



global witness

# WILL STAR SHINE FOR SOUTH SUDAN?

Scrutinising South Sudan's  
first post-independence  
oil deal

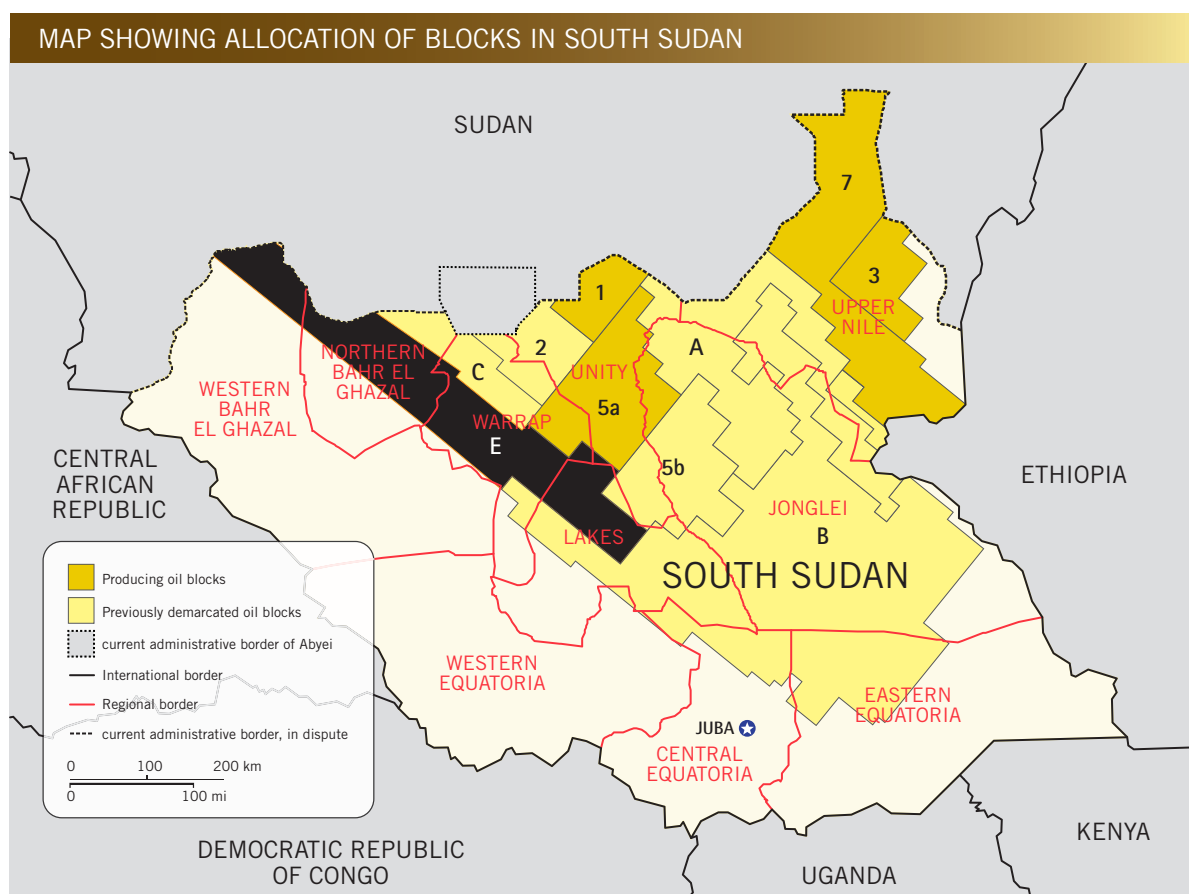
OCTOBER 2014

**Star Petroleum**, one of the only oil companies still active in South Sudan, is in negotiations with the government to exploit two of the country's remaining oil concessions. These blocks, known as E1 and E2, are economically important to South Sudan, the world's most oil dependent country. Income from oil found could provide the country with a vital source of development capital for its citizens. It is essential that whichever company is awarded the contracts is the best qualified for the job, and is committed to long term investment in South Sudan.

The deal is being struck as South Sudan's costly civil conflict continues, raising the stakes for the government and the investment risk for the company. The potential benefits and risks mean that it is crucial that this deal is scrutinised by the national legislature, citizens and international donors.

A loophole in the law means the deal is being done behind closed doors and without the open bidding for contracts that ensures competition between companies and a better deal for South Sudan.

Global Witness' analysis of Star Petroleum raises urgent questions about whether the company meets the criteria for investors set by South Sudanese law. These are technical competence, sufficient experience, history of compliance and ethical conduct and financial capacity.<sup>1</sup> Our research has found that the identity of the company's ultimate owners is opaque and that it is not operating anywhere else in the world. Equally as concerning, Javier Merino, who served two terms as director on the board of Star Petroleum, was found guilty of insider trading immediately prior to his second appointment.





Rebels soldiers patrol and protect civilians from the Nuer ethnic group as they wade to reach a UN camp. 1.7 million South Sudanese citizens have been displaced, and 4 million face alarming food insecurity as a result fighting. (Credit: Matthew Abbott/AP Photo).

This report presents the results of research and analysis into the company and the deal. In the process of this research Global Witness has been provided with documentation currently not on the public record by Star Petroleum. The government of South Sudan itself has also requested and been given, in accordance with the law, additional information by the company. This is a positive step. Global Witness is now calling on the government and the company to make this information public, so that parliamentarians, civil society and ordinary citizens are able to scrutinize the deals being done on their behalf.

South Sudan is oil rich, and yet its citizens are some of the poorest in the world.<sup>2</sup> Oil revenues have been earmarked by the government to provide the economic development that the country so badly needs, but for citizens, this resource has more often been a source of conflict. To avert mistrust, parliamentarians must be given adequate time and information to scrutinise the

deal before it is finalised. After the contract is signed, the swift disclosure, to citizens, of key information about the deal and the company will be critical to build further trust.

## The company

The most serious questions surround former Star Petroleum director, Javier Merino, who was found guilty of a €1.5 million (\$1.9 million) insider trading scam in 2010, just five months before his second appointment to the board of Star Petroleum.<sup>3</sup> Merino was a director of the company from its creation in 2005 until his resignation in 2007.<sup>4</sup> He was reinstated to the board a second time in November 2010 and remained there until the end of 2012.<sup>5</sup> Between these two terms, in July 2010, Merino was found guilty of insider trading in the sale of his stake in the Cartera Hotelera hotel group. According to the report from the Public Prosecutor's Office against Corruption, this deal brought him an illicit profit

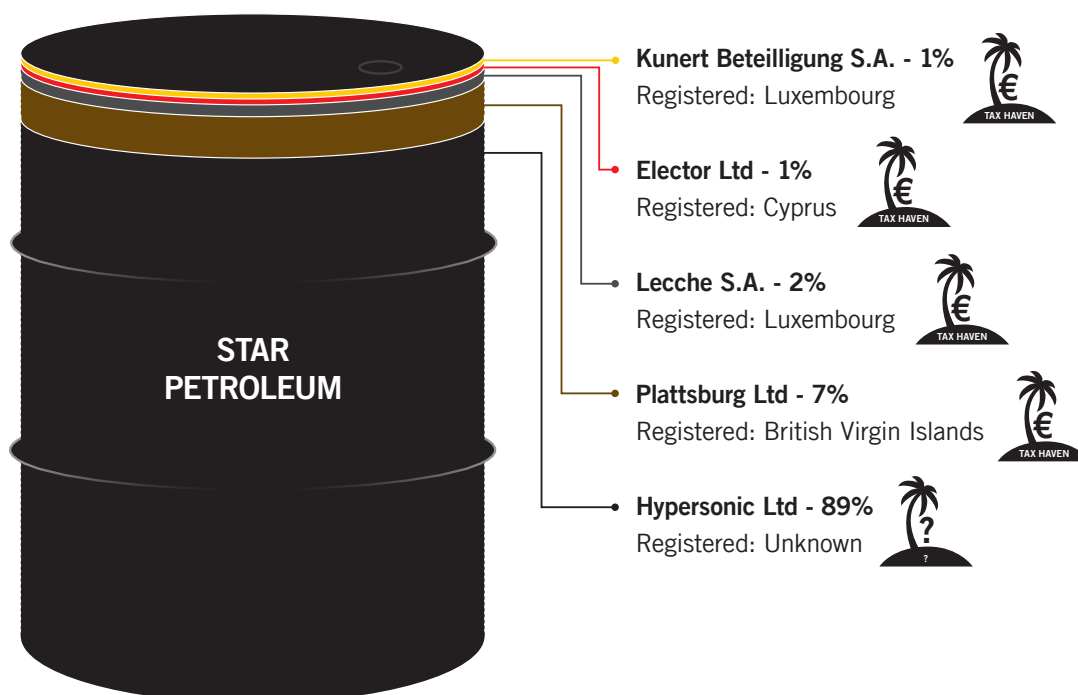
of over €1.5 million.<sup>6</sup> The charge earned him a fine in excess of €1.5 million and a one year prison sentence.<sup>7</sup> An appeal to suspend payment of the fine was denied in April 2014, but Merino's prison sentence is currently suspended while his appeal against it is resolved.<sup>8</sup> A letter from Star Petroleum clarified that Merino remains a shareholder, owning around 3% of the company's shares.<sup>9</sup>

