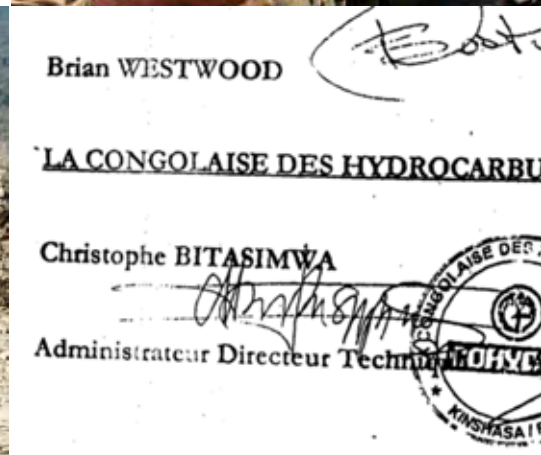
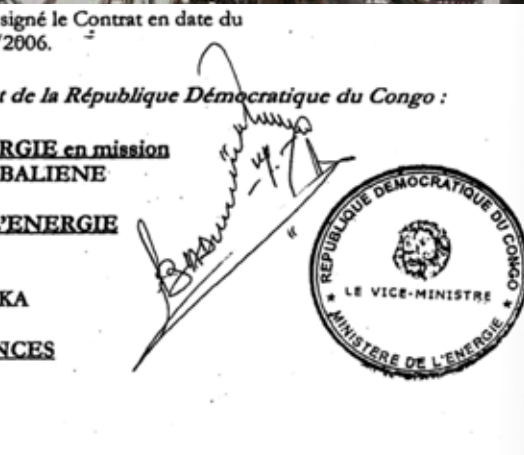
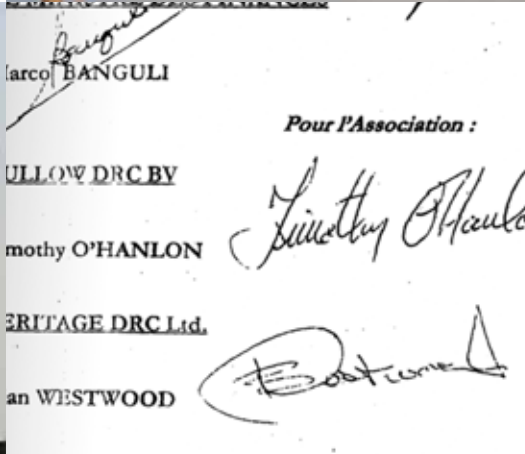
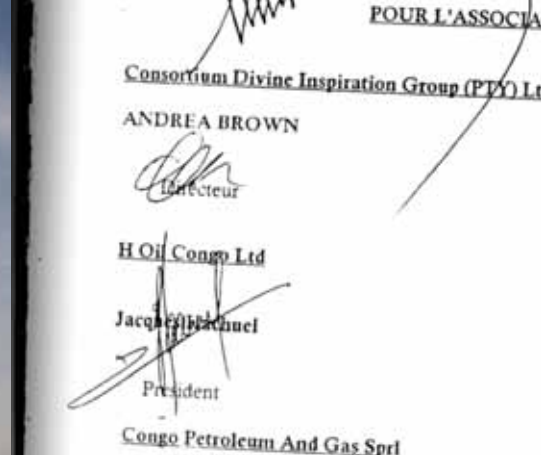
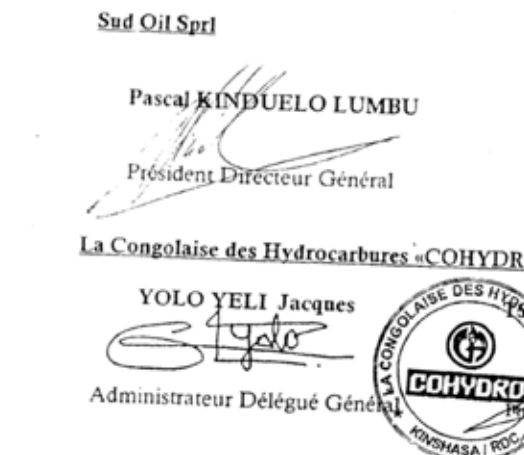




A Lake of Oil

Congo's contracts escalate conflict, pollution and poverty

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Introduction

Following a two-year impasse, oil exploration on the DRC side of Lake Albert is set to begin in 2010/11. This report aims to provide an in-depth analysis of the confidential – and now disputed – Production Sharing Agreements (PSAs) Kinshasa signed with two sets of companies in 2006 and 2008.

PLATFORM has investigated the secret contract terms relating to economics, sovereignty, human rights and the environment. We examine relevant paragraphs in the Congolese context, and in comparison to the situation in Uganda, where exploration is ongoing and first production imminent. PLATFORM released Uganda’s PSAs in November 2009 to warn of flaws in the deals¹; this report likewise explores the balance of rights and responsibilities between the DRC government and the oil companies, and identifies the legal provisions that will directly contribute towards an ‘oil curse’ in eastern DRC.

In particular, the report explains how much money the companies and Kinshasa will make over the 20 years of the contracts; the ways in which articles in the deal will affect local communities’ rights and benefits; how environmental protection has been ignored; and the risk oil extraction poses to human rights and security in the region.

DRC is no stranger to oil extraction – though on a smaller scale. Perenco’s concession (see Appendix 1) in Bas-Congo already provides a textbook case of secrecy, lack of corporate accountability, environmental problems, negligible development outcomes, corruption and heavy-handed responses to legitimate community protest².

While Bas-Congo has been producing around 30,000 barrels per day (bpd), DRC’s Lake Albert blocks could, based on discoveries on the Ugandan side, yield over two billion barrels of oil, with peak production over 150,000 bpd. That would generate revenue in the billions of dollars (see p26 ff) and a scale of operation far beyond anything the state and communities in DRC have had to deal with before.

This level of invasive corporate activity will be happening in one of DRC’s poorest and least stable regions, whose communities are still recovering from the brutal 1998-2003 war, are heavily reliant on the United Nations presence to maintain peace, and where the authority of the central government and national army remains uncertain.

The Production Sharing Agreements (PSAs)	
Block 1 & 2 (disputed):	Tullow (48.5%), Heritage (39.5%), COHYDRO (12%)
Block 1:	Divine Inspiration Consortium, including SacOil Holdings with assistance from Petro SA (51%), H-Oil (37%), Sud Oil (2%), Congo Petroleum and Gas (3%), COHYDRO (7%)
Block 3:	SacOil Pty (Joint venture between Divine Inspiration and Encha Group)
Block 4:	Open
Block 5:	Dominion Petroleum (46.75%), Soco

Oil in DRC

Two British companies, Tullow Oil and Heritage, signed a contract with DRC in 2006, covering Blocks 1 and 2 – all of the Ituri side of Lake Albert. The status of that contract is now disputed by both sides since the Ministry of Energy appeared to annul it in October 2007, ahead of reassigning Block 1 twelve months later. This report raises serious concerns about key provisions in the deal and compares it to the PSAs that Tullow and its new partners hold on the other side of the lake in Uganda.

However, the 2008 contract for Block 1 signed by Divine Inspiration and SacOil, H-Oil, and two private Congolese companies, Sud Oil and Congo Petroleum and Gas, also requires careful scrutiny. This contract shares many of the flaws of the earlier contract, while differing in key areas, including revenue flows and social spending.

President Kabila is expected to reach a decision soon on which of these two contracts to approve by decree, or whether to force a partial renegotiation, or indeed, to introduce a whole new set of agreements for the blocks.

A host of other companies are seeking to enter DRC, either as partners to these existing contracts or under new arrangements: these include French company Total and the China National Offshore Oil Corporation (CNOOC), both of whom, with Tullow, will develop the oil fields on the Ugandan side of the lake. They will argue that having the same three companies in both countries will speed up development and facilitate a joint-production zone. The Italian company Eni also remains interested. Heritage, who are selling their license-shares in Uganda, look likely to exit DRC.

The ownership, origins and capacities of the various smaller companies, in particular the 2008 group, has raised concerns in DRC about corruption. A full assessment of Divine Inspiration, H-Oil and the two private Congolese companies granted small – but lucrative – license shares in the contract, is beyond the scope of this report, but we do provide brief profiles and advocate further investigation of the role of Sud Oil and Congo Petroleum and Gas.

Given the current state of political confusion and the secrecy that surrounds oil contracts, we hope this report will be used by local communities, civil society organisations, journalists, donors, political actors and negotiators to ensure that the Congolese government, foreign governments and private companies are held to account.

‘The South African consortium’s 2008 contract shares many of the flaws of the earlier Tullow/Heritage deal, but is different in key areas, including revenue flows and social spending.’

Company profiles

2006 CONTRACT for Blocks 1 and 2



Tullow Oil

A British exploration company that has acquired potentially lucrative licenses in Uganda, Ghana, Sierra Leone and Ethiopia. A series of successes have transformed Tullow into a significant presence on the London stock market. It specialises in upstream exploration and development and is partnering with the China National Offshore Oil Corporation (CNOOC) and Total in Uganda. It will remain the operator of crude extraction in Ghana and Uganda in 2010 but will leave major additional infrastructure projects, including the pipeline and refinery, to the bigger companies. Vice President for Africa Tim O'Hanlon visited Kasenyi in 2007 and has been defending the company's contract in Kinshasa.

Heritage Oil and Gas

Owned by the notorious mercenary fighter, Tony Buckingham, Heritage has a history of military involvement in Angola during the civil war. The company will make \$1.3bn from selling its two license shares in Uganda, even before production starts. It has signed a PSA with the Kurdistan Regional Government in northern Iraq, where its attentions are shifting. While nominally still partnered with Tullow in DRC, relations between the companies have broken down after a dispute over leaked documents in Uganda.

2008 CONTRACT for Block 1



Divine Inspiration Consortium

There has been considerable confusion over the ownership and capacities of the South African business interests who secured the PSA. Andrea Brown is the sole director of the Divine Inspiration Consortium, whose key partner is the South African **Encha Group**, an investment company founded by controversial businessman Tiego Moseneke, who is reported to have key relationships in Kinshasa, including with President Kabila's brother, Zoe. The other controlling interest alongside Encha is **Investec Bank**, dual-listed in London and Johannesburg. Moseneke is alleged to have used DRC national Nozi Mwamba as a 'consultant' to help broker the 2008 deal. Mwamba has twice been accused of currency fraud and links to militias.

Divine then partnered with Encha to create the South African Congo Oil Company, **SacOil Holdings** (formerly Samroc, which had various mineral interests) as a new oil exploration company listed in Johannesburg. The involvement of **Petro SA**, the South African state oil company, is restricted to technical assistance and a letter of support for the consortium, presumably to back up its credentials, given the consortium's lack of direct

experience in the industry. "Divine Inspiration" is the signatory to the PSA and will be the operator in Block 1 if the contract is approved.

The longstanding allegation has been that the former energy minister, Lambert Mende, had links to Divine Inspiration and sought to elbow out Tullow/Heritage in the South Africans' favour in 2008. But it may be more complex than that: the South African companies were also connected to key players around Thabo Mbeki; Kabila is said to be reluctant to go through with the second deal if it risks alienating new President Jacob Zuma.

Note that the Block 3 PSA was signed not by SacOil Holdings, but with "**SacOil Pty Ltd**", which is a 50/50 Joint Venture between Divine Inspiration and Encha Group, for which a \$2m signature bonus was paid.

H-Oil

H-Oil hold a major share in the 2008 contract. They have a history in oil trading and "contract execution" in Angola and Nigeria, and claim a "technical team of H Oil & Minerals Ltd has operated oil and gas exploration concessions either for the Company or as a team at Repsol", a Spanish oil company.³ They list offices in Iraq, Southern Sudan and Iran, among other places, without giving addresses or contacts. At least part of the company is registered in Cyprus. Chairman of the group, Jacques Hachuel, previously worked with Marc Rich & Co (now Glencore International), a privately owned commodities group which has a long history of corruption and kickbacks across the world.

Sud Oil

Holds a 2% share in the licence that, as our economic analysis shows, could be worth close to \$1bn in profit revenue over the lifetime of the contract. The company does exist as an oil trader but it is unclear what expertise it brings to the partnership. It is also not required to invest any capital – its costs will be "carried" by the Divine Consortium and H-Oil, raising concern that its share is designed merely to transfer funds from the state to private hands.

Sud Oil is run by **Pascal Kinduelo**, a key backer of President Kabila before the 2006 elections. Kinduelo is from Bas-Congo and is godfather to Kabila's wife. In 2008 Kinduelo sold BIC (Banque Internationale de Crédit) to Dan Gertler, an Israeli diamond dealer and Kabila associate.

Congo Petroleum and Gas

A second private Congolese company whose role in the contract is unclear. It holds 3% of the 2008 PSA. Its share was signed by chief executive, **Jean Bosco Muaka Khonde**. The company's costs will also be carried by the other partners.

Cohydro

The DRC state oil company, created in 1999, which has a share in both PSAs.

MAJOR COMPANIES LOOKING TO ENTER DRC

Total – French oil major which is set to take a 33% share in the Lake Albert blocks in Uganda. Total were in Kinshasa in March 2010, lobbying the DRC government for a new set of agreements, arguing the advantages of having the same three companies on both sides of the Lake.

China National Offshore Oil Corporation (CNOOC) – The state-owned company has interests across Africa, including Nigeria, and will be responsible for building a power plant, oil refinery and pipeline in Uganda.

Eni – The Italian company came very close to securing Heritage's licences in Uganda before losing out to Total and CNOOC, despite allegations of offering bribes to senior Ugandan politicians. It has signed a strategic partnership with Kinshasa and remains interested in exploration and production on the Congolese side of Lake Albert.

Images

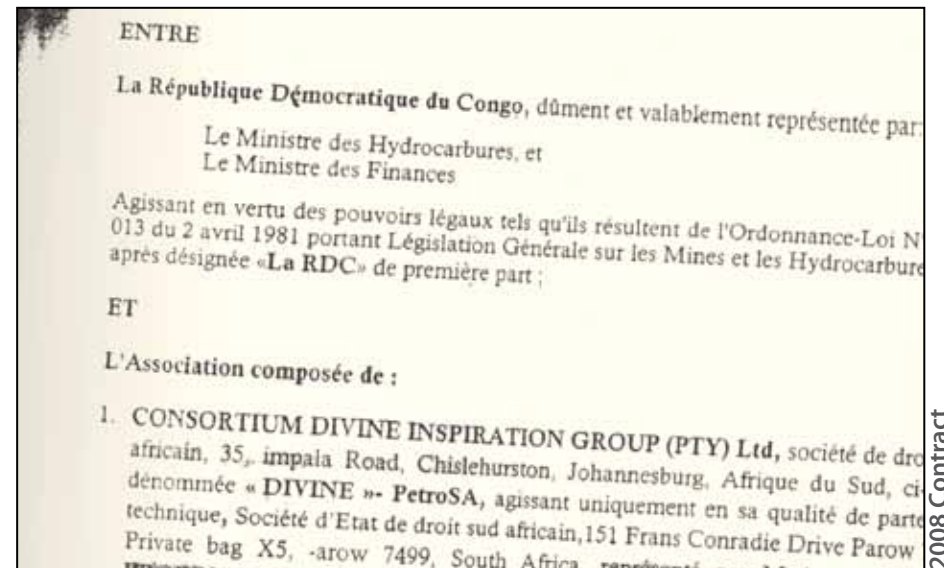
Top: Tullow VP for Africa Tim O'Hanlon with President Kabila in Kinshasa, in 2007.

Bottom: PetroSA's oil platform in Cape town, by Ifjay <http://www.flickr.com/photos/ifjay/>

Analysis of contracts

'Tullow still argue that their PSA was legitimately signed by the Congolese government.'

1. AGREEMENT



2008 Contract

The 2006 contract was made and signed by the Government of the Democratic Republic of Congo, through the Ministry for Energy and the Ministry for Finance, state oil company Cohydro, Tullow DRC BV and Heritage DRC Ltd.

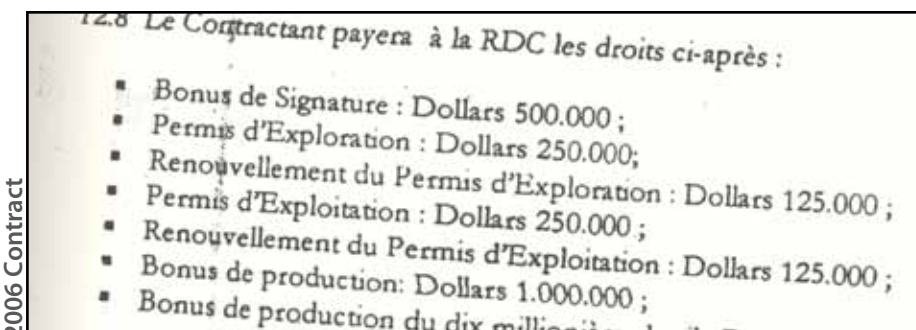
The 2008 contract was made and signed by the Government of the Democratic Republic of Congo, through the Ministry for Energy and the Ministry for Finance, state oil company Cohydro, Consortium Divine Inspiration Group (PTY) Ltd, H OIL Congo Ltd and two small Congolese companies, Sud Oil Sprl and Congo Petroleum & Gas Sprl.

- This means that DRC as host government has assumed contractual liability as a direct party to the agreement. While this is not uncommon, it is good practice for the host government to avoid direct responsibility and unlimited liability by participating through a state-owned enterprise (usually the national oil company, in this case Cohydro) as contractual partner instead. Operating as a separate legal entity, this would limit the Congolese liability, as only the enterprise's assets can be seized.⁴
- For example, the 1994 ACG contract signed in Azerbaijan was between a consortium of oil companies led by BP and the State Oil Company of Azerbaijan (SOCAR). PSAs in Libya are signed by the Libyan National Oil Corporation.⁵
- In contrast the oil companies participating in both contracts have avoided contractual liability. Rather than the parent company signing the contract (eg Tullow Oil), the private signatories are all Congolese subsidiaries (eg Tullow DRC).
- This is extremely serious, as without legal guarantee by the subsidiary's ultimate parent, a host government ultimately has no protection, and is subject to the company's "goodwill". If the company

is found to be in breach of liability, DRC only has access to Tullow DRC's resources, not those of the parent company.

- According to contract expert Jenik Radon of Colombia University, "The only appropriate and rightful contractual partner is the ultimate parent. In fact, such a requirement is no more than bank and other lenders regularly receive and secure from oil companies, and host governments should be treated no differently."⁶

2. REVENUE AND TAX



2006 Contract

i) Bonuses (Article 12.8)

Both contracts stipulate a range of bonus payments by the companies to the government, from a \$500,000 sum upon the signing of the contract to a further \$1m payment when production begins. These figures are broadly comparable to amounts being paid in Uganda. Heritage's Block 3A PSA at Lake Albert included a \$300,000 signature bonus, while Tullow Block 2 carried a \$200,000 bonus.

It was a central strategy of the cancellation/amendment of the 2006 Tullow/Heritage contract that Kinshasa wanted to attract further bonus payments. SacOil and Divine Consortium, the key players in the South African consortium, confirmed paying \$2.5m for the signature bonus alone in 2008 to secure Block 1. The then Minister of Energy, Lambert Mende, repeatedly claimed it was unfair Tullow had secured two blocks in 2006 whilst only paying one \$500,000 bonus.

- Host governments are often distracted by signature bonuses, as they represent hard cash up front. Much of the debate in DRC over the contracts has focused on these kinds of payments at the expense of looking at more important provisions.
- Oil contracts such as these determine revenue flows of billions of dollars. In this context, a \$500,000 payment is largely irrelevant to both the company paying it and to government income. Indeed, when threatened by the new contractual arrangement in 2008, Tullow's Vice President, Tim O'Hanlon, immediately offered Kinshasa an additional \$500,000 bonus; an indication of the relative unimportance of this sum.
- The production bonus of \$1m in these contracts compares unfavourably with the \$5m bonus Dominion Petroleum will have to

'Host governments are often distracted by signature bonuses, as they represent hard cash up front. Much of the debate in DRC over the contracts has focused on these kinds of payments at the expense of looking at more important provisions.'

'The contracts exempt the companies and their subcontractors from all taxes normally applicable in the DRC. This is in stark contrast to Uganda.'

- pay the Ugandan government on the first day of oil production in Block 4.
- Further, it appears that there has been no accountability regarding the bonus money already paid to the government and which revenue stream it has been channelled through.
- While these sums are comparatively small, it generates concern that future bonuses, including the \$1m and \$5 million production bonuses will likewise disappear.
- On a larger level, if the government has failed to track and account for the destination of these bonus payments, it raises questions over the intention & ability to manage the larger oil revenues to come.
- The DRC is a candidate country for the Extractive Industries Transparency Initiative, a commitment which is explicitly mentioned in both contracts. When ratified in 2010, adherence to the principles of the voluntary code would require regular publication of payments and revenues.⁷

ii) Royalty (Article 12)

2.2 Sans préjudice de calcul du taux de Royalty défini à l'article 12.1 ci-dessus, en reconnaissance des particularités liées au site, la Royalty sera calculée à un taux de :

- Neuf pourcent (9%) pour les douze (12) premiers millions de barils d'Hydrocarbures Liquides produits.
- Douze et demi pourcent (12,5%) pour les barils d'hydrocarbures liquides suivants (au-delà de douze millions).

The 2006 contract only has a 9% royalty for the first 12 million barrels, then 12.5% thereafter; while the 2008 deal has a royalty applying at 12.5% throughout.

iii) Tax terms (Article 12)

2.4 Toutes les activités du «Contractant» et de tous les Sous-Traitants impliqués dans les Travaux Pétroliers sont exonérées de tous impôts et taxes afférents aux sociétés en République Démocratique du Congo.

2.5 Il est perçu un bonus équivalent à Quarante pourcent (40 %) de la plus value réalisée sur la cession d'intérêt de l'association durant la période d'exploration et de vingt pourcent (20 %) durant la période d'exploitation. Ce bonus n'est pas

Article 12.4 of the South African consortium contract (replicated in Article 12.5 of the Tullow/Heritage contract) exempts the companies and its subcontractors from all taxes normally applicable in the DRC. This is in stark contrast to Uganda where the PSAs explicitly affirm that 'all central, administrative, municipal or other local administrators' taxes and duties will apply.⁸ The sums involved will be significant, especially if this exemption covers corporation tax which amounts to 30% on profits companies make in Uganda.

Significantly, the 2008 contract at Article 12.5 provides explicitly that 'a bonus will be collected equivalent to forty percent (40%) of the capital

gains realised on the cession of interest during the period of exploration and twenty percent (20%) during the period of extraction.' This means that if one of the companies sells its share in the licence – as Heritage has already done in Uganda – the state has a right to tax that capital gain. This provision is not in the 2006 contract which raises concern that should Heritage sell to a major oil company, the DRC will lose out. Heritage stand to make \$1.3bn from selling its share of two blocks to CNOOC and Total – Uganda is seeking to tax that profit at around 30% but there are indications Heritage will avoid paying in full because of ambiguity in the PSAs.

iv) Cost recovery (Article 14)

14.21 Dès le démarrage de la production d'Hydrocarbures Liquides sur un Permis d'Exploitation, chaque entité composant le Contractant commencera à récupérer sa part des Coûts Pétroliers (actualisés, conformément à l'article 3.6 et indexés comme indiqué ci-dessus) relatifs au Permis en recevant chaque Année Civile une quantité d'Hydrocarbures Liquides, le « Cost Oil », au plus égale à septante cinq pour cent (75 %) du total de la Production Nette du ou des Permis d'Exploitation multipliée par le pourcentage d'intérêt qu'elle déient

14.23 A l'exception du bonus du Permis d'exploration et de ses renouvellements éventuels, le remboursement des Coûts Pétroliers pour chaque Année Civile au titre des Permis d'Exploitation s'effectuera selon l'ordre de priorité suivant :

- a) Back Costs ;
- b) Bonus ;
- c) Les coûts des Travaux d'Exploitation ;
- d) Les coûts des Travaux d'Evaluation et de Développement ;
- e) Les coûts des Travaux d'Exploration;

These paragraphs mean that after payment of the royalty in the Tullow/Heritage contract, up to 75% of the remaining oil in the first years of production can go towards covering costs incurred during exploration, development and operation. In the 2008 contract, the amount of revenue that can be eaten up by cost oil in any year is limited to 60% of the profits, a figure comparable to the companies' provisions in Uganda. If the companies have greater unrecovered costs than can be reclaimed in any one year, the difference is carried forward to subsequent years.

Significantly, allowable contract expenditures in both contracts also include the bonus payments, social spending in Ituri and environmental management. This effectively means that companies are not incurring real costs in these areas, since they will be able to claim the money back once production starts. If Tullow build a school in Kasenyi, for example, that money will come from oil profits, not from the company itself. In Uganda, independent auditors rejected Heritage's attempts to claim back Corporate Social Responsibility spending.

- When the cost oil total is increased (in the 2006 contract up to 75%), this reduces the quantity of oil remaining as "profit oil". As the profit oil is split between the companies and the state, the cost of "allowable expenditures" is passed on to the state in the form of reduced profit

'Allowable contract expenditures in both contracts include the bonus payments, social spending in Ituri and environmental management. This effectively means that companies are not incurring real costs, since they will be able to claim the money back once production starts.'

'The most striking provision in the Tullow/Heritage contract is how the sliding scale is structured so that the government share of profit-oil revenues is effectively frozen at just 45% for production above 12m barrels, meaning the companies are always getting the majority of the profits generated during production.'

oil. As profit oil is shared by the state, increased costs are in large part offloaded onto the state's revenue stream.

- Thus the question of what counts as expensable costs, and how this is checked is a crucial issue. It is normal practice for companies (in the language of production sharing agreements) to try to profit from 'cost oil'. Indeed, this is the reason multinational companies spend so much money on accountants. There are various ways of doing this – one is by trying to recover costs that should not be expensable. Another way is to hire an affiliated company as a contractor, and pay them a rate by which they can make a profit.

v) Production sharing (Article 15)

Production Nette Cumulée (BBLs)	Pourcentage du Contractant	Pourcentage de l'Etat
< 20.000.000	60	40
20.000.001 - 50.000.000	50	50
> 50.000.000	40	60

2008

After paying the royalty and cost recovery, the remaining "profit oil" is split incrementally, according to the remaining daily production of barrels per day (bpd). Thus the government's share of profits goes up as the number of barrels produced increases, and falls as it drops.

- It is common for production sharing agreements to specify that the profit oil be split according to a sliding scale, to ensure some level of return for the private companies while delivering an appropriate rent to the host government. This sliding scale is in evidence in the 2008 contract, with the state percentage peaking at 60% when production is over 50,000 bpd. This is a comparatively low percentage (in Uganda's PSAs, the highest profit share percentage ranges from 68.5% to 80%).

La Production Nette sur un Permis d'Exploitation, déduction faite de la Royalty conformément aux dispositions de l'article 12 et de la quantité affectée au remboursement des Coûts Pétroliers, conformément aux dispositions de l'Article 14 ci-dessus, sera partagée à hauteur de quarante cinq pour cent (45 %) pour la RDC et cinquante cinq pour cent (55 %) pour le Contractant sur les Hydrocarbures Liquides produits.

2006

However, the most striking provision in the Tullow/Heritage contract is how the sliding scale is structured so that the government share of profit-oil revenues is effectively frozen at just 45% for production above 12m barrels, meaning the companies are always getting the majority of the profits generated during production.

For this reason, as shown in the economic analysis (see p14), the 2008 deal signed by Kinshasa represents a set of better terms for DRC. The exceptionally generous terms afforded to Tullow/Heritage in this fundamental section of the contract may well have been the real reason

Kinshasa sought to tear up the deal.

- In addition, it is very unusual for the profit-oil split to be based purely on the level of production. This means that the profit sharing terms provide no check for excessive company profits at the expense of DRC – for example at times of high oil prices. Even the IMF, an institution predisposed to supporting most corporate demands and excessive liberalisation, admits in a confidential report that this is a major flaw with Uganda's PSAs. The Uganda contracts are based on the false assumption "that the profitability of the projects is only be determined by the volume of production".⁹ The contrary is in fact the case – fiscal structures based on company profits are better able to obtain greater shares of rent than those based purely on the quantity of oil produced.
- The revenues accruing to both Uganda and DRC is further undermined by the contracts' stipulations that the profit oil split is set incrementally, and only based on the level of "remaining oil production per day after the deduction of cost oil."

vi) State participation (Article 22)

2008	22.2 Une part d'intérêt dans le Contrat de 7% sera attribuée à Cohydro.
2006	22.2 Une part d'intérêt dans le Contrat de douze pour cent (12%) sera attribuée à COHYDRO.

Both contracts grant a license share to the state oil company Cohydro – as with the bonuses paid, much attention in DRC has been focused on these differing shares. In the Tullow/Heritage deal, Cohydro has a right to a 12% share, which drops to just 7% in the 2008 contract. This 5% reduction has often been cited as meaning the 2006 contract is a 'better deal' for DRC. But it is the profit share from production (see below) that will do most to determine how much money the government receives from oil. While the license share is important, since it will have an impact on pre-profit share revenues, it is worth noting that the contracts in Uganda give the government a potential 15% stake, without providing upfront investment. The Block 4 contract in Uganda allows state participation up to 20%.

The 5% drop in state participation for Cohydro in the 2008 contract is accounted for by the minor license shares assigned to the two private local Congolese companies, Congo Petroleum & Gas (a 3% share, signed in the contract by Jean Bosco Muaka Khonde, a Kinshasa businessman) and Sud Oil (2%, signed in the contract by Pascal Kinduelo, the chief executive of Banque Internationale de Credit.) It is unclear what role these two Congolese companies are meant to play in the consortium given the absence of investment or apparent expertise.

The benefits of state participation are that the state receives a greater proportion of revenues, shares in the private company's profitability, while ensuring a more even sharing of the potential "upsides". Host governments will often insist on developing oil reserves through joint

'In the Tullow/Heritage deal, COHYDRO has a right to a 12% share, which drops to just 7% in the 2008 contract. The Block 4 contract in Uganda allows state participation up to 20%.'

'Under Article 22.4 in both contracts, the private companies can recoup the costs of carrying COHYDRO (and in the 2008 contract, the two local companies also) through their cost oil as well as 50% of their profit oil – an abnormally generous provision which defers when the state will get its full profit proportion.'

ventures, with a national oil company participating. The proportion held by the state company varies widely, from 5% to 80%.

- A frequent stipulation, particularly where the private company is the dominant partner, is that the government's portion of development costs are "carried", ie fronted by the private oil company. The private company recoups these costs through cost oil, and the state company is responsible for ongoing production costs once the oil project is up and running.

Under Article 22.4 in both contracts, the private companies can recoup the costs of carrying COHYDRO (and in the 2008 contract, the two local companies also) through their cost oil as well as 50% of their profit oil - an abnormally generous provision.

Les entités autres que COHYDRO formant le Contractant doivent récupérer les fonds prêtés à COHYDRO par l'intermédiaire du Compte Avance, plus intérêt, en utilisant cent pour cent (100%) du Cost Oil et cinquante pour cent (50%) du Profit Oil attribué à COHYDRO.

2008/2006

This means Tullow, for example, can claim back the costs they've fronted for Cohydro by adding it to their cost oil figures as expected, but can also take up to 50% of the state company's profit oil share in the first years of production until the fronted and ongoing costs are met, thus deferring again when the state oil company will get its full profit proportion.

Further it is astonishing that the two private Congolese companies are also having their costs "carried" within the contract. In effect, Sud Oil and Congo Petroleum and Gas receive a free ride, since they do not have to contribute capital to exploration, and can simply wait to take a share of production profit while others invest. This constitutes an inexplicable transfer of money from the state to private hands.

- Entering a joint venture will allow DRC to develop greater domestic expertise of oil. This enables the government to better understand the technical details of the business, reducing the likelihood of being ripped off or agreeing to damaging deals in the future.

ECONOMIC ANALYSIS

Whereas a royalty is a simple concept and is easy to calculate (if the rate of production and oil price are known), the calculation of taxes on profit (and of the sharing of profit oil) necessarily depends on the definition of profits – including such factors as how assets are depreciated, which costs are allowable and disallowable, the treatment of financing costs (such as bank interest) and so on.

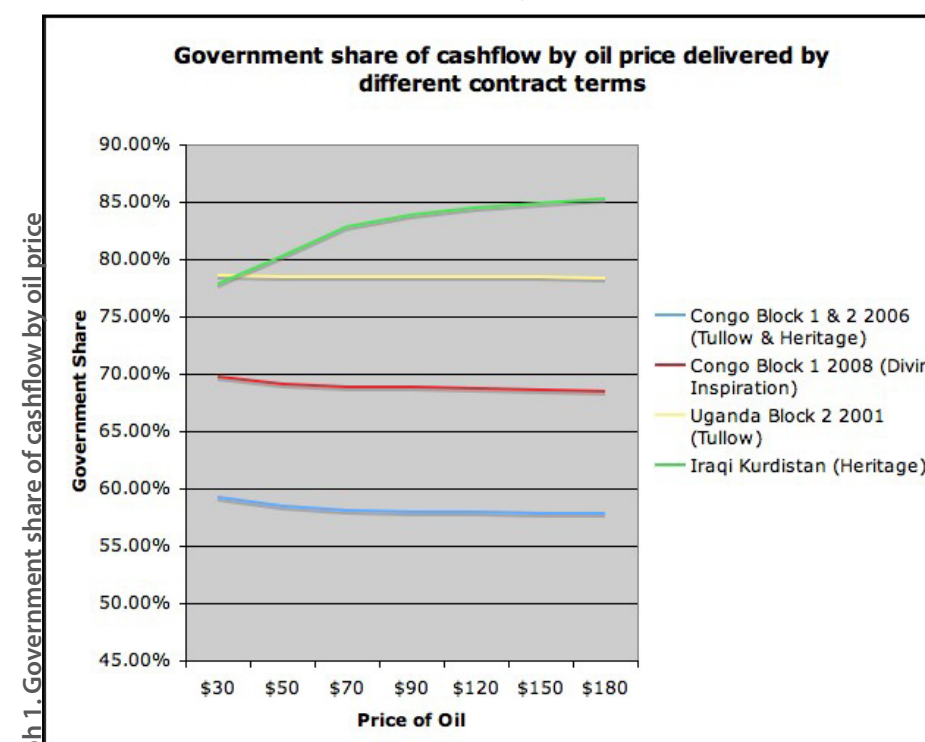
Complexity naturally favours those with the most accounting resources, but also tends to favour the company over the government, as the company has a far greater knowledge base of the details of its business. Conversely, it makes the operations largely inaccessible to scrutiny by civil society.

i) State Revenue – exaggerated?

PLATFORM's assessment provides varying figures for government revenues, depending on the price of oil, size of fields, development costs and other factors. Lower oil prices, smaller fields and higher development costs reduce the revenue flow to the government.

A possible middle-ground scenario based on oil prices predicted by the US Energy Information Administration would result in government take of net revenues of 57.9% in case of 2006 Tullow/Heritage contract and 68.7% for the 2008 Divine/H Oil contract. The portion of revenues delivered to the state remains pretty steady with varying oil prices: 57.8-59.2% for the Tullow contract, 68.5-69.7% for the Divine Inspiration contract. Thus whatever the oil price, the Divine Inspiration contract delivers 16-17% more revenues than the Tullow contract. This corresponds to between \$1.7 billion and \$11.2 billion, depending on the oil price.

'The Ugandan terms are stronger than those in Congo, delivering between \$3.6 billion and \$29.2 billion more than the 2006 Tullow/Heritage contract.'



PLATFORM's model, demonstrated in Graph 1, compares cashflow from the model field under the fiscal terms set out in the two PSAs to the terms of Tullow's Block 2 in Uganda (adjoining the Congo blocks) and to Heritage Oil's Miran prospect in Iraqi Kurdistan. This comparison, as shown in Graph 1, reveals that the Ugandan and the Iraqi Kurdistan terms offer a greater government take than the Congolese. Even at low prices, the Kurdish terms deliver a take that does not fall below 77%, while plateauing at over 85%. The Ugandan terms are also stronger than those in Congo, delivering between \$3.6 billion and \$29.2 billion more than the 2006 Tullow/Heritage contract. In this context it should be borne in mind that PLATFORM's February 2010 report "Contract Curse" demonstrated that Uganda's terms are themselves comparatively weak.¹⁰

The comparisons are particularly striking, given that these contracts

'Congo's contracts are highly profitable for the oil companies. In the most likely scenarios, Divine/H Oil would make a 38-57% profit-return while Tullow/Heritage would walk away with a whopping 44-63% IRR. This represents an extraordinarily high profit level for the oil industry, even for risky projects.'

were signed by the same Tullow Oil and Heritage Oil that are operating in Congo. Moreover, Heritage managed to secure a significantly better deal in Kurdistan, despite the fact that the Kurdistan Regional Government is not a recognised state, does not have the legal authority to negotiate, is locked in a lengthy battle with the central government over who has authority regarding oil matters and remains under military occupation by a foreign army with continued high levels of internal conflict.

Furthermore, the Congolese contracts were signed in 2006 and 2008, at a time of high oil prices and rising demand, when fossil fuel companies were scrambling to access reserves. At such times, host governments have significantly stronger bargaining positions, with less need to entice oil companies with overly profitable terms. When there is no assumed energy surplus, producing nations are competitively in the driver's seat of negotiations.

ii) Corporate Profits – excessive?

When analysing the suitability of particular contracts, it is important to examine the benefits that will flow to both the government and the oil company extracting the reserves. A key measure of oil project profitability is the Internal Rate of Return (IRR) – this is what the oil company will assess to decide whether a project is financially worthwhile. In simplified terms, the rate of return describes the profit that the company will make off its investment.¹¹

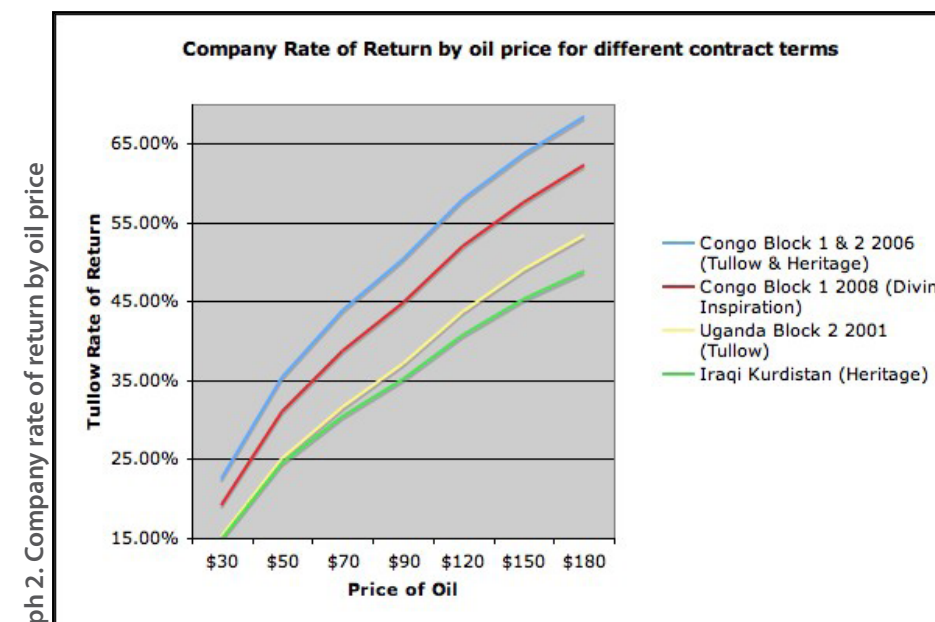
If this profit is greater than that which could be made by investing the money elsewhere, the project is worthwhile. The likely rate of return can be assessed to see whether the host government is receiving a fair deal, or whether the oil company has managed to sign terms that will lead to excessive profits.

By way of comparison, oil companies generally consider any project that generates an IRR of more than a 12% to be a profitable venture. In riskier projects, companies will push for rates of return of 15-20%. Above 20% is a staggering profit rate.

The calculations in this report reveal that Congo's contracts are highly profitable for the participating oil companies. In the most likely scenarios, Divine/H Oil would make a 38-57% return while Tullow/Heritage would walk away with a whopping 44-63% IRR. This represents an extraordinarily high profit level for the oil industry, even for risky projects. Even when stress testing profitability by modelling the least promising (and less likely) scenarios, such as a \$30 oil price combined with a smaller fieldsize, Tullow/Heritage still make 15.6% while Divine/H Oil take 12.4% – a comfortable profit margin.

Graph 2 compares the rate of return that the companies are set to make from Congo's contracts to the terms used in Uganda and Iraqi Kurdistan. At any oil price, the companies will be making far greater profits in Congo than they would on Ugandan or Kurdish terms. Moreover, the gradient for projected IRR increases with rising oil prices is significantly steeper for the DRC contracts. This means that the profits from Congo will rise faster and

out of proportion to profits made in Iraqi Kurdistan or Uganda.



Graph 2. Company rate of return by oil price

In examining what DRC's PSAs mean in terms of government take and corporate IRR, we can see that Uganda's loss in terms of government revenue will be the oil companies' gain. A wildcat company exploring for oil should expect to make a reasonable return on its investment – but not to be able to sign permanent terms that guarantee excessive profits for 20 years. When host governments feel the need to offer excessively favourable terms, these should be clearly time-limited and open to revision once investment costs have been recovered through cost oil.

In this context, mechanisms for a "windfall" profits tax, where the government take increases when company profits exceed a certain threshold, are reasonable and sensible. This enables the state to receive its equitable share of increased oil prices or other external factors which boost corporate profits without increasing costs. Failure to incorporate such a tax, as is the case with existing DRC (and Uganda) contracts means that the state enables excessive corporate profits at its own expense.

Contract expert Jenik Radon suggests viewing oil companies as regulated utilities – "by starting with the normal proposition that profits are oil sales less expenses and that all profits belong to the state, other than an agreed rate of return for the oil companies. This approach is akin to the approach underpinning a service contract. This admittedly simplistic method has the virtue that the oil companies have the burden of justifying and proving their demand for compensation, namely by disclosing their internal rate of return (a jealously guarded secret), rather than making the government shoulder the burden of justifying its claim to a higher share."¹²

Tullow's PSA for offshore oil exploration and extraction in Ghana includes such a windfall profits tax in the form of an "additional oil entitlement". This accrues to the state when the project's IRR "exceeds the targeted

'A wildcat company exploring for oil should expect to make a reasonable return on its investment but not be able to sign permanent terms that guarantee excessive profits for 20 years.'



'If the oil price rises, it is the oil companies, not Congo, which capture the 'upside' – the chance of ever-higher profits. In comparison, DRC not only fails to increase its proportion of revenues, but the proportion of income drops slightly as prices rise.'

rate of return used to evaluate the profitability of the venture during the negotiations." In the case of the Jubilee field, Tullow's targeted IRR is 19%. Net profits in excess are subject to an additional 7.5% tax. Higher tax rates apply at progressively higher rate-of-return thresholds on a sliding scale.¹³

iii) High oil prices – DRC losing out?

Graph 2 also shows that DRC's contracts not only fail to capture an increased portion of rent as the oil price rises, but the stake take actually falls. This is a major flaw, especially in light of the high prices we have seen in recent years and associated revenues. As oil prices rose through the 2000s, there was recognition amongst producer governments that the state has a duty to its citizens to capture the rent from higher prices and that the private companies do not have a right to excessive profit-taking.

At a very low oil price of \$30 per barrel and a small oil field Tullow/Heritage will still make a strong return on their investment of over 15%. Divine/H Oil will make a comfortable 12%.

However, the uncertainties in an investment comprise not just 'downside' – the risk that things go worse than planned – but also 'upside': the chance that things in fact go better.

Yet if the oil prices rise, it is the oil companies, not Congo, which capture the 'upside' – the chance of ever-higher profits. At \$70 Divine makes a rate of return of 38.8%, at \$120 it is 52.0% and at \$180 the company makes 62.2%. Tullow's IRR grows even faster – 44.0% at \$70, 57.9% at \$120 and 68.4% at \$180. The company's profits rise at a steady gradient with increased prices. In comparison, DRC not only fails to increase its proportion of revenues, but the proportion of income drops slightly as prices rise. Over price variations of \$150, state take falls by 1.2% in to the 2008 contract and 1.4% in the 2006 contract. In other words, the oil companies take over 40% (2006 contract) or over 30% (2008 contract) of revenues, regardless of whether the oil price is \$100 or \$250 – accruing enormous profits.

The aims of an oil company in negotiations on economic terms are to maximize upside, while minimizing downside. As Thomas Wälde (1996: 203) writes:

"Companies will try to obtain a flexible regime, but flexible only with respect to downside developments. Rare the financial analysis presented to the government team which does not use a 'marginal' base case and rare the tax package proposed which will not 'just' allow the development of a marginal project. The psychology of negotiators, particularly in an organisation, will tend to strive for a bargaining victory advertised to the corporate home front, and such bargain victories will rarely be famous for 'upside flexibility', i.e. for increasing the government share when the project turns out to be a big success."

In DRC's case, in both contracts the oil companies clearly succeeded in capturing the potential benefits of high prices for themselves. As can be seen from the graphs, the Kurdistan contract leads to an improvement in government take as oil prices rise (although only partially successful),

while the Ugandan contract also fails to capture the benefits of higher oil prices.

This was criticized by the Norwegian Agency for Development Co-operation (NORAD) in 2008 when it warned the Ugandan government that its model PSA "does not provide for the Government to capture economic rent as a consequence of higher prices, cannot be regarded as being in accordance with the interests of the host country. The enormous increase in oil prices during the last 5 years have fully demonstrated the need for production sharing models that adequately protect the interests of the host country by securing the economic rent for the country. The economic rent should be for the benefit of the host nation owning the petroleum resources, and not the oil companies, which should only be secured the fair return on their investments. [This is] not a modern production sharing model protecting the economic rate rent for the state."¹⁴

However, while the Ugandan government sold its assets at a time of cheaper oil and failed to establish mechanisms to reap the benefits of higher prices for the future, the Congolese government has no such excuse – it negotiated these contracts at a time many analysts predicted "an end to cheap oil".

iv) Risks dumped on DRC?

Apart from price risk, there is also the risk that something might not go according to plan – that costs over-run or that management or technical failures mean that the project falls behind schedule. By examining the revenues of the project at different costings, we can determine how this risk is shared between the different parties.

Oil companies frequently fail to keep budgets under control, and are known to inflate budgets to transfer higher revenues into their own accounts. By comparing a medium cost scenario of \$2.3 billion invested with a high cost scenario of \$4.6 billion, we discover that DRC stands to lose more than the oil companies as costs rise. In the case of the 2006 terms, Congo will eventually have to shoulder just over 50% - losing \$1128 million in revenues compared to the companies \$1122 million. Yet if Divine's 2008 terms are applied, Congo carries over 60% of the additional burden, covering \$1377 million to Divine and H Oil's \$830 million.¹⁵

Although both are carrying some of the risk, the state stands to lose a greater sum of money than the oil company. This is despite the fact that project risk is something the company should be responsible for, given that it has been brought in with the technical expertise and skills, and government has little direct say over spending.

The terms of the PSAs provide significant protection to the companies from price risk and project risk, with guaranteed profits. Furthermore, the arbitration and stabilization clauses (Article 28 and Article 30) in the contracts protect corporate profits from changes in the law and signing of international treaties. Thus, DRC is constrained in its ability to legislate or regulate, or to manage its economy. Meanwhile, citizens will not have

'Effectively the people of Congo carry the risks on behalf of the foreign oil companies.'

'Sud Oil and Congo Petroleum and Gas are receiving a free ride, since they do not have to contribute capital, but can simply wait to take a share of production profit.'

the benefit or protection of international human rights or environmental protection. Effectively the people of Congo carry the risks on behalf of the foreign oil companies.

v) Public revenues disappearing into private pockets?

The 2008 contract contains a remarkable anomaly, in terms of the participating companies.

It is common for the local state oil companies to participate in PSAs awarded to private oil corporations. In such cases, the capital investment due from the national company is generally fronted – “carried” – by the private corporations to “carry”, who recoup the increased investment through cost oil. Our models for Ugandan Block 2 assume that Uganda takes up its opportunity for a 15% national stake, which will be carried by Tullow et al.

In the 2006 Tullow/Heritage contract in Congo, Congolese state oil company COHYDRO has signed the contract as a member of the contracting parties, and holds a 12% interest. However, according to the 2008 Divine/H Oil terms, this government holding has been reduced to a 7% stake. The missing 5% have been awarded to two little known companies: Congo Petroleum and Gas and Sud Oil. What is particularly strange is that these companies do not need to provide the relevant 5% investment to cover their share of costs – their share will also be carried by Divine and H Oil.

PLATFORM has been informed that the introduction of the two private companies came late during the negotiations with the South African consortium, at the government's behest, and was resisted by other parties given the lack of justification for apportioning them a 5% share.¹⁶

Neither company appears to have a website and online information as to their operations is extremely limited. Even the other companies participating in the contract are unclear about their background. Pascal Kinduelo sold BiC to found Sud Oil as a trading company (see company profiles) but trading oil in itself does not really qualify a company to explore and extract crude on a large scale. A range of journalists and analysts in Kinshasa were unable to find any record of Congo Petroleum as an enterprise in operation.

It appears highly unclear what Sud Oil and Congo Petroleum & Gas will contribute to the project. The reason to invite corporations to extract resources is that in some circumstances they can bring investment, experience and ability not available locally. However, in this case neither Sud Oil nor Congo Petroleum and Gas are providing any investment, neither is bringing any relevant skills or experience to the table and neither will participate in operating the fields.

In years of examining and analysing oil contracts, PLATFORM has never seen a contract that contains something like this. In effect, Sud Oil and Congo Petroleum and Gas are receiving a free ride, since they do not have to contribute capital, but can simply wait to take a share of production

profit. The revenues received by the two companies will depend on a number of factors. Our models show a range from \$300 million to \$4 billion taken in, with around \$2 billion the most likely outcome.

This constitutes an inexplicable transfer of wealth from state to private non-productive hands.

4. ENVIRONMENTAL PROTECTION (Article 5)

5.3 Le «Contractant» allouera annuellement, un montant de deux cent cinquante mille Dollars (USD 250.000) en phase d'Exploration et trois cent mille Dollars (USD 300.000) en phase de Production, au titre d'interventions sociales au profit des populations locales environnant les sites pétroliers suivant un programme concerté avec le Ministère des Hydrocarbures. Ces interventions toucheront notamment le domaine de la Salubrité Publique, de l'Education et de la Culture. Les montants y réservés font partie des Coûts Pétroliers et sont donc récupérables.

5.3 Le Contractant allouera annuellement et par bloc, un montant de cent vingt cinq mille (125.000) Dollars en phase d'exploration et un autre montant de deux cent mille (200.000) Dollars en phase de production, au titre d'interventions sociales au profit des populations locales environnant les sites pétroliers suivant un programme concerté avec le Ministre de l'Energie. Ces interventions toucheront essentiellement les domaines de la Santé et de l'Education. Les montants y réservés font partie des Coûts Pétroliers et sont donc récupérables.

How communities in Ituri will benefit from exploration and production has been a major source of uncertainty since expectations of an oil boom were raised in 2006. Oil companies, including Tullow, have visited Lake Albert to promise roads, schools and hospitals. Tullow VP, Tim O'Hanlon, has suggested sums in excess of \$1m a year to be spent on local projects.

These two contracts reveal the true extent of the companies' potential legal obligations. In Uganda no specific amounts are mentioned in the contracts; Corporate Social Responsibility (CSR) – as it often referred to – is left to the discretion of the companies. In the DRC contracts, however, Tullow/Heritage are obligated to spend \$125,000 a year during the exploration period and \$200,000 a year during production. The 2008 contract with the South African consortium raises these figures to \$250,000 and \$300,000, respectively. The money is to be spent on 'education, public health and culture', as part of projects designed by the Ministry of Energy. This suggests the funds will be channelled through Kinshasa and will not be earmarked directly for local administrations in Ituri.

The companies may or may not exceed these obligations – Divine Inspiration and Dominion are reported to have since been required by the Economics and Finance Committee to commit to letters increasing their social spending to \$500,000 a year during exploration and \$1m a year during production¹⁷ - but under the contract they will be entitled to claim the costs back once production starts. In that sense, these projects are not a 'gift' from the companies but are funded indirectly by the oil profits.

For the purposes of perspective and comparison, Tullow spent \$98,000 in 2008 on a teacher training programme for eight schools in Buliisa District¹⁸ while a maternity clinic in Kyehoro was said to have cost \$68,000. The exploration phase can be expected to last for at least 5 years. In that

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'The oil companies can spend \$70 million drilling wells and constructing chemical dumps in fragile areas and near communities for five years, without adequately assessing impacts or establishing a management plan.'

time local communities in DRC can expect some benefits; but they will be piecemeal, geographically scattered and unlikely to contribute to integrated development outcomes. The companies can expect to make billions of dollars in profits over the 20-year lifetime of the contracts. CSR spending is not a significant dent in their accounts.

Moreover, a confidential Ernst & Young audit of Heritage Oil's exploration activities in Uganda between September 2004 and October 2006 found that Heritage had overclaimed cost recoverable expenditure by \$586,511 and warned of the "risk of inflating costs and expenses, more especially costs incurred outside Uganda." The auditors rejected Heritage's attempt to include Corporate Social Responsibility spending as cost recoverable, warning of "the potential of recoverable expense being overstated if undefined costs are included in the recoverable costs."¹⁹ CSR expenditure is regularly used to boost the reputation and image of operating companies, so claiming back these costs (at the expense of the state) is particularly odd.

Le «Contractant» élaborera un Plan d'Atténuation et de Réhabilitation (PAR) dans les six (6) mois de la première période de la ZERE, suivi d'une Etude d'Impact Environnemental et le Plan de Gestion Environnemental du Projet (EIE/PGE) pour la phase de production.

Les termes de référence, en ce compris l'évaluation des frais d'instruction, de ces différentes obligations seront fournis par le Ministère de l'Environnement qui approuvera les versions finales faisant partie intégrante du présent Contrat. Le Ministère de l'Environnement donnera à cet effet un avis environnemental et délivrera un Permis d'Exploitation.

Sans préjudice de l'avis de l'Etat.

The contract commits the companies to a preliminary mitigation plan for the exploration period. However, an environment impact study and management plan is not required until oil fields have been located and assessed and operations are shifting to production. This means that the oil companies can spend \$70 million drilling wells and constructing chemical dumps in fragile areas and near communities for five years, without adequately assessing impacts or establishing a management plan.

5.5 Les travaux d'exploration- production devront être menés dans normes relatives aux aires protégées.

"The exploration and production works must be led in accordance with the norms relative to protected areas."

Environmental impacts of oil & gas extraction are particularly serious along Lake Albert. As well as protected areas of exceptional biodiversity on the Ugandan side, the Congolese exploration areas include forests already under pressure from the timber trade, savannah, agricultural land used for crops and livestock and, crucially, fishing on the lake itself, all of which support millions of people in Ituri. Oil extraction therefore poses a direct threat to food security and employment in the region.

Specifying 'norms relative to protected areas' makes no mention of the standards to apply in the rest of Ituri district – the contracts are silent on this - when the nearest officially protected area is the Virunga National

Park, south of Semliki.

The Uganda contracts at least make a general statement about 'good international and industry practice', but this is largely meaningless, as oil company practice primarily depends on local levels of regulation ("applicable laws") and varies accordingly. Where a lack of government oversight or enforcement has enabled oil companies to cut corners, they have generally done so, leading to environmental devastation in Ecuador,²⁰ Russia²¹ and the Niger Delta²². Greater levels of regulation in rich countries have tended to lead to higher standards, although even there environmental problems have been repeated and frequent, including tar sands pollution in Canada, pipeline ruptures in Alaska and the Exxon Valdez spill.

According to Jenik Radon of Colombia University, "governments must take into account that companies prefer to pay relatively low noncompliance penalties rather than make investments in pollution control. So fines need to be high enough to act as a deterrent, and restoration of polluted areas by companies should be mandatory. [...] Government must have objective standards for environmental protection and must not lower them in the hope of increasing profits. There is no reason why environmental standards should be lower in developing countries considering that oil and gas are in such high demand."²³

However, DRC's Production Sharing Agreements carry no enforceable safeguards, