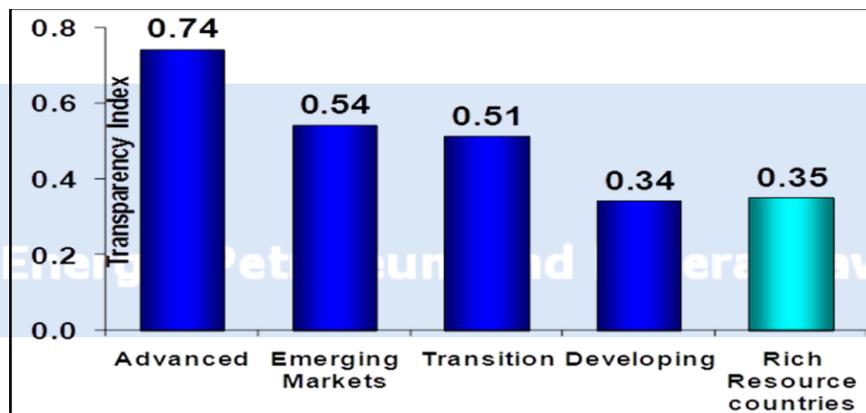


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4.3 Challenges and Special Issues

The major challenge to progress on transparency comes from entrenched interests – those with a significant stake in avoidance of transparency to advance their own personal or political agendas. The low scores of resource-rich developing states in transparency assessments suggest the seriousness of this challenge (see **Figure 4.3** below). In addition to the obstacle of entrenched interests, a number of special, more technical issues have arisen relating to the implementation of transparency. Listed below are a number of examples that relate primarily to resource revenue transparency.

Figure 4.3: Resource Wealth and Transparency



Source: Transparency International/Revenue Watch Institute (2011)¹

Mandatory versus Voluntary.² Admittedly, information disclosure, a key benefit of transparency, is complicated by the various standards of mandatory or voluntary disclosure. The various principles put forward by the IFC, the IMF and the like are primary examples of voluntary information disclosure standards except on the occasion that they are integrated specifically into a contract. This is also the approach adopted by the Extractive Industries Transparency Initiative (EITI) (see **Section 4.4** below). Critics object that this approach lets the

¹ *Promoting Revenue Transparency: 2011 Report on Oil and Gas Companies*. Berlin: Transparency International: available at: http://www.transparency.org/whatwedo/publication/promoting_revenue_transparency_2011_report_on_oil_and_gas_companies (last accessed 5 March 2016).

² For a thorough account of the mandatory versus voluntary debate, see Gillies, A. and Heuty, A. (2011), "Does Transparency Work? The Challenges of Measurement and Effectiveness in Resource Rich Countries," 2011 *Yale Journal of International Affairs*, pp. 25–42.

most recalcitrant country performers 'off the hook' and instead advocate mandatory transparency on the part of EI companies, regardless of location, with respect to their payments to resource-rich countries. Transparency under this approach would become mandatory through laws and regulations in the home state of the EI sector companies making disclosure a requirement for listing on major stock exchanges.

A state's decision to promote transparency and the practical measures which follow from that decision are sovereign matters and are generally considered to be voluntary at the state level. However, once a government decides to implement a transparency measure, it may well become mandatory for EI sector participants operating in that state. This approach has in fact been adopted in Liberian,³ Nigerian and US⁴ legislation, for example. Most recently, the European Union (EU) has introduced new disclosure requirements designed to increase transparency regarding EI sector businesses listed on EU regulated markets⁵.

Some argue that mandatory disclosure as required by inflexible rules, most often found in legislative acts or regulations, may place too great a constraint on commercial interests and distort competition, an argument voiced against Section 1504 of the Dodd-Frank Wall Street Reform and Consumer Protection Act⁶ (Dodd-Frank Act).⁷ Section 1504 (also known as the Cardin-Lugar provision and formally as the Energy Security Through Transparency (ESTT) Amendment) would require EI project issuers who are otherwise obliged to report to the US Securities and Exchange Commission (SEC) to report all information relating to any payment made by the resource extraction issuer, a subsidiary of the resource extraction issuer, or an entity under the control of the resource extraction issuer to a foreign government or the US Federal Government for the purpose of the commercial development of oil, gas, or minerals. The aim of the section is to provide greater transparency in that the obligation attaches to every commercial, public or private entity involved in an EI project, no matter how small its role. It was not until late 2015, however, that a revised proposal to implement Section 1504 was adopted by the US Securities and Exchange Commission to mandate certain types of

³ Act Establishing the Liberia EITA, 10 July 2009. See the Source Book website, available at <http://www.eisourcebook.org/cms/January%202016/Liberia%20EIT%20Implementation%20Act%202009.pdf> (last accessed 7 March 2016).

⁴ See *Dodd-Frank Wall Street Reform and Consumer Protection Act of 2010*, Pub.L. 111-203, 124 Stat. 1376-2223 (21 July 2010).

⁵ Directive 2013/34/EU of the European Parliament and of the Council, 26 June 2013, OJ L182/52 (2013) (2013 Accounting Directive), see particularly para. 44 and Chapter 9; Directive 2013/50/EU of the European Parliament and of the Council, 22 October 2013, OJ L294/13 (2013) (2013 Transparency Directive), para. 7.

⁶ See *Cardin-Lugar Provision* (Section 1504) of the *Dodd-Frank Wall Street Reform and Consumer Protection Act of 2010*, Pub.L. 111-203, 124 Stat. 1376-2223 (21 July 2010).

⁷ Sepp, P. (2012). 'How the Dodd-Frank Act Harms the U.S. Energy Industry', *US News & World Report*, 22 February 2012, available at <http://finance.yahoo.com/news/dodd-frank-act-harms-u-172731138.html> (last accessed 7 March 2016).

disclosure and put the information into the public domain (see **Box 4.1** below). If adopted, its effects are unlikely to be felt before 2018.

Box 4.1: Balancing Transparency Interests: Opposing Dodd-Frank

American Petroleum Institute v. Securities and Exchange Commission

US Dist. Court for the District of Columbia, Civil Action No. 12-1668, 2 July 2013.

In early 2013, the American Petroleum Institute (API) filed a civil action against the US Securities and Exchange Commission (SEC) challenging its rule implementing Section 1504 of the Dodd-Frank Wall Street Reform and Consumer Protection Act. The API is an association of EI sector actors, including BP, Chevron, Exxon-Mobil and Shell, among many others. A primary argument advanced by API was that some information required under the new reporting procedures should be confidential and that the SEC should have greater discretion as to what entered the public domain. The argument reflected comments made during legislative debate on Section 1504. In a summary judgment, the District Court of Washington, DC, vacated the initial disclosure rule promulgated by the SEC holding that the SEC rule would harm investors due to the “fundamentally miscalculated” lack of discretion in the rule’s current form. The SEC proposed a new rule in December 2015, which was then open for consultation prior to a vote in June 2016. It is important to note that there is no unified corporate position in the oil, gas or mining industries, with a number of companies (BHP Billiton, Rio Tinto, Statoil and Tullow, for example) providing detailed disclosures for some time.

Equally ambitious and far-reaching, the EU Transparency and Accounting Directives⁸ specifically recall EITI standards in order to “provide civil society and investors with information to hold governments of resource-rich countries to account for their receipts from the exploitation of natural resources”⁹ through enhanced financial reporting procedures on the part of private EI sector participants; however, the directives have an element of reporting flexibility at the discretion of individual EU Member States and small to medium businesses have reduced reporting requirements. Other mandatory legal measures are discussed in **Section 4.5**.

⁸ Directive 2013/34/EU of the European Parliament and of the Council, 26 June 2013, OJ L182/52 (2013) (2013 Accounting Directive); Directive 2013/50/EU of the European Parliament and of the Council, 22 October 2013, OJ L294/13 (2013) (2013 Transparency Directive).

⁹ 2013 Transparency Directive, para. 7.

Confidentiality. Almost all EI sector contracts contain clauses covering the confidentiality of certain financial and technical data, which have acted to restrict transparency and information access.¹⁰ Some EI sector companies have defended the clauses as a means for protecting what they see as sensitive commercial information. However, many leading companies in the mining sector and some oil companies have taken a positive approach to transparency. Host governments, on the other hand, often accept these clauses in EI sector contracts as a necessary prerequisite for attracting investors.¹¹ Yet, most observers favour lifting confidentiality restrictions, with limited exceptions, on the grounds that EI sector contracts relate to public assets, revenues and expenditures – often on a very substantial scale and to decisions otherwise impacting the public interest; and such contracts therefore belong in the public domain.¹²

Confidentiality is an underlying concern particularly in relation to information disclosure with respect to revenue reporting. Some information may legitimately need to be kept confidential in order to protect a government's security and strategic interests and investors' commercial interests.¹³ However, sometimes confidentiality provisions are invoked by the government or investors to control information without a legitimate justification for doing so. Confidentiality, particularly in the commercial context, is often put forth by investors as a counter-argument against disclosure of data; thus, clearly defined parameters about what information should be deemed confidential is necessary. The IFC, for example, has included an outline of what materials will be considered commercially sensitive or confidential and will not be subject to disclosure requirement. It is important that the need for confidentiality in some cases is not used illegitimately to protect corrupt practices and vested interests or to hide the kind of deals that would not stand up to public scrutiny. Confidentiality considerations can also be used to disadvantage communities particularly at risk from EI sector operations.¹⁴

Credibility and Auditing. If payments to governments are to be published in the interest of transparency and accountability, they have to be credible and trustworthy. To this end, many

¹⁰ See Transparency International/Revenue Watch Institute (2011). *Promoting Revenue Transparency: 2011 Report on Oil and Gas Companies*. Berlin.

¹¹ However, governments do sometimes claim that confidentiality clauses are in their interest as well. An example of this is where governments seek to keep negotiations with EI sector companies secret.

¹² Revenue Watch Institute (RWI). *Contract Transparency*. New York: RWI. Available at: http://www.revenuewatch.org/training/resource_center/backgrounders/contract-transparency (last accessed 6 March 2016).

¹³ Waelde, T. (1996). *International Energy Investment*. Energy Law Journal, Vol.17, p.192.

¹⁴ See Revenue Watch Institute (2009), *Contracts Confidential: Ending Secret Deals in the Extractive Industries*, <http://www.revenuewatch.org/analysis-tools/publications/contracts-confidential-ending-secret-deals-extractive-industries> (last accessed 6 March 2016).

argue that these published payments should be subject to professional third party audits.¹⁵ However, there are a number of issues that often arise over the nature of these audits: how the audits are conducted; how to ascertain whether a payment has been made or received; and how to determine whether the payment made was the payment that should have been made under existing legal contractual and fiscal requirements.

Level of Aggregation. Many EI sector companies have suggested that publication of data on payments to governments should be restricted to sector-wide aggregate data.¹⁶ While this approach is likely to serve the objective of promoting accountability in government, it could also leave undetected irregularities at the individual company level. Civil society groups tend to take the position that disaggregated EI sector data is the best way to assess whether a company is actually paying what it should and to that end they argue that EI sector companies should disclose payments at the individual level.¹⁷ The Revenue Watch Institute (RWI)¹⁸, for example, has issued a series of reports on EITI reporting which point to disaggregation as essential to good practice.¹⁹

Civil Society Engagement. Public disclosure of important information has little value if it cannot be easily accessed and used to promote government and company accountability. If transparency is to lead to accountability, civil society must be recognized and allowed to participate in the discourse. To achieve this, civil society must be able to analyse the information disclosed and be able to respond with policy recommendations. While international civil society groups have played an indispensable role in the past, local civil society groups in many resource-rich states are increasingly involved in promoting public participation in the development of the EI sector.

Social Accountability. This approach, which is highlighted in **Box 4.2** below, is most effective where there are established coalitions of different groups participating with both companies and government on EI sector issues across the whole sector (especially on licensing, fiscal,

¹⁵ Katz, M., et al. (2004). *Lifting the Oil Curse: Improving Petroleum Revenue Management in Sub-Saharan Africa*. Washington, D.C.: IMF Media Services Division, p. 54.

¹⁶ Ravat, A., and Ufer, A. (2010). *Toward Strengthened EITI Reporting: Summary Report and Recommendations*. Washington, D.C.: World Bank Publications, pp. 4-5.

¹⁷ *Id.*, p. 4.

¹⁸ The RWI merged in 2014 with the Natural Resource Charter to form the Natural Resource Governance Institute.

¹⁹ See, for example, Gillies, A. (2011), *What Makes a Good EITI Report?*. New York: RWI. Available at http://www.revenuewatch.org/sites/default/files/EITI_good_report_2011-02-23.pdf (last accessed 5 December 2013).

environmental, and social issues).²⁰ However, civil society engagement can succeed only if government and companies are willing to facilitate civil society participation.

Where companies and governments do encourage civil society participation, effective engagement will also need civil society to be objective and constructive, and to have realistic expectations about outcomes. For example, while issues regarding the minimization of negative local community impacts from mining operations may improve rapidly from civil society engagement, issues relating to a mining company's operational and marketing decisions are likely to be more difficult for civil society to engage with.

IFI Conditionality. Often it is suggested that loans or support from International Financial Institutions (IFIs) like the World Bank or IMF be conditioned on credible government commitments to transparency programs such as the EITI. The IFIs have resisted making this a blanket requirement, recognizing the multi-issue complexity of their relationships with client governments. In some cases, however, transparency has been made an explicit requirement and, more generally, IFIs – especially in resource-rich states – have ‘mainstreamed’ transparency in their country dialogues. Strict conditionality provisions in IFI agreements have provided the basis for IFI intervention when governments fail to keep their end of the transparency agreement; for example, following amendments to the EI revenue management law in Chad, the World Bank froze the country's petroleum revenues held abroad.²¹ It must be recognized, however, that conditionality has often been cited as the downfall of projects in developing, resource-rich countries and many question whether the principle should endure.²²

²⁰ A successful example of coalition-building relating to transparency issues, see the *Publish What You Pay (PWYP) Campaign* website. Available at: <http://www.publishwhatyoupay.org> (last accessed 6 March 2016).

²¹ "Bank Freezes Pipeline Funds to Chad", 20 January 2006, Bretton Woods Project website. Available at <http://www.brettonwoodsproject.org/2006/01/art-507557/> (last accessed 6 March 2016).

²² Koeberle, S.G. (2003). "Should Policy-Based Lending Still Involve Conditionality?" 18(2) *World Bank Research Observer*, pp. 249-273; Bird, G. (1998). "The Effectiveness of Conditionality and the Political Economy of Policy Reform: Is it Simply a Matter of Political Will?" 1(1) *Journal of Policy Reform*, pp. 89-113.

Box 4.2: Social Accountability

Fully successful and sustainable EI sector management depends upon the participation of all key stakeholders – parliament, government, industry, civil society, and IFIs. While objectives and focus may differ among stakeholder groups, constructive and successful models of collaboration are emerging. Social accountability represents a potentially important and emerging governance good practice which can hold state institutions accountable by providing additional checks and balances and thereby help reduce the risk of state failure. The two basic principles of social accountability are:

1. transparency: defined as the mandatory public disclosure of information, in particular, to civil society at large; and
2. participation: defined as the ability and opportunity for civil society to engage with government and industry on issues of concern.

The characteristics of effective social accountability include:

1. a diverse range of civil society organizations who take on the role of forming coalitions that focus on specific issues across the whole EI value chain and that are supported with capacity-building activities that improve knowledge about what information to seek out and how to use it effectively.
2. a focus on social equity and achieving positive development outcomes on the ground by holding governments accountable for their development priorities and holding companies accountable for their management and mitigation of risks.
3. tools such as: media and letter writing campaigns (to draw attention to public issues), hearings, formal audits, enquiries by parliamentary sub-committees, independent budget analyses, participatory budgeting and public expenditure tracking systems (PETs), citizen report cards, community score cards (to develop and present information and analysis regarding issues of concern), policy statements, citizen charters, and legislative reforms including grievance procedures and Ombudsman's offices (to bring about improvements).

The achievement of effective social accountability can include:

1. an initial approach that is confrontational and requires organizing media campaigns and seeking policy change through non-violent protests. Once issue awareness is achieved, engagement of companies and governments can follow;
2. an evolutionary approach that progresses towards the recognition of common ground and collaboration with governments and companies to achieve policy and regulatory improvements, and improved practices on the ground; and
3. important international stakeholder partnerships and networks such as the EITI (which publishes and reconciles tax payments by EI sector companies with the tax receipts published by governments) and the Publish What You Pay (PWYP) campaign. These partnerships can provide a vehicle for international non-governmental organizations (NGOs) to transfer knowledge and build the capacity of local civil society participants.