when the Balochistan government disclaimed responsibility for funding its 25 per cent share of project costs. The matter remained unresolved when in December 2009 Nawab Aslam Raisani, Balochistan's chief minister, announced that the provincial assembly had decided to cancel the Reko Diq licence and to develop the deposit as a state-owned enterprise: 'Cancellation of the Reko Diq copper and gold project agreement is a step towards getting control over provincial resources in accordance with the wishes of the people.'[8]

Throughout 2010, it was unclear whether or not Balochistan would or could follow through on its threat. Also, damaging complaints began to circulate about how Tethyan would short-change the province by exporting low-value, unrefined ore instead of processing a higher-value refined product in Balochistan.

Tethyan, meanwhile, had submitted its plan for Reko Diq and was pushing for a mining licence. The matter was urgent because its exploration licence expired in early 2011. In trying to resolve the mounting problems facing the project, the company may have miscalculated by lobbying the federal government harder than the provincial government. Islamabad was seen as sympathetic to foreign direct investment in Balochistan, Pakistan's poorest province. The administration of President Zardari was trying to pacify the latest insurgency, in part through increased financial disbursements. A spokesman for the federal government affirmed in 2010 that the Tethyan contract remained valid.[9] By contrast, since 2009 the Balochistan government had several times declined to meet and negotiate with Tethyan, according to company employees.

The company stepped up its lobbying efforts in Islamabad in the last months of 2010. But at the same time nationalist parties in Balochistan were calling for a halt to any federal deal over Reko Diq, claiming it was a provincial matter. They warned that even Chief Minister Raisani, who had maintained a hardline stance on provincial control of Reko Diq, did not truly represent the Baloch people in the matter.[10]

Between November 2010 and January 2011, a growing number of Pakistani politicians both within and outside Balochistan joined in presenting a petition to the Supreme Court requesting a halt to any deal at Reko Diq. Six months of ill-tempered dealings between Balochistan and the federal government ensued.

The Supreme Court, a federal body, at first declined to get involved after the federal government affirmed a statement that it had signed no agreements on Reko Diq. In February, however, the Supreme Court issued a 'stay' order forbidding Balochistan from granting licences for Reko Diq. The order appeared to reflect exasperation about Balochistan's dealings with the court and a desire to get to the bottom of the Reko Diq licences. For months, the court issued requests for Balochistan to submit a complete record of the exploration licences at Reko Diq. It requested the province to settle the matter out of court, which Balochistan's lawyers publicly refused to do. In June 2011, it officially excused itself, ruling that the Reko Diq licence was a provincial matter.

Tethyan had offered concessions to Balochistan in the meantime. The company agreed in principle to establish a refining facility in the province. It also agreed to offer interest-free loans in order to enable the province to take up its 25 per cent project-financing obligation. On a $3.3 billion project, this vendor-financing agreement would save Balochistan tens of millions of dollars in interest payments.

But the rhetoric around Reko Diq had intensified at both the provincial and national levels. In September 2011, the province raised 10 objections to Tethyan's application for a mining licence. Among the most important was that it was not registered in Pakistan, which the company denied. Also, the province claimed, Tethyan's project for the mine was incomplete insofar as it did not include sufficient plans for in-country processing of ore. In November 2011, Balochistan formally rejected Tethyan's application. Tethyan complained that the government had refused to meet it before doing so.

Tethyan immediately filed for international arbitration in Washington and in Paris. The arbitration applies to both the Balochistan and the Pakistan governments, contending that Balochistan violated its 2002 mining code and that Pakistan violated a bilateral trade agreement with Australia. In June 2012, the federal government warned Balochistan that it is responsible for paying compensation if international tribunals rule in favour of Tethyan.[11] In January 2013, Pakistan's Supreme Court ruled that the joint venture between the Balochistan Development Authority and BHP, which had initially explored Reko Diq, was void and that, as a result, Tethyan had no claim to the deposit. In May, Tethyan decided to abandon the project and focus on seeking monetary damages through international arbitration.[12]

The Reko Diq case shows the disjointed nature of the national decision-making that can drive disputes. Reko Diq's developers were not facing a unified 'Pakistan' but were caught between two power centres with different agendas. This complicated Tethyan's efforts to find a political and economic solution to the opposition to its project. Reko Diq was a contested object in a longer power struggle between regional government and central government. This case is similar to the political entanglements encountered by mining and oil investors in Iraq between Baghdad and the Kurdistan regional government, in the Democratic Republc of the Congo (DRC) between Kinshasa and the governor of Katanga province, and in Canada between Ottawa and the provincial government of Saskatchewan.

Reko Diq also provides an important lesson about the effect of asymmetrical information on investment disputes. The investors' and the government's information on a project is frequently unequal during the development stage, as the investors spend years assessing a complex array of factors about geology, economics, finance and logistics. Governments may look at the project through the simpler lens of the politics of the day, either not understanding or disregarding the countervailing technical and economic arguments. In the case of Reko Diq, the information imbalance was extreme.

A popular campaign about Reko Diq's economic value to Balochistan turned the province against the project perhaps more than any other factor. However, the campaign was based on a fundamental misunderstanding of mining industry economics. Beginning in early 2010, Pakistani officials claimed that Reko Diq would generate only $40–50 billion if the foreign consortium developed the project and exported concentrated ore, whereas Pakistan could earn up to 10 times that amount if it processed the copper in the country. The first Supreme Court petitions questioned why Pakistan was selling an asset worth $260 billion or $500 billion, or even $1 trillion, taking into account the market prices for gold and copper at the time.[13] Estimates of its economic value continue to vary widely.

In an effort in 2011 to combat what it deemed a 'misrepresentation of facts', Tethyan presented a calculation of undiscounted cash flows over the life of the project. The value of the mineral resource was $157 billion and the value of the mineable reserves was $75 billion, based on conservative long-term commodity prices, which were in sharp contrast to the prices of the day. Net profits would be $25 billion after capital costs, operating costs, smelting charges and metallurgical losses. The company emphasized that the governments of Pakistan and Balochistan would together receive more than half of the $25 billion in life-of-mine profits through royalties, income taxes and equity value.[14] But Tethyan's calculations were rooted in the arcane world of mineral economics and project finance, and they did not take hold in the popular imagination. The literacy rate in Balochistan is well below 50 per cent, and this may have impeded efforts to sway opinion using material aimed at analysts or economists. This asymmetry of information is a danger to project development in many countries with limited experience in large-scale resource development.

2.1.5 The Pacific islands

Environmental concerns and land ownership issues have plagued a number of mining disputes in Papua New Guinea and the Pacific islands. Disputes have often broken out between companies and communities rather than between companies and governments.

Perhaps the most extreme example of such a dispute was that relating to Banaba Island, part of Kiribati in Micronesia. Between 1900 and 1979, phosphate mining removed 90 per cent of the surface area of the island, leaving it largely uninhabitable. At the end of the Second World War, the UK decided to relocate the inhabitants of Kiribati to Rabi Island, in Fiji, which it purchased using royalties from the phosphate being mined on Banaba.

After mining ended, the few remaining Banabans were moved to Rabi Island. The Banaban Council of Elders, based in Fiji, started legal proceedings against the British government in 1972 on the grounds that the British government must have been aware of the methods used by the British Phosphate Commission (BPC), which had been responsible for the mining. The Banabans argued that the BPC had failed to meet their contractual pledge to replant trees felled as a result of phosphate mining. They also alleged that the British government had underpaid the Banabans in relation to the phosphate royalty. They claimed that the phosphate was sold below market price so as to benefit farmers in Australia and New Zealand and that some of the royalties had been given to the Gilbert and Ellice Islands.

The case finally came to trial in 1976. The High Court of Justice in London agreed that the BPC had failed to replant mined land but did not specify the damages that it should pay. It found the British government not technically liable for the injustices committed but added that the government had failed in its moral duty. In 1977, a documentary about the case sparked an outcry in the UK. Soon after, the foreign secretary at the time, David Owen, announced that the governments of the UK, Australia and New Zealand planned to make available AUD 10 million to establish a fund for the benefit of the Banaban community. The British government maintained that this fund was not an admission of liability.

The case highlighted the divergence between traditional and Western patterns of land ownership. Some of the Banabans argued that they wanted their land returned to normal rather than to receive financial compensation. The Banaban claim also involved the relationship between Banaba and the government of the Gilbert Islands (now Kiribati). The Banabans asserted that they had simply been added to the Gilbert Islands for administrative convenience rather than because of a commonality of ethnicity, culture and language.

In 2005, the Kiribati government decided not to allocate any of the trust fund, which now amounted to several hundred million dollars, to the displaced people of Banaba, even though many still had Kiribati passports. In 2006, a request was made to pay the Banabans $23 per month in pensions but the Kiribati parliament rejected this. Many felt that the Banabans on Rabi were entitled to the pension. Banaba's pension fund was partly financed from the reserve fund that had resulted from phosphate mining, and those now living on Rabi had been forced to leave Banaba against their will. Phosphate mining in Nauru and Christmas Island presented a similar predicament to the island's inhabitants.

The Inco nickel mine in Goro, part of the French overseas territory of New Caledonia, has also been involved in a similar dispute. Inco, later purchased by the Brazilian mining company Vale, set up a pilot plant in the 1990s to test its acid-leaching technology. Goro Nickel Company, a subsidiary of Inco, began full-scale construction of the Goro mine in 2001.

Local community opposition to the Goro mine stemmed from two factors. First, there were concerns about the environmental impact of both the acid-leaching process and the proposal to eject waste into the sea. Second, locals worried that their 10 per cent stake in the project was too small; some groups demanded a 40 per cent share. In 2006, opponents of the mine blockaded it and vandalized equipment. In July of that year, a local court cancelled Goro Nickel's licence to mine at the site because the environmental impact of the project had not been properly assessed. The court's ruling did not prevent the continued construction of the plant but it did represent a victory for its opponents. In 2008, Goro Nickel (since purchased by Vale) signed an agreement pledging to create a 'Sustainable Development Agreement', with around €84 million to be paid out to various local groups over a 30-year period. Then, in April 2009, a sulphuric acid leak from the Goro plant caused an ecological disaster, as an estimated 40,000 litres of sulphuric acid was spilt. While Vale was to face a court judgment over the pollution, a police tribunal dismissed the case in August 2011, citing the time lapse since the incident. Three years after the accident that Vale was fined a mere $5,000.[15]

2.1.6 The Philippines

Mining in the Philippines has a long history, including a boom in the 1960s and 1970s under President Ferdinand Marcos. Rising international prices were accompanied by vigorous policies to control wages. More recently, numerous reports have noted that mining has failed to benefit the wider economy of the Philippines and that the impact of mining on local communities has frequently been disastrous. Many observers have concluded that mining, like logging, has benefited only a few elite families.

Since the overthrow of the Marcos dictatorship in 1986, the Filipino nation has been struggling with the legacies of debt, corruption, over-exploitation of natural resources and militarization that underpinned the Marcos regime.[16]

Environmental disasters, rather than concern over the allocation of rents, have frequently provoked disputes and contract renegotiations in the Philippines. The most notable example of this is the Marcopper project. The Marcopper Mining Corporation began mining in Luzon in 1969. The Canada-based company Placer Dome controlled 40 per cent of the project and President Marcos and his associates owned a majority share through several front companies. Unsurprisingly, the company was able to operate on favourable terms and with little regulatory oversight. Between 1975 and 1988, Placer Dome dumped an estimated 84 million tonnes of mine tailings into a nearby bay.

When Marcos was ousted in 1986, local villagers renewed their campaign against the dumping of tailings. In 1988, after a number of legal challenges, the chairman of the Pollution Adjudication Board noted that Marcopper had been operating without a valid permit since 1987 and ordered it to cease production. Marcopper immediately shut down, thereby causing massive power cuts to the local community. In the end, President Cory Aquino, facing the threat of a legal challenge from Marcopper, allowed it to continue dumping tailings in the bay.

In 1996, a storage pit for mine tailings fractured and 1.6 million cubic metres of waste were discharged into a nearby river, causing enormous environmental damage. After the disaster, Marcopper closed down the mine and the government attempted to cover up the fact that environmental laws had never been enforced. Two years later, President Fidel Ramos declared Calancan Bay to be in a state of calamity for health reasons.

Corruption continues to beset the mining sector in the Philippines. In 2009, an inquiry was launched to investigate why a coal extraction project worth 6.2 billion Philippine pesos (roughly $150 million) in Catanduanes province had been granted to Monte Oro Resources & Energy without public consultation. The company was reportedly owned by Enrique Razon Jr, a businessman close to President Gloria Macapagal-Arroyo. The contract caused concern among environmental groups, which feared that the mine would disrupt the lives of marginalized residents in the area. In the years since, Monte Oro has reportedly abandoned the project, which was no longer profitable, but the company is still exploring for coal in Catanduanes province.

The failure of successive governments to renegotiate contracts and to enforce environmental laws has placed a stronger focus on the wider legal framework under which mining operations are permitted in the Philippines. The issue is complicated by the relative importance of small-scale mining, which faces even less regulation.

Small-scale mining is an important source of income for local governments, but the power to issue mining permits for it has been widely abused. In April 2011, at least eight people were killed following a landslide in Pantukan that had been caused by small-scale mining.

This disaster prompted the Catholic Bishops Conference of the Philippines, an important body in Filipino politics, to call for a moratorium on all mining until a satisfactory monitoring system could be put in place. The conference further called for the closure of loopholes in the 1995 Philippine Mining Act, which allowed substantial foreign ownership of Filipino mines, before either small- or large-scale mining could be allowed to resume. The conference had earlier called for large-scale mining to be halted because of its environmental damage and impact on farmers and fishermen.

A new law currently under discussion would remove the cap on foreign mining investment that was included in the 1995 act. However, the Bishops Conference has opposed such a move and called on the current president, Benigno Aquino III, to make public all existing mining contracts. The issue is increasingly important politically. The governor of South Cotabato province recently banned opencast mining there, jeopardizing a $5 billion Xstrata project. One of the first foreign companies to enter the Philippines after the passing of the 1995 act was Lafayette. Eventually the company sold its stake after a cyanide spill that sparked protests both from the Catholic Church and from local environmentalists.

In February 2011, President Aquino said that the government would process no more than 300 applications for mining rights because of lack of community support. ‘We will support whatever is the position of the communities. While they stand to economically benefit from mining projects, they are also the ones to suffer if anything goes wrong,’ he said, adding that ‘I will listen to you. If you don’t like it, let’s not do it.’

2.2 The Middle East and North Africa

Paul Stevens

Since the 1950s, oil-producing countries have gradually been winning a larger share of returns from their assets while international oil companies have seen the extent of their share eroding. This is especially the case in the Middle East and North Africa (MENA) region, which has always dominated global oil and gas in terms of reserves and exports. Over the past half-century, there have been many disputes between the state and investors but the state remains dominant.

Table A4: Global oil reserves and exports – the Middle East and North Africa's share, 1960–2009 (%)

	Oil reserves	Oil exports
1960	60	51
1970	56	50
1995	65	47
2009	57	35

Resource nationalism has been in evidence throughout this evolution. It became a driving force in the decades after the First World War, when governments reacted against colonial concession arrangements that they believed did not give them a fair share of income.

These oil concessions had their roots in the immediate aftermath of the First World War. The major powers, specifically Britain, France and the United States, were seeking to gain access to the region's reserves for their own oil companies to exploit. The latter were often fighting not only among themselves but also against small-scale prospectors. Most tensions over licences arose between developers, not between international oil companies and host governments. There was even competition within government ministries in Britain: the Foreign Office, the Colonial Office and the India Office fought lively skirmishes over licensing in the Persian Gulf.

The original Middle East oil concessions were granted on terms that were extremely favourable to the international oil companies, as set out in Box 2.3 of this report. By the 1940s, however, the balance of power was changing. In 1943, Venezuela pioneered the practice of 50:50 profit-sharing, claiming that 50 per cent of project profits were due to the state, in one of the earliest production-sharing contracts. The international oil companies (IOCs), still smarting from Mexico's nationalization of its oil industry in the 1930s, adopted the 50:50 model, recognizing it as a system that protected their investments and appeared preferable to the alternative. The use of 50:50 profit-sharing spread from Venezuela to the Middle East and by 1952 Saudi Arabia, Kuwait and Iraq had adopted it.

In the 1950s, the bargaining power of states increased markedly. All forms of nationalism were ascendant in the post-colonial era as newly independent countries of the Third World asserted their sovereignty, and state intervention in the economy was increasingly regarded as the norm. For host governments, two drivers were crucial: the rise of 'permanent sovereignty' over natural resources and dissatisfaction with the original terms of their concession.

The first eruption happened in Iran. Disputes over payments to Iran by the London-based Anglo-Iranian Oil Co (later BP) resulted in Dr Mohammad Mossadegh, the prime minister, nationalizing the Anglo-Iranian Oil Company. In consequence, the British, American and French governments exerted such strong pressure that no one was willing to lift Iranian oil. In 1953, Dr Mossadegh was overthrown in a coup organized by the American and British secret services. He lived the rest of his life under house arrest.

The United Nations passed its first resolution on 'permanent sovereignty over natural resources' in 1952. A decade later, another resolution recognized the rights of a country to dispose of its natural wealth in accordance with its national interests. Resolution 2158 of 1966 was even more explicit: host countries were advised to secure maximum exploitation of natural resources by acquiring full control over production operations, management and marketing. OPEC, created in 1960 to protect the interests of the producer governments, supported this idea strongly. Radical actions by host governments, however, were severely constrained by their knowledge of the fate of Dr Mossadegh.

Pressure to relinquish at least some of the huge concession territories grew. In 1961, Law 80 in Iraq in effect nationalized all the unused acreage of the foreign-owned Iraq Petroleum Company (IPC). The IPC was left its existing producing fields. Other IOCs in Kuwait and Saudi Arabia quickly began to relinquish acreage 'voluntarily'.

Fiscal terms were changing quickly too. In 1970, Libya, then a new producer, agreed a profit-sharing deal that shattered the 50:50 status quo. Soon Iran and other countries followed, with the split widening to 55:45 and 60:40. 'Fair share' was redefined through ratios increasingly favouring the state.

The state's returns were calculated through taxes on profits, and this created major disputes about what constituted profits. The issue centred on the setting of the posted prices that were used to compute revenue, as well as on what should be included as costs. OPEC began to play a prominent role in the negotiations, as producer governments had more leverage if they acted collectively.

In the area of calculating profit, as in so many other areas, the governments won. During the 1960s, host governments succeeded in expensing royalties, which increased their take. In 1970, following huge pressure from Libya, the IOCs accepted host-government involvement in setting posted prices. The Tehran and Tripoli agreements of 1971 extended to other MENA countries the right of governments to 'negotiate' posted prices with IOCs. And by October 1973, the governments had embraced this prerogative, which was so crucial to determining government revenue and unilaterally announced price hikes. This was the first 'oil shock'.

The IOCs slowly began to lose managerial autonomy in their licence areas. At the same time, governments looked with increasing disfavour on a system that allowed IOCs to be effective 'states within a state', able to choose the rate of exploration and development and the level of production. Governments might try to influence these decisions but their power was limited. The original agreements did not allow them any role in the operating companies, although some of the latter paid lip service to the possibility of host-government involvement.

But as host governments gained confidence and bargaining strength in the 1960s, they gradually secured better terms from the IOCs. New oil-production arrangements involved the state in the operation of the assets. The arrangements took the form of joint ventures, production-sharing agreements (PSAs) and service contracts. The seeds of state participation in the sector were planted. The PSAs were a form of settlement between company and producer. Both sides would benefit, in recognition of the government's ownership of the asset and the company's capital commitments and risks.

However, resource nationalism had reached fever pitch. The PSAs might be considered a compromise but they failed to address the issue of control. Pressure from the 'Arab street' to nationalize the IOCs, which were seen to embody an imperialist past, was intense. It had peaked by June 1967 when Zaki Yamani, Saudi Arabia's oil minister, proposed a solution to the control problem. He promoted the idea of 'participation', to begin the process of seizing control without provoking a political backlash from the Western governments affiliated with the IOCs.

The Gulf's major oil producers met to work out a negotiating position. The October 1972 General Agreement on Participation gave producers an initial 25 per cent equity stake, projected to rise to 51 per cent by 1982. But in the same year that the agreement was signed, Algeria and Iraq decided on nationalization, having lost patience with a negotiated settlement. The Western powers failed to retaliate in any serious way, hastening the destruction of the General Agreement on Participation and its gradualist approach to state participation.

By 1976, the old-style concessions had been swept away. The producer governments now had full control over their oil operations and oil prices too. Only in Libya and Abu Dhabi, where officials felt that they lacked the capacity to take over complete control of all oil operations, did the government stop short of complete nationalization. With the exception of Libya, the United Arab Emirates and Oman, the IOCs were shut out of the MENA region's most prolific oil blocks.

Nationalization engendered serious disputes between foreign investors and host governments, but these did not necessarily show up in international arbitration. However, following Iran's nationalization of its oil industry in the wake of the 1979 revolution, many arbitration cases were filed in The Hague, appended to the US–Iranian Claims Tribunal.

The situation in the MENA region changed after 1986. After the collapse of oil prices, many of its governments began to encourage IOC entry in an effort to offset lower prices with higher production levels. MENA oil producers instituted increasingly progressive fiscal terms, as did major mining countries. Under a progressive fiscal system, host governments gained the majority of large windfall profits, whether generated by unexpectedly large volumes or by higher prices. After 1986, all the MENA countries except Saudi Arabia began to encourage the re-entry of the IOCs. They were not always successful. In both Kuwait and Iran, efforts at re-privatization clashed with domestic political issues and generally failed.

After 1999, the region began to see a resurgence of rising prices and resource nationalism, which led to a revival of states' appetites to renegotiate contracts in their favour. There was also genuine concern among some of the producer governments, most clearly in Algeria, that revenues from the commodities boom could well lead to the detrimental consequences associated with the resource curse. Such fears were yet another factor compelling governments to attempt to change agreements and fiscal systems.

2.3 Russia and Azerbaijan

Alex Nice

2.3.1 Russia

The private sector invests, the state demands an increasing share and eventually it nationalizes: this is the path travelled by the oil industry in the Middle East and many other regions, including post-Soviet Russia.

The presence of this pattern in post-Soviet Russia is arresting for two reasons. First, in much of the post-Soviet period, foreign investors have been only small players in the debates and conflicts over the governance of the hydrocarbon sector. The USSR, unlike countries in the Middle East and Africa, was a command economy that had developed its oil and gas industry virtually from scratch with little external involvement. Oil enterprises were privatized after the fall of communism, but that process largely excluded foreign investors.[17] And although Russia has moved to renationalize swathes of its oil industry since 2000, renationalization cannot be seen as a reaction to foreign involvement, as there has been virtually none over the past century. Russia shows how the creep of the state can occur under any conditions.

Second, Russia demonstrates how states' contests for a fair share of resource revenues are implicated in larger political designs and frequently divorced from mineral economics or patriotism. In post-Soviet Russia, the cycle of resource ownership was entirely dominated by the cycle of Russian political fragmentation and consolidation.

Boris Yeltsin's government orchestrated the privatization of valuable energy assets in the 1990s. In the conditions of a reduced state whose command economy had already broken down, the privatization of the oil sector had a clear political logic. Yeltsin faced formidable political opponents and the prospect of Communist revanchism in the early 1990s. Privatization enabled him to create new constituencies of support. The newly minted oil tycoons reciprocated by supporting Yeltsin's re-election in 1996. In addition, privatization ensured that the president's opponents would face powerful opposition if they tried to reverse his economic policies in case he was defeated.[18] Privatization cannot be explained by an ideological commitment to free markets alone, as shown by the fact that foreign companies were largely excluded from the process.

Russia did, however, sign three production-sharing agreements with foreign companies in the 1990s. Two were for Sakhalin Island in Russia's Far East (Sakhalin 1 and 2) and the other was for Kharyaga in northwestern Russia. All three oil and gas fields presented significant technical challenges that required IOC expertise. The three investment agreements all came under pressure during the first Putin presidency, whose reassertion of control over the oil and gas industry was one thrust in the campaign to reconsolidate central Kremlin power.

In June 1994, the Russian government signed a PSA for Sakhalin Two. That field was intended to supply liquefied natural gas to Japan, South Korea and North America. By 2004, the partner IOC consortium was led by Shell, which had a 55 per cent stake, with minority partners Mitsui and Mitsubishi. The consortium committed itself to a $10 billion project. In July 2005, Shell admitted that the projected costs of Sakhalin 2 had doubled to $20 billion. Target dates for the beginning of LNG production were pushed back from 2007 to 2008.[19]

In September 2006, the Russian ministry of the environment cancelled its approval of environmental protection procedures at Sakhalin and launched an investigation into alleged infringements of environmental laws. Its concerns had substance. In early 2005, a congress of indigenous people held demonstrations to protest against the cumulative impact of oil and gas development on their quality of life.[20] Their cause was supported by an international campaign involving a number of major environmental NGOs. But as soon as the state reasserted control, the authorities ceased to object to environmental hazards. One analyst described the environmental dispute as 'a classic example of the misuse of purportedly civil society institutions by the state and state-controlled business interests'.[21]

In December 2006, Shell ceded control of the project to Gazprom. Its stake was reduced from 50 per cent to 27.5 per cent. The stakes of Mitsui and Mitsubishi were also halved. Gazprom controlled Sakhalin 2 with a 50 per cent plus one share.[22]

The Kremlin's pressure on IOCs was informed by the economic rationale of the obsolescing bargain. Rising oil and gas prices as well as delays and cost blow-outs made the 1990s agreements look increasingly unfavourable. President Vladimir Putin described the Sakhalin 2 project as 'a colonial treaty that had nothing to do with the interests of the Russian Federation'.[23] The Russian government set its sights not only on not the Sakhalin project, but also on the Total-led Kharyaga consortium. The Kharyaga PSA entered into force in 1999. Total had a 50 per cent stake and Norsk Hydro 40 per cent. In 2005, the consortium was accused of cost overruns and was drawn into a tax dispute that was settled out of court. In 2006, a report accused Total of failing to invest adequately in project development: production in that year was 3.6 times lower than projected and only one of six promised wells had been drilled.[24] Pressure on the consortium appeared to ease in 2009 after Total and Statoil each ceded a 10 per cent stake in the project to the Russian state-owned Zarubeshneft.

There was a clear political as well as economic dimension to the resource nationalism that confronted IOCs. Since 2004, the Russian state had significantly expanded control over 'strategic sectors'. In 1997, the European Bank for Reconstruction and Development estimated that 30 per cent of GDP was controlled by the state.[25] In 2010, Igor Jurgens asserted that its share of GDP had risen to more than 50 per cent.[26]

William Tompson has argued that state dominance over the oil sector and other strategic sectors was the response of a weak state to the political threat posed by powerful independent economic actors. President Yeltsin privatized the oil industry in part to create strong political allies who would become the opposition in the event of his defeat. Under Putin, this political opposition melted away. With no immediate threat to his tenure, Putin was well placed to pursue a statist economic policy towards the natural resources sector with the aim of maximizing rents but also of neutralizing the Yeltsin-era tycoons' power base.

These political motives climaxed in the renationalization of Yukos, a giant energy company. The imprisonment of Mikhail Khodorkovsky, its owner, on charges of tax evasion and allegedly stealing his own company's oil, confirmed the dangers of operating an independent financial and political base in the Putin era. Prior to his arrest, the billionaire had begun to finance opposition parties and to lobby aggressively in parliament for changes to the tax regime. In 2003, he was arrested and Yukos was presented with massive backdated tax claims that in effect drove the company to bankruptcy. Rosneft, a state-owned oil company, then acquired Yukos after a closely controlled auction.

The state's firm approach to Yukos might suggest that there will be further renationalizations and that resource nationalism has become so deeply entwined with Russian state policy that soon there will be no room for independent natural resources

companies. Indeed, the state-controlled Rosneft's acquisition of TNK-BP in 2012 suggests that the state is committed to further expanding its ownership of the resource sector. As Philip Hanson has argued, however, the key issue is not so much ownership as control. In view of the powerful demonstration effect of the Yukos affair, influence could be exercised over the industry while leaving much of it in nominally private hands.[27] Likewise, elites have found rent-seeking arrangements that do not need to involve the formal nationalization of extractive companies.

Resource nationalism, however, does not account in full for the motivations behind the reassertion of state control. In the case of Russia, the institutional logic of the transition from communism to capitalism was key. To the governments of both President Yeltsin and President Putin, the resources industry was a piece in a political chess game with many pieces and many players. The exact division of rents was secondary to the industry's role in the broader battle for political control.

2.3.2 Azerbaijan

Azerbaijan concluded major PSAs in the early 1990s. Among them was the 'contract of the century' covering the Azeri-Chirag-Gunashli complex of oilfields in the Caspian Sea with a BP-led Azerbaijan International Oil Company (AIOC) consortium in September 1994, shortly after Azerbaijan's defeat in the war with Armenia.[28] Since its independence from the Soviet Union, Azerbaijan has signed 26 PSAs with a wide range of international oil companies.

Despite the subsequent consolidation of power by the Azerbaijani elite and a sharp increase in oil and gas prices, Azerbaijan has not attempted to nationalize its oil industry or to revise PSAs in favour of its national oil company SOCAR. As in Kazakhstan, resource nationalism may be constrained by geopolitical considerations. Members of the elite are well aware that their oil and gas reserves are the main guarantee of Western economic and political investment in the country. Azerbaijan has sought to encourage Western strategic interest in order to balance Russian involvement in the region and to maintain support for it in its territorial dispute with Armenia over Nagorno-Karabakh and the occupied territory around it.

Azerbaijan needed the financial and economic backing of the West in order to construct the Baku–Tbilisi–Ceyhan and Baku–Tbilisi–Erzurum pipelines, which enabled it to break its dependency on export routes via Russia. As Vugar Gojayev has noted, those pipelines 'have reinforced the independence and geopolitical standing of Azerbaijan in comparison with other post-Soviet countries that must still export their oil and gas through Russian territory'.[29] This argument was put forward by the current president, Ilham Aliyev, in 1998 when he was the vice-president of SOCAR: 'We have no strong diaspora lobby, or sources for obtaining funds. We rely, therefore, on ourselves and oil.'[30] This leads to the paradoxical conclusion that a benevolent regional security environment is not necessarily more favourable to foreign investors in the resource sector. Azerbaijan's precarious geopolitical situation may in fact have contributed to the security of investors' contracts.[31] As international oil companies are typically powerful economic players with strong political leverage in their home countries, they can act as subjects as well as objects of geopolitical conflict.

There is little likelihood that Azerbaijan will seek to revise its contracts with IOCs formally, but it has nevertheless used low-level pressure to shift costs to foreign partners. In 1998, it emerged that the second pipeline for the Azerbaijan International Oil Company consortium would cost $591 million rather than the originally projected $315 million. SOCAR would not allow the AIOC to cover the cost overruns with oil sale revenues, arguing that it should pay them directly. This prevented a reduction in the state's revenues from 'profit oil'.

US diplomatic cables released by Wikileaks and the *Guardian* appear to indicate that SOCAR and the Azerbaijani government have in the past put informal pressure on BP. On one occasion, officials reportedly threatened to put Azerbaijan BP's president Bill Schrader on trial for stealing billions of dollars of oil. According to cables, SOCAR has repeatedly warned the AIOC consortium that the government might adopt the approach of Kazakhstan and seek to revise PSAs (there has been no public acknowledgment of any dispute between the consortium and the government of Azerbaijan).[32] The cables also indicate that the Azerbaijani government's hostility to the consortium disappeared after the Russia–Georgia war, again suggesting that the geopolitical importance of Western investment in Azerbaijan is a key factor in the absence of resource disputes.[33]

In October 2012, President Aliyev threatened the operator BP with 'serious measures' and accused it of making false promises and 'grave mistakes' after it announced that lower-than-projected production levels would result in an $8.1 billion shortfall in government revenues.[34] Although it seems unlikely that BP will lose its licence, the company will be forced to increase investment in order to stabilize production, resulting in lower margins. Sources within the company have argued that doing so will not be commercially viable unless the PSA is extended beyond 2024.[35]

2.4 Sub-Saharan Africa

Alex Vines, Tom Cargill, Markus Weimer and Ben Shepherd

Extractive companies are increasingly looking to invest in resource-rich countries in sub-Saharan Africa, and with good reason. The region has significant reserves of both fossil fuels and essential minerals, and has the world's biggest reserves of platinum, chromium, manganese and diamonds. It is also an important producer of copper, gold and uranium.[36]

Extractive companies working in sub-Saharan Africa face a number of challenges. Many countries there have been beset by conflicts, predatory elites and an absence of the rule of law since achieving independence from their colonial rulers in the 20th century.

2.4.1 Colonial legacy

Many oil-rich African states began exploiting their natural resources shortly after independence. New governments sought to renegotiate deals that international partners had struck with the colonial authorities. In many cases, these negotiations were not between equals: they involved 'expert' outsiders (IOCs) and 'non-expert' local elites who were busy establishing sovereign states and often looking for an arrangement advantageous in the short term.

At the time these deals were struck, local officials' lack of experience in the extractive industry, still evident in some places today, compounded the power imbalance. Many sub-Saharan African governments lacked information on the size and profitability of the reserves in question. Nor did officials fully understand the costs or processes of exploration and production. The new states had an acute need for income, and deals were sometimes negotiated by officials who were more interested in personal gain than in the public good.

These factors tilted the playing field in favour of the capital-rich external negotiating parties, which were often international mining conglomerates. They frequently had more data on the resources in question and a clearer understanding of the likely costs and returns of the projects. Also, resource extraction was very often not integrated into other parts of the new countries' domestic economy, operating instead within a separate 'enclave' economy. Apart from rents, therefore, few benefits from resource extraction accrued to the African states.

Today, the deals negotiated under such a power imbalance are widely considered to be unfair, especially if the elites or individuals who benefited personally from them are no longer in power. Over the years, various governments have attempted to rectify them. Their main aim has been to increase revenue, to integrate 'enclave' economies into the national economy and generally to increase the positive influence of resource extraction. In some cases, governments have renegotiated contracts, introduced additional taxes and fees and imposed requirements aimed at increasing local content in operations.

2.4.2 African agency

Many African states still have dominant ruling parties, weak parliaments and inefficient judiciaries that struggle to enforce government regulations. In some cases, laws and regulations that were inherited from colonial powers have little or no relevance in the current context. New rules are often piled on top of existing ones, further complicating regulatory and

legal regimes. This combination creates a difficult operating environment for extractive companies. It also provides a fertile ground for rent-seeking, bribes and other forms of corruption.

A co-opted public service with no independent oversight or recourse to due process presents serious challenges for international investors. State officials may hold the power to extract 'facilitation payments' or to demand payments in return for a clean bill of 'regulatory compliance'. Conversely, they may have the power to fine firms for 'failing to comply' with regulations. As positions in the state apparatus are frequently a consequence of favouritism and patronage, power is ultimately concentrated among a handful of elites. All too often they wield that power with little or no accountability, and for personal gain. This situation provides African ruling elites with enormous influence over state and government affairs, and particularly over procurement, mineral extraction, mining and public-sector contracts.

Given the power of African elites, disputes in the extractives sector in Africa have mostly been caused either by leadership changes or by shifts in the interests of the ruling class. For example, after a military coup in 2008, the Guinean government began to renationalize Rusal's alumina refinery in Guinea, forcing the company to pay $1 billion in compensation. According to the Guinean minister for mines Mahmoud Thiam, 'the sale was illegal […] and our partners know Guinea was totally wronged'.[37]

Predatory elites are able to tilt the playing field in their favour by both legal and illegal means. Private interests can be advanced and 'directed' within the limits of the law. This can happen through a combination of vested interests, insider knowledge and the power to act quickly and decisively. For instance, Angolan elites stymied various efforts by IOCs in the country to sell off acreage to commercial bidders. Thus when Marathon Oil wanted to divest its Block 32 share to a consortium of Chinese NOCs in a commercial transaction, Sonangol prevented this by exercising its right of first refusal. It offered the stake instead to another Sino-Angolan company, China Sonangol International (CSIH). CSIH is well connected and has gained equity in the latest offshore (pre-salt) bidding round.

2.4.3 Predation versus development

In Angola, Chad, Nigeria and Guinea, local elites were able to assess the value of potential investments – and the value of the resources that the investment was exploiting – and to dominate the relationship with outside investors. Often elites in these countries have very good access to data and information as well as to networks of experts, international consultants and other partners.

The power wielded by elites in these countries limits the utility of international arbitration and can also blunt initiatives to improve transparency in the extractives sector. For instance, it took intense political pressure from President George W. Bush to compel Chevron to publish a signature bonus of $500 million that the company paid to Angola in 2003. Earlier, the Angolan government had heavily censured BP after the company had published its operational data without prior approval from state officials.[38] It sent an open letter to all oil companies operating in the country threatening to throw BP out of the market and making sure that all involved understood who was in charge. No other company published data after this incident except Sonangol, the Angolan national oil company. Chatham House research on Asian national oil companies in Nigeria and Angola provides further evidence of how African actors are often firmly in control of the relationship with external parties.[39]

African states and societies are not static. As in other parts of the world, African populations are increasingly holding their governments to account. Citizens with better access to information and international news are increasingly critical of government mismanagement and corruption and of the lack of basic services and inequality. The revolutions in North Africa are cases in point, but similar, if less momentous and permanent, events have taken place in South Africa, Mozambique, Malawi, Uganda and elsewhere.

Not all governments in sub-Saharan Africa are predatory. Some governments, or substantial parts of them, do act in the public interest or attempt to do so. South Africa and Ghana, for example, have followed a 'developmental' rather than a

'predatory' model. Their system of checks and balances and their judicial systems are stronger than those of other countries in sub-Saharan Africa.

There are no predetermined pathways for African governments in their relationships with the extractives sector. After getting a raw deal initially, many countries are embarking on a developmental path, or at least claim to be doing so. Similarly, some countries are working to improve institutions that may in the past have been captured by predatory elites and individuals.

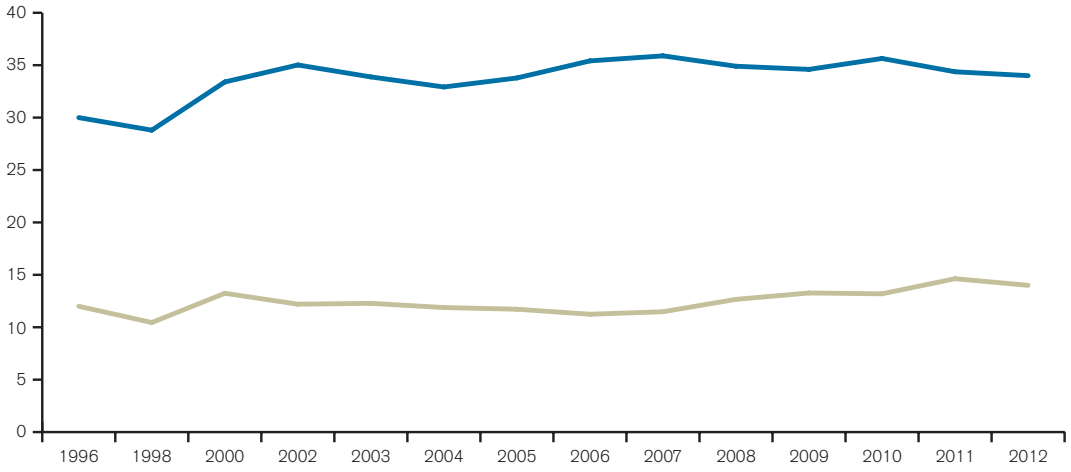
Mozambique finds itself at a crossroads in this respect. After the end of the civil war in 1992, companies such as Sasol and BHP Billiton managed to get preferential terms for their investments there. These agreements have been criticized by prominent experts, who have recommended their revision and renegotiation. The Mozambican government has thus far resisted renegotiation of contracts, but state officials may ultimately give way owing to increasing pressure from a growing and ever more dissatisfied populace. After emerging from decades of civil war, the country seems to be embarking on a developmental path. This is not assured, however, and predation could still occur. This will be a test of Mozambique's institutions and the rule of law.

2.4.4 The shifting landscape of governance challenges

Notwithstanding their different predicaments, the outlook of countries and their leaders can and does change. The Arab uprisings, for example, have reminded many African leaders of the dangers of inefficiency and inequitable growth. With this stronger impetus for leaders to act in the public interest, many are taking steps in that direction. The robustness of the rule of law and other governance institutions is one of the key factors that will determine the course of these countries and whether it will be sustainable.

In this regard, it is revealing to compare the quality of institutions of new oil and gas producers such as Ghana, Chad, Mozambique, Tanzania and Uganda with the more established producers, for example Nigeria, Gabon, Equatorial Guinea, the Republic of Congo, the Democratic Republic of the Congo (DRC) and Angola. The Worldwide Governance Indicators Project compares the scores of old and new producers on the World Bank's rule of law indicator. The analysis shows that old producers have a markedly less robust rule of law than new ones. The difference may be attributed to the 'resource curse' as well as to the comparative advantage that new producers have had in establishing institutions and oversight bodies before they start resource extraction. It remains to be seen whether new producers will sustain their rule of law or whether their institutions will erode over time.

Figure A24: The rule of law in established and emerging producer countries, 1996–2009 (average percentile)



Source: The Worldwide Governance Indicators Project.

2.4.5 Partners matter

The key lesson from Africa's experiences in the extractives industry is that institutions matter – not only for partnerships with international investors but also for the political trajectories of the countries involved. But the quality of international investors makes a difference too. In many ways, the type of investors that a country attracts reflects its institutions and regulatory regimes.

Clear regulatory regimes and a strong rule of law will attract investors who are more averse to risk. They will shy away from countries where the rule of law is absent or where opportunities and operations depend on the whims of individuals. By choosing to invest in countries with a strong rule of law, risk-averse investors help to reinforce the associated institutions. Because such companies tend to invest over the long term, it is in their interest that government institutions have permanence and command respect. Risk-averse investors also tend to be larger companies more exposed to reputational risk and to have more stringent internal codes of conduct. Partnerships with such companies have the potential to contribute to a virtuous cycle (the opposite of the 'resource curse') in African countries.

African governments can try to jumpstart this virtuous cycle by building and strengthening their regulatory and legislative institutions and by choosing their partners wisely. Conversely, corruption, bad governance and mismanagement pose fundamental threats to independent institutions. As such, they ultimately risk undermining sustainable resource extraction as well.

2.4.6 Cross-border disputes and subsoil resources: examples from Africa

The reason for border disputes in Africa is often a lack of clarity in colonial-era treaties and documents relating to various territories. Minerals play a role in those disputes but not to the extent that might be expected. Only 30 per cent of the cases in the Chatham House Border Dispute Database for sub-Saharan Africa are related to minerals. More than half are related to territory and about a fifth of the cases are related to water.

With improvements in infrastructure, which help to open markets and integrate even remote regions better into national economies, and with more capable and responsive African states and regional bodies, the number of non-mineral-related border disputes is likely to decline.

However, the number of mineral-related border disputes is likely to increase. Although most border disputes are not ostensibly mineral-related, the presence of minerals and other resources such as fish stocks often spark, exacerbate and prolong latent disputes. Also, more of Africa's resources are being explored with newer technology, and producers with declining reserves are keen to extend their oil and other rents. Mineral-related disputes may be mitigated to some extent by regional dispute resolution.

Box A2: Examples of current and historical border disputes in Africa

Côte d'Ivoire–Ghana

The discovery of oil off the coast of Ghana in 2006 provoked a maritime boundary dispute with Ghana's neighbour Côte d'Ivoire. Ghana's Jubilee oilfield is one of the biggest new finds in recent years; it has 1–2 billion barrels in proven oil reserves. The field extends across West Africa, and Côte d'Ivoire has similar volumes of proven oil reserves from the same field in its own territory. The two countries met for negotiations in April 2010 but the issue remains unresolved. The case has been referred to the UN.

Angola–DRC

There have been continuous land and maritime disputes between Angola and the Democratic Republic of the Congo over areas around the mouth of the Congo River.

At the Conference of Berlin in 1885, Cabinda was separated from the Angolan mainland by a narrow strip of land along the Congo River to its mouth in the sea and given to today's DRC. The DRC argues that oilfields off Cabinda producing for Angola are actually in its territory. It claims to be losing more than 200,000 barrels/day. The two countries began to expel each other's nationals in 2009.

Angola and the DRC are in many ways opposites: Angola is an emerging regional power while the DRC is more akin to an impotent giant at risk of breaking apart. Angola is a major producer of oil – its output is nearly 2 million barrels/day – while the DRC produces only some 27,000 barrels/day. Owing to this imbalance, the dispute is likely to be protracted, with the DRC attempting to seek international arbitration.

Separatism in Cabinda, Angola

Cabinda is a province of Angola. It has a population of around 300,000 and is roughly three times the size of Luxembourg. The province is an exclave, separated from the Angolan mainland by the DRC. To its north lies the Republic of Congo. Cabinda's main economic activity is oil production, and its reserves, although declining, are a major source of oil for Angola. Oil rents from it also sustained the war effort of the government MPLA troops against the UNITA rebels during Angola's long and violent civil war.

Cabinda has experienced a low-level insurgency for many years. This has been driven by the secessionist Front of the Liberation of the Enclave of Cabinda (FLEC). FLEC, which predates oil production in the province, bases its legal and historical claims for independence on a treaty of 1885 between the Portuguese and local authorities that established Cabinda as a protectorate of Portugal.

Over the years, FLEC has splintered into different factions, making peace deals difficult. For instance, a deal brokered in 2006 by Antonio Bento Bembe, a former FLEC leader and then a minister in the Angolan government, did little to pacify the province. Incidents were reported in December 2007, March 2008 and November 2009 in which expatriate workers were killed, with FLEC splinter groups claiming responsibility. The most high-profile incident involving FLEC in recent years was its attack on 8 January 2010 on the bus carrying the Togo football team to the African Cup of Nations in Angola.

Angola is investing heavily in the province with a view to 'winning hearts and minds' while also maintaining a strong security presence. The central government is also planning to build a bridge between Angola and Cabinda, hoping to bind the province closer to the mainland.

Lake Albert, Uganda–DRC

Lake Albert is located in central Africa, between Uganda and the DRC. In 2006, Heritage Oil and Tullow Oil announced major oil finds in the Lake Albert basin. They are estimated to be the largest onshore field found in sub-Saharan Africa for more than 20 years.

Rukwanzi island, in southern Lake Albert, is home to some 1,000 (mostly Congolese) fishermen. The island is seen as a strategic location for oil exploration and is the subject of a border dispute between the DRC and Uganda. In July 2007, the Congo army captured four Ugandan soldiers that it claimed had entered Congolese territory. On 3 August 2007, a skirmish near the island left a Congolese soldier and a British geologist dead after their vessel was attacked. On 12 August 2007, the DRC occupied the island.

Uganda's foreign minister Sam Kutesa paid an emergency visit to the Congolese capital on 13 August 2007, and it was agreed that a joint commission would begin the demarcation of the colonial-era boundary. In December 2010, Uganda and the DRC signed a memorandum of understanding for the coordination of oil exploration and development along their common border.

Sudan–South Sudan

A border dispute was rekindled upon the creation of South Sudan. Africa's newest state seceded from Sudan and became independent on 9 July 2011. The border between Sudan and South Sudan is not yet fixed and there are instances of violence and displacement along ethnic lines.

The source of conflict is that the border area lies above proven reserves of oil and other minerals such as copper. Officially both countries have agreed that ownership of any resource is determined by territory. This may exacerbate and prolong the dispute.

A mitigating factor is that both states recognize that the management of petroleum production, processing, transport and export is possible only if both cooperate. South Sudan has the majority of the oil; Sudan has the transport and export infrastructure.

Corisco Bay, Equatorial Guinea–Gabon

Corisco, also known as Mandj, is a 14-km² island 29 kilometres southwest of the Rio Muni estuary, which defines Equatorial Guinea's border with Gabon. Corisco became part of Equatorial Guinea upon independence. But in 1972, the then Gabonese president Ali Omar Bongo visited Mbanie, an island in Corisco Bay, and raised the Gabonese flag. War between the two countries was only just averted, and tensions remained high.

Corisco and Corisco Bay are claimed by Gabon because of the perceived value of oil deposits thought to be in the area. A consortium of Elf Aquitaine and Petrogab began prospecting in 1981, but no full oil exploration was possible owing to the dispute.

In February 2003, the Gabonese defence minister Ali-Ben Bongo Ondimba, the son of Ali Bongo Ondimba, visited the islands and restated Gabon's claim to them, thus rekindling the dormant conflict. The African Union and the UN had to intervene to prevent a further increase in tension. Both countries have since agreed that the dispute should be settled through the UN, but it remains to be seen whether both parties will accept its ruling.

At current production levels, Equatorial Guinea has another 8.5 years of proven oil reserves remaining and Gabon another 22 years. As both countries are declining oil producers, Corisco Bay with its presumed reserves may be a prize worth fighting over, especially in the case of Equatorial Guinea.

Agacher Strip, Mali–Burkina Faso

The Agacher Strip is a 160-km-long strip of land in the northeast of Burkina Faso. It was long disputed by Burkina Faso (formerly Upper Volta) and Mali, and fighting occurred there in 1974 and 1985. The conflict may have been exacerbated because the area is believed to be rich in minerals and natural gas, raising the prospect of sizeable rents for whoever controlled its resources.

In January 1986, the two countries' presidents withdrew their troops to pre-war positions and prisoners were exchanged. By June, diplomatic relations were restored. The dispute was brought to the International Court of Justice; and on 22 December 1986, it ruled that the Agacher Strip would be split more or less equally: Burkina Faso would receive the eastern portion and Mali the western part of the 3,000-km^2 area.

Aouzou Strip, Libya–Chad

The Aouzou Strip along Chad's border with Libya is an area roughly the size of Benin (114,000 km^2). The dispute began in 1973 and the area was annexed by Libya in 1976. The two countries referred the case to the International Court of Justice (ICJ) in 1990 following several rounds of inconclusive talks.

Libya argued for ownership of the area based on an unratified 1935 treaty between France and Italy that confirmed possession of the Aouzou Strip by Italy, the former Libyan colonial power. Chad, on the other hand, based its claim on a 1955 treaty between France and Libya.

Libya's interests in the area derived from the presence of uranium there and a desire to use it as a base to influence Chadian (and central African) politics. Some even feared that Libya would annex the whole of Chad with the support of Muslims in the south of the country.[a]

On 3 February 1994, the ICJ judged that Chad should have sovereignty over the Aouzou Strip. Both governments pledged to abide by its ruling. The withdrawal of Libyan troops from it was complete by June 1994.

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2.4.7 Impact of disputes on the development of a mineral base

Where land is disputed and the chance of violent conflict exists, any commercial mining operation is in a precarious position. First, there is the danger of becoming a target of violence. Second, in such circumstances it is often impossible for companies to remain neutral. Mining operators will have to ally with one side or the other. As the outcome of the dispute is unknown, this will be a gamble.

This is the case, however, only when land is claimed by two claimants with a more or less equal political, cultural and social status as well as military capabilities. In an asymmetrical power relationship between claimants, international operators may find a relatively conducive environment for mining operations. This is most likely in areas where secessionist movements are active. Either the area is so remote that secessionists are able to maintain control and allow mining operations to take place – for instance in the Katanga province of the DRC in the 1960s – or the central government is strong enough to maintain control of the region – for instance in Cabinda, where Chevron produced oil throughout the Angolan war (and after) under protection from central government troops and allies. In the case of Katanga, mining operations were deemed illegal by the central government. Mining in rebel-controlled areas thus presents a reputational risk for international mining firms and tends to attract smaller (local) miners and/or mining companies without scruples that tap into local networks of smuggling and corruption.

The inability of the central DRC government to assert its power effectively in the east of the country, along with a lack of infrastructure, economic opportunities and other social and political factors, allowed the renegade general Laurent Nkunda to take control of the eastern regions, ostensibly to fight against Hutu militias present in the DRC. The trade in minerals across borders was a major factor in sustaining his operations and, arguably, exacerbated the conflict.

2.4.8 Future flashpoints

Subsoil resources in contested territories could lead to future conflicts in many parts of Africa (see Table A5). New gas finds and thus potential new sources of rents could, for example, rekindle dormant disputes in West Africa. In Bakassi, oil discoveries could reawaken the dispute over the peninsula. The situation in the Agacher Strip is similar.

Table A5: Overview of disputed resource-rich territories

Disputed territory	Mineral resources: status of reserves/current exploration/extraction	Existing claims on territory/countries involved	Potential for disputes (high/medium/low)
Bakassi peninsula	Fishing grounds, potential oil (exploration, no reserves)	Nigeria, Cameroon	Low
Cabinda province	Oil (production, reserves: 5.4 billion barrels)	Government of Angola, FLEC	Medium
Lake Albert	Oil (exploration, reserves: >1 billion barrels)	Uganda, DRC	High
Corisco Bay	Oil (exploration, reserves: substantial)	Equatorial Guinea, Gabon	High
Agacher Strip	Minerals, natural gas (reserves: considerable)	Mali, Burkina Faso	Low
Jubilee Field (maritime boundaries)	Oil (production, reserves: 0.5 billion barrels)	Ghana, Côte d'Ivoire	Low
Mouth of Congo River (maritime boundaries)	Oil (production claimed lost by DRC: 200,000 bpd)	Angola, DRC	Low
Sudan–South Sudan border	Oil (production, reserves 5 billion barrels), other minerals (copper and cobalt)	Sudan, South Sudan	High

The dispute between the DRC and Angola could escalate as a result of unilateral demarcation of the maritime border by either side as well as by the escalation of the dispute in other areas, such as population movements. The ultimate escalating factor would be the active support of FLEC in Cabinda by the DRC. This is a remote possibility, however, given Angola's greater power compared with that of the DRC. The potential for disputes between the two countries is therefore rated as low.

The risk of conflict in Cabinda province is rated as medium owing to the nature of the insurgency and the failure of the Angolan state to end this low-intensity conflict since 2002. The risk of escalation of the dispute between Ghana and Côte d'Ivoire is rated as low, as both sides have too much to lose from conflict. But the dispute could be escalated by a unilateral demarcation of the maritime boundary by either side.

Companies looking to operate in these areas face much uncertainty. Any rights to explore and develop discoveries or prospects in them are very precarious and depend on the outcome of the dispute. The reputational risk for companies operating in these environments is also very high. Without exception, the legality of operations in disputed areas will also be disputed by the conflicting parties.

In areas where there is a legal vacuum because of insufficient state resources to assert the rule of law and state force, any mining operations allowed by local secessionists will also be deemed illegal by the state in question. Although operators or miners do not yet have a presence in most disputed areas, there may be exploration activities, as in Lake Albert. This potentially exposes staff engaged in the area to danger of death and/or could be the catalyst to escalate a dispute.

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3. International initiatives for improving public and corporate governance in the extractive industries

Laura Wellesley and Jaakko Kooroshy

3.1 Promoting transparency in government–company revenue-sharing

The **Extractive Industries Transparency Initiative (EITI)** provides a global standard for reporting revenues from oil, gas and mining. The EITI regularly publishes payments by oil, gas and mining companies to governments ('payments') and all material revenues received by governments from extractive industries ('revenues'). Comparing data on payments and revenues enables the identification of gaps in public- and private-sector accounting, which is itself a key tool for fostering transparency in the industry. The EITI is being implemented in 37 countries and is supported by leading international NGOs, including Transparency International, the Revenue Watch Institute and the Open Society Institute, together with 70 of the world's largest oil, gas and mining companies. Despite this support, the EITI has been criticized for failing to take adequate account of the perspectives and priorities of local communities and civil society.[1]

Publish What You Pay (PWYP) is a coalition of civil society organizations engaged in the promotion of transparency of payments and revenues in the oil, gas and mining sector.[2] As of January 2013, the PWYP network comprises more than 650 member organizations.[3] It includes both national coalitions of NGOs, of which there are more than 35, and organizations operating as individual members.[4]

The **Natural Resource Charter** is a set of principles for governments and societies setting out how best to manage the development opportunities created by resource extraction.[5] It was drafted by an independent group of experts assembled by Paul Collier, Director of the Centre for the Study of African Economies at Oxford University. The Charter has 12 precepts, or principles, that encapsulate the choices and strategies that governments might pursue in order to increase the prospects of sustained economic development from natural resource exploitation. In June 2013, it was announced that the Natural Resource Charter would merge with the Revenue Watch Institute.[6]

The **Revenue Watch Institute** advocates the transparent and accountable management of oil, gas and mineral resources for the public good.[7] In addition to helping to promote the EITI, the institute undertakes research on best practice in the management of revenues from the extractives sector. It is also developing local partnerships for capacity-building and technical assistance in more than 30 countries. In 2013, it launched the Resource Governance Index, a measurement of the 'quality of governance' in the oil, gas and mining sector in 58 resource-rich countries.[8] The index ranks the countries according to four indicators: institutional and legal setting; reporting practices; safeguards and quality controls; and enabling environment.

Section 1504 of the Dodd-Frank Act (also known as the Cardin-Lugar Provision) requires all companies listed or registered on US stock exchanges and operating in extractive industries to disclose publicly all payments (or series of related payments) in excess of $100,000 to governments in any country. It applies to all stages of the mineral and gas development process, from exploration and extraction to processing and export.[9] It is a national law; but as most internationally operating oil, gas and mining companies are US-listed, the Cardin-Lugar provision is a significant regulatory development for the sector globally. President Obama signed the Dodd-Frank Act into law on 21 June 2010 and the Securities and Exchange Commission (SEC) published the final rules for the implementation of the Cardin-Lugar provision in August 2012. The provision is currently subject to a legal challenge by various industry bodies.[10]

In June 2013, the European Parliament enacted similar legislation when it approved new accounting and transparency directives. These directives require companies engaged in the extractives sector to disclose payments to governments on a country-by-country basis.[11] They also require that payment details be attributed to specific projects or licences. The Accounting Directive applies to all limited-liability companies registered in the European Economic Area (EEA). The Transparency Directive has a broader reach: its disclosure requirements apply to all companies listed on EU-regulated markets regardless of whether or not they are registered in the EEA.[12]

The **Extractive Industries Source Book (EI SourceBook)** is a resource developed by the World Bank in partnership with a consortium of academic institutions led by the Centre for Energy, Petroleum and Mineral Law and Policy (CEPMPL) at the University of Dundee. It provides an interactive reference source on technical and policy issues related to the development of extractive industries in the form of reports, overviews and policy briefs that are free and available online.[13] The EI SourceBook is aimed primarily at policy-makers, technical specialists and senior government officials in developing countries.

3.2 Ethical codes of conduct and due diligence for companies and investors

The **United Nations Global Compact (UNGC)** provides organizations and businesses with a framework to align their operations and strategies with 10 principles addressing the issues of human rights, environmental impact, labour and anti-corruption.[14] Launched in 2000, the UNGC is a voluntary corporate responsibility initiative that requires its signatory organizations to include those principles in their strategies and decision-making processes. It has more than 10,000 participants, including more than 7,000 businesses in 145 countries.[15] It has been criticized for its lack of enforcement or monitoring powers, as companies can join without having to demonstrate concrete progress in implementing its principles.[16]

The **UN Guiding Principles on Business and Human Rights** offer guidance to businesses and governments on how to mitigate adverse impacts of their corporate activity on the human rights of local communities. The guiding principles are intended as a practical guide to implementing the UN 'Protect, Respect and Remedy' Framework (the 'Ruggie Framework'). This consists of three core tenets: 1) the state's duty to protect human rights, 2) corporate responsibility to respect human rights, and 3) the need to ensure greater access to remedy when human rights are violated.[17] The Guiding Principles have been criticized for failing to recognize the central importance of transparency requirements and external monitoring and evaluation to fostering due diligence in corporate activity.[18]

The **OECD Guidelines for Multinational Enterprises** set out voluntary principles and standards for responsible business conduct in areas such as environmental impact, information disclosure, measures to combat bribery and respect for human rights. First adopted in 1976 and updated in 2011,[19] the Guidelines constitute one of the four elements of the Declaration and Decisions on International Investment and Multinational Enterprises.[20] Countries adhering to the guidelines agree to encourage multinational enterprises operating in or from their territory to implement them.

The **Voluntary Principles on Security and Human Rights** are a set of principles agreed upon by a number of governments, NGOs and companies in the extractive and energy sectors. The Voluntary Principles (VPs) are intended to provide

guidance to companies in developing an operational strategy that protects the rights and freedoms of all stakeholders. They fall under three categories: risk assessment; relations with public security; and relations with private security. Established in December 2010, they are the result of dialogue and cooperation between the governments of the US, the UK, Norway, the Netherlands, Canada, Colombia and Switzerland together with extractive and energy companies and NGOs. The VPs' corporate participants include Rio Tinto, Shell, the BG Group, BP and ExxonMobil. Among the NGO participants are Amnesty International, International Alert, Human Rights Watch and Partnership Africa Canada. Other organizations, among them the International Council of Mining & Metals and the International Committee of the Red Cross, hold observer status.[21]

Signatories of the **Principles for Responsible Investment** commit themselves to incorporating the consideration of environmental, social and governance issues into investment decision-making and ownership practices.[22] The six principles were finalized in 2006 under the auspices of the UN secretary-general and were coordinated by the UNEP Finance Initiative and the UN Global Compact. As of January 2013, there were 1,155 signatories, including asset-owners (272), investment managers (705) and organizations that offer products or services to asset-owners and/or investment managers (178).[23] Many of the participating asset-owners are European, including a sizeable number of state and private pension funds. In 2010, the Principles for Responsible Investment initiative published a policy paper on corporate activity and conflict-affected areas. It offers guidance for companies seeking to invest in high-risk regions.[24]

The **Equator Principles (EPs)** offer a framework for risk management in the financial sector. They provide a 'minimum standard for due diligence' to be carried out by financial institutions as a means of identifying, assessing and managing social and environmental risk in project financing.[25] Launched in 2003 in response to pressure from NGOs, the EPs were developed by private-sector banks led by Citigroup, ABN AMRO, Barclays and WestLB with support from the International Finance Corporation (IFC) and input from NGOs. They are modelled on World Bank and IFC environmental standards and social policies. As of September 2013, 78 financial institutions from 35 countries had adopted them.[26] Banks that have adopted the EPs apply them globally, across all industry sectors, including mining, forestry and oil and gas, and to all projects with a capital cost of $10 million or more. No formal organization oversees the EPs. They exist by common agreement among the banks that have adopted them and are adhered to on a voluntary basis.

3.3 Promoting supply-chain governance for conflict-sensitive resources[27]

The **Kimberley Process (KP)** is a joint government, industry and civil-society initiative intended to prevent the trade in conflict diamonds.[28] It also has the backing of the UN: in 2000, UN General Assembly Resolution A/RES/55/56 gave official support to the creation of an international certification scheme for diamonds.[29] Through this scheme, the KP requires its members to certify shipments of rough diamonds as 'conflict-free'. As of November 2013, the KP had 54 members, representing 81 countries (the European Union counts as a single participant), including all major rough-diamond producing, exporting and importing countries. Participating states agree to issue and to require certificates for the import and export of rough diamonds and to prevent their import and export from non-participant countries. Furthermore, they must establish internal controls in order to eliminate conflict diamonds from shipments of rough diamonds that they import and export.[30]

A number of NGOs, such as Amnesty International, have suggested that a lack of mandatory, impartial monitoring of the diamond industry itself has undermined the integrity of the scheme.[31] Others, such as the African Diamond Council, have attacked it as being fundamentally unenforceable on the ground, arguing that the official networks and bureaucratic procedures upon which it relies are easily undermined in many countries, particularly in Africa.[32] The founding text of the KP has also been criticized for adopting an overly state-centric understanding of the term 'conflict diamond',[33] highlighting as it does the use of diamond revenue by rebel groups while excluding diamonds that fund repressive government regimes or lead to broader human rights abuses. Global Witness and Partnership Canada Africa, both organizations instrumental in the creation of the KP, have called for the revision of the KP's definition of 'conflict diamond'. [34]

The **OECD Due Diligence Guidance for Responsible Supply Chains of Minerals from Conflict-Affected and High-Risk Areas** offers a five-step framework by which companies dealing in tin, tantalum, tungsten and gold may assess the risk of conflict minerals being present in their supply chain. The Guidance is the result of engagement between the OECD and 11 countries from the International Conference on the Great Lakes Region.[35] It adopts a practical approach to traceability and transparency in the region's mineral trade, focusing on the development of 'collaborative constructive approaches' to the problem of conflict minerals.[36] It seeks to assist companies in achieving responsible supply chain management and includes commodity-specific supplements that advise on how to conduct robust risk assessments.

Section 1502 of the Dodd-Frank Act aims to reduce the flow of 'conflict minerals' from eastern DRC and the surrounding Great Lakes region. It requires companies listed on the US stock exchanges to conduct a due diligence assessment on whether they are using tin, tantalum, tungsten or gold originating from the DRC or neighbouring countries in any of their products. If companies find that they are using those materials, an additional assessment is required in order to demonstrate that armed groups in the eastern DRC have not directly or indirectly benefited from their production or export. Companies able to demonstrate that their materials do not originate in the DRC or surrounding countries or that any materials originating from the region have been sourced ethically can label their products as 'DRC conflict-free'. The results of these annual due diligence assessments require a certified audit and must be disclosed to the public on the internet.

Like Section 1504 (see above), Section 1502 affects a wide range of non-US companies which are either listed on US stock exchanges or which supply companies that are so listed, including, for example, large parts of the electronics and motor industries. Section 1502 has been criticized by some who argue that the imposition of due diligence measures and public disclosure amount to a 'de facto embargo' on the artisanal mining industry of the DRC and its neighbours – a vital sector for the impoverished region – as it lacks the regulatory capacity to comply with the exacting due diligence demands of Section 1502.[37]

The Electronic Industry Citizenship Coalition (EICC) Code of Conduct provides guidelines for both EICC members and non-member companies on how to achieve effective corporate social responsibility policies in five areas: environment, ethics, health and safety, labour and management. The Code forms the principal foundation of the EICC. Together with the **Global e-Sustainability Initiative (GeSI)**, the EICC also runs a Conflict-Free Smelter programme and supports traceability mechanisms such as the ITRI Tin Supply Chain Initiative (iTSCi) in eastern DRC.

The **ITRI Tin Supply Chain Initiative** is a joint initiative intended to facilitate compliance with the OECD Due Diligence Guidance among upstream companies working in the tin industry.[38] The Initiative is intended to act as a tool on which companies may draw in reporting to the US Securities and Exchange Commission on their due diligence measures under Section 1502 of the Dodd-Frank Act. It requires both supply chain operators and mine sites to undergo an independent third-party risk assessment and operates by 'bagging and tagging' labelling. Each bag of minerals must be accompanied by two bar-coded tags that identify both the site from which the minerals originated and the site at which they were processed.[39] iTSCi has been under development since 2008, and is in its implementation phase both in the Katanga province of southern DRC and in Rwanda.[40]

The **Conflict-Free Gold Standard**, developed by the World Gold Council, is an industry-led approach to tackling the problem of 'conflict gold' and to promoting a responsible and sustainable supply chain in the gold industry.[41] It provides guidance to both implementing companies and assurance providers so as to ensure the initiative's credibility among corporate, government and civil society actors. In order to label their products conflict-free, producers must publicly disclose evidence of their compliance with the Standard, which must be assured by an independent third party.

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