The company's close association with an individual convicted of a million dollar financial crime casts doubt on the company's commitment to ethical conduct. South Sudan's Petroleum Act 2012 demands that companies entering the oil sector demonstrate a history of ethical conduct, a measure which should mitigate corruption risk.<sup>10</sup> Furthermore, it requires the government to publically disclose proof of the company's commitment to this when a contract is signed.<sup>11</sup> Global Witness put our concerns about Star's close relationship with Merino to the company. Star responded that his conviction has no relation to Star Petroleum or his position as a shareholder or former director, and that he has no role in the company's activities.<sup>12</sup> Global Witness

accepts that his conviction was not related to Star Petroleum's activities. However, South Sudan's high corruption risk, in conjunction with Merino's service on the board after conviction and his ongoing financial interest in the company, remain troubling to Global Witness and should be justified by the company.

Of equal concern to Global Witness, is the fact that the ultimate ownership of Star Petroleum itself is opaque. This means that information on the individual or group of individuals likely to be financially benefitting from Star Petroleum's commercial activities is not available on the public record. Instead, Star Petroleum's shares are owned by five companies. According to Star's company records from 2007, all five of these shareholding companies were registered in secrecy jurisdictions. Lecche and Kunert Beteiligung were both registered in Luxembourg. Plattsburg was registered in the British Virgin Islands. Elector was registered in Cyprus. Hypersonic- the majority shareholder and controlling stakeholder was, in 2007, registered in Samoa.<sup>13</sup> (See diagram x.) According to publically available company records running up until 2014, the five companies that

### OWNERSHIP OF STAR PETROLEUM



own Star Petroleum's shares have not changed. In correspondence with Global Witness, Star Petroleum reported that in 2009, Hypersonic changed its legal domicile from Samoa to a 'cooperative jurisdiction' and that its owner is a Spanish national and tax resident.<sup>14</sup> The company did not disclose where Hypersonic is now registered, and this information is not provided in publically available company records. This shines little light on who the beneficial owners of Hypersonic or the four other shareholding companies are, and so leaves citizens in the dark concerning the ultimate beneficial ownership of Star Petroleum.

This opaque ownership structure means that South Sudanese citizens do not know who will

financially benefit from deals signed by their government with the company. Furthermore, opaque ownership structures can, in some cases, be used to avoid tax obligations (albeit legally), or to allow public officials to hold secret stakes in state assets (see box 1).<sup>15</sup> The Petroleum Act recognises this danger and requires the public disclosure of the beneficial ownership of companies entering the oil sector.<sup>16</sup> Global Witness is not claiming that this is what Star Petroleum is doing. However, if its beneficial ownership remains opaque, any deal signed with Star Petroleum would directly contravene the spirit of this legislation.

### Box 1: Beneficial ownership: how corruption hides behind opaque companies

A 'beneficial owner' is the individual who truly exercises control over and derives benefit from a company or other corporate vehicle. This individual must be natural person: a live human being rather than a trust or another company.

#### *Importance of Identifying the Beneficial Owner*

In theory, identifying a company's beneficial owner should be a straightforward process. The company should publish information on its ownership information in annual reports and online, it should be included in government filings, and also documented in corporate registries. Unfortunately, in practice, this is often not the case. People conceal beneficial ownership information by appointing a relative or trusted friend to act as a nominal director, or using complex legal structures, shell companies, and offshore tax havens. In some cases this is done to avoid tax obligations. In others it is done to allow public officials to hold secret stakes in a state asset or to hide stolen funds.

For example, in Nigeria, a huge oil block was awarded by the oil minister, Dan Etete, in 1999 to a Nigerian company called Malabu Oil and Gas. Malabu was only formed a few days before it won the block, and had no assets or employees.<sup>19</sup> Lady Justice Gloster, in the UK High Court, found "as a fact that, from its incorporation and at all material times, Chief Etete had a substantial beneficial interest in Malabu".<sup>20</sup> In other words, the oil minister had awarded the block to himself.

The only way to prevent this kind of exploitation is to require that companies identify and prove their beneficial ownership, and for this information to be made available to the public for scrutiny.



A fisherman traverses the swamps in Northern Bahr El Ghazal state, South Sudan. This state is one of four crossed by block E's concession area. (Credit: AWL Images/Getty Images).

Another concern is that Star Petroleum has no operating assets anywhere in the world. The company owns the rights to two blocks in the Iranian Caspian but has conducted no activity on these concessions as a result of the UN sanctions regime.<sup>17</sup> The fragile social and environmental context presented by South Sudan demands that any company entering the sector must have the appropriate technical experience and competence to ensure that oil production does not lead to further disruption and damage. South Sudanese law acknowledges this, making requisite technical competence and sufficient experience requirements for contractors.<sup>18</sup>

Global Witness wrote to Star Petroleum with our concern that, according to our analysis, the company does not have the requisite experience to operate successfully in South Sudan. In their response to Global Witness, a Star representative stated that their technical team have gathered considerable experience from other positions

prior to their employment at Star Petroleum, and flagged, in particular, the 35 year tenure of their COO at Repsol.<sup>21</sup> They also stated that an initial environmental impact assessment was commissioned through an international consultant, and has been given to the government.<sup>22</sup> This information begins to answer some of Global Witness' questions, but to make these assertions meaningful, it is critical that documentation proving them is put into the public domain by the government and the company. The environmental assessment should also be made public.

## How is the deal being negotiated?

The deals for blocks E1 and E2 are being negotiated under the Petroleum Act 2012. This law is based on the fundamental principle that building a transparent sector is the best way to ensure that South Sudanese citizens benefit from

the sale of their resources, and that transparency increases citizens' ability to trust their government, minimising conflict risk.<sup>23</sup>

Section 100 of this law addresses 'prior contracts'- deals agreed by Khartoum for South Sudanese concessions before independence- and introduces a loophole which is not consistent with the transparent practice underpinning the rest of the law.<sup>24</sup> The deal with Star falls under this section. Despite there being reasons to ask questions about Star Petroleum, the government is employing an interpretation of Section 100 that removes a critical transparency mechanism from the deal. Star Petroleum has not been subject to an open and competitive bidding process for the contract.<sup>25</sup> This means that South Sudanese citizens have so far seen no proof that Star is the right company for the job, and the company has faced no competition to encourage it to offer the government the best terms possible. Instead, the deal is being agreed behind closed doors.

The deal does not have to be done this way. Section 100 gives the government freedom to choose new companies or to renegotiate contract terms, allowing them to craft better deals for citizens. Critically, it absolves the government of South Sudan from any obligation to honour pre-independence contracts.<sup>26</sup> In short, the government is under no obligation to allocate the block E concessions to Star Petroleum. The law also sets out stringent qualification requirements companies should meet in order to bid for new, rather than renegotiated, deals. These are technical competence, sufficient experience, history of compliance and ethical conduct and financial capacity.<sup>27</sup>

It also demands that documented proof of these qualifications, along with the beneficial ownership of the contractor and the contract itself are made public.<sup>28</sup> Global Witness recommends that the government apply the qualification and publication requirements for *new* contracts to the renegotiation of the Star deal.

Global Witness has discovered that the government has obtained useful information in the process of its negotiations with Star Petroleum. The company states that it has provided a list of its beneficial owners and proof of the staff's technical experience to the government.<sup>29</sup> That the government have requested this should be lauded, but it is only through making these documents public that this disclosure becomes useful and meaningful for citizens.

**6 Ingredients for a transparent oil deal**

	1. The contract published	<input type="checkbox"/>
	2. Beneficial ownership information of Star Petroleum published	<input type="checkbox"/>
	3. Proof of Star Petroleum's technical competence published	<input type="checkbox"/>
	4. Proof of Star Petroleum's history of ethical conduct published	<input type="checkbox"/>
	5. Proof of Star Petroleum's financial capacity published	<input type="checkbox"/>
	6. The environment impact assessment published	<input type="checkbox"/>

## The investment environment

The investment environment in South Sudan currently presents a very high level of risk and volatility for both the South Sudanese government and investing companies.

South Sudan is in the midst of a civil conflict which has destabilised large swathes of the country, fragmented systems of authority, undermined democratic structures and sparked an enormous humanitarian crisis. For governments worldwide, contracts negotiated in times of crisis have often resulted in less favourable terms and, in the long run, have accrued less benefit to citizens from the exploitation of their resources. And for citizens already suffering severe poverty and displacement, upholding their rights under a new contract or the law is extremely difficult.

Beyond the immediate risks posed by the ongoing conflict, corruption risk in South Sudan remains high. This risk is well documented. In May 2012, President Kiir sent a letter addressed to “corrupt government officials, current and former”. In it he states that, “An estimated \$4 billion are unaccounted for or, simply put, stolen by current

and former officials, as well as corrupt individuals with close ties to government officials. Most of these funds have been taken out of the country and deposited in foreign accounts.”<sup>30</sup> The weakening of democratic structures as a result of the ongoing conflict raises corruption risk for this deal even further.

In light of these risks, Global Witness is calling on the government to issue a moratorium on all new oil sector contracting, and contract renegotiations until peace is restored. The economy is oil dependent (in the 2014-15 budget oil exports accounted for over 75% of state revenue<sup>31</sup>), and the government is in need of long-term investment in the oil sector in light of dwindling production. However, research shows that deals drawn up in times of instability and emergency tend not to result in long term and stable investment. What is more common is speculative investment which can result in a loss of a significant portion of the asset's value for the government (see box 2).<sup>32</sup> Global Witness put these concerns to Star which stated its intention was “to be a long term investor and partner with the government of South Sudan.”<sup>33</sup> Global Witness welcomes this commitment and urges the company to seriously consider both the deal, and the context in which it is being negotiated.

### Box 2: Asset flipping

Global Witness has seen in other countries the negative impact that speculative companies can have on the potential profit that the state can make from its natural resources. A company is sold an asset- often, at times of crisis, the sale price is below market value- and instead of developing the asset, the company sells it on later at a far higher price. The end result is that the government loses out on the profit, which all goes to the company, and also has no control over the quality of company that the asset is sold on to.

In the Democratic Republic of the Congo, the loss to the government from 2010 and 2012 mining deals was \$1.36 billion- twice the country's health and education budgets combined. Rather than the state collecting most of the profits from these deals, the bulk of the money instead went to a series of offshore companies mostly registered in the British Virgin Islands.<sup>34</sup>

## Recommendations

### The government of South Sudan should:

- Apply the principles of transparency, upon which the Petroleum Act 2012 is founded, to this deal.
- Allow the National Legislative Assembly and the National Petroleum and Gas Commission sufficient time and information to consider any contracts negotiated with Star Petroleum, and to exercise their oversight powers to approve or reject it.
- Publish any contracts when they are approved, along with the list of beneficial owners and documented proof of technical competence, experience and history of ethical conduct of Star Petroleum in accordance with section 79 of the Petroleum Act 2012.
- Publish the results of the environmental impact assessment commissioned by Star Petroleum in accordance with section 59(4) (f) of the Petroleum Act 2012.

### Star Petroleum should:

- Produce documentation for the government of South Sudan, proving their technical competence, experience, history of ethical conduct and financial capacity according to the Petroleum Act 2012.
- Justify their relationship with Javier Merino in light of his close association with the company and his criminal conviction.

### The National Petroleum and Gas Commission should:

- Scrutinise any contracts provided to them, ensuring they are consistent with the provisions of the Petroleum Act 2012, and in the best interests of South Sudanese citizens.

### Parliamentarians should:

- Scrutinise any contracts provided to them, ensuring they are consistent with the provisions of the Petroleum Act 2012, and in the best interests of South Sudanese citizens.

### International donors should:

- Support South Sudanese civil society groups and journalists to investigate, analyse and report on oil sector deals.
- Support the National Legislative Assembly to understand and analyse complex oil sector contracts.



Information about the deal for block E should be made public, and readily accessible. That way, South Sudanese citizens can see and discuss the terms their government are negotiating for their resources. (Credit: Crispin Hughes/Panos Pictures).

## Endnotes

1. The Petroleum Act 2012, chapter 8, section 18 (4) accessed at <http://bit.ly/1mGchof>.
2. UN Human Development Index 2014, accessed at <http://bit.ly/1wPFLUK>.
3. Extraconfidencial, 9 July 2010, "The husband of Mar Flores is charged with abusing privileged information in Madrid's court no. 46", accessed at <http://bit.ly/YArhNm>.
4. Star Petroleum company records dated 26 May 2005 and 16 April 2007.
5. Star Petroleum company records dated 3 December 2010 and 21 January 2014.
6. Extraconfidencial, 9 July 2010, "The husband of Mar Flores is charged with abusing privileged information in Madrid's court no. 46", accessed at <http://bit.ly/YArhNm>.
7. El Pais, 30 March 2014, "Javier Merino, husband of Mar Flores, ordered to pay €1.5 million", accessed at <http://bit.ly/1kkLFED>
8. *Ibid.*
9. Response to Global Witness' opportunity to comment letter, received 22 September 2014.
10. The Petroleum Act 2012, chapter 8, section 18 (4) accessed at <http://bit.ly/1mGchof>.
11. *Ibid*, chapter 17, section 79 (1) (c) accessed at <http://bit.ly/1mGchof>.
12. Response to Global Witness' opportunity to comment letter, received 22 September 2014.
13. Star Petroleum company records dated 16 April 2007.
14. Response to Global Witness' opportunity to comment letter received 3 October 2014. Global Witness understands a "cooperative jurisdiction" to be one that cooperates with other jurisdictions in efforts to combat money laundering and terrorist financing, as defined by the Financial Action Task Force, <http://www.fatf-gafi.org/>.
15. For more information on the use of opaque ownership structures, see Global Witness, September 2014, "The Great Rip Off", pp.14-15, accessed at <http://bit.ly/1swEhbb>.
16. The Petroleum Act 2012, chapter 17, section 79 (1) (c) accessed at <http://bit.ly/1mGchof>.
17. Response to Global Witness' opportunity to comment letter, received 22 September 2014.
18. The Petroleum Act 2012, chapter 8, section 18 (4) accessed at <http://bit.ly/1mGchof>.
19. The Economist, 15 June 2013, "Safe Sex in Nigeria", accessed at <http://econ.st/VNqMNS>.
20. "Approved Judgement", 17 July 2013, Energy Venture Partners Versus Malabu Oil & Gas, Commercial court, Queen's Bench Division, 2011-13. For a discussion of the case, see Economist, Safe Sex in Nigeria, 15 June 2013, <http://econ.st/VNqMNS>.
21. Response to Global Witness' opportunity to comment letter, received 22 September 2014.
22. *Ibid.*
23. For more information on the benefits of transparency in South Sudanese legislation see Global Witness, November 2012, "Blueprint for Prosperity", accessed at <http://bit.ly/1ugyl9W>, pp. 5-6.
24. The Petroleum Act 2012, chapter 17, section 100 accessed at <http://bit.ly/1mGchof>.
25. In a letter to Global Witness received 8 July 2014, the Minister refers to section 100 as granting the "discretion to enter into new agreements in respect of those [previously allocated] blocks outside of the public tender procedures". This letter can be accessed at <http://bit.ly/1tLiaH3>.
26. The Petroleum Act 2012, chapter 17, section 100 (1) accessed at <http://bit.ly/1mGchof>.
27. *Ibid*, chapter 8, section 18 (4) accessed at <http://bit.ly/1mGchof>.
28. *Ibid*, chapter 17, section 79 (1) accessed at <http://bit.ly/1mGchof>.
29. Response to Global Witness' opportunity to comment letter, received 22 September 2014.
30. Letter from President Kiir, 3 May 2012, "Re. Return of Stolen Funds (full or partial) to the GoRSS Bank Account in Kenya", accessed at <http://bit.ly/1zElaCS>.
31. Government of the Republic of South Sudan, presented to Parliament on 25 June 2014, "2014/15 Budget Speech".
32. Africa Progress Panel, 2013, "Equity in Extractives", pp. 55-104 accessed at <http://bit.ly/10icUy4>. Global Witness, June 2014, "South Sudan: the call for a moratorium on new oil contracts", accessed at <http://bit.ly/1tbVChH>.
33. Response to Global Witness' opportunity to comment letter, received 22 September 2014.
34. Global Witness, 2013, "Secret Sales", accessed at <http://bit.ly/1htu5h4>. Africa Progress Panel, 2013, "Equity in Extractives", pp. 55-104, accessed at <http://bit.ly/10icUy4>.





## **global witness**

Global Witness investigates and campaigns to change the system by exposing the economic networks behind conflict, corruption and environmental destruction.

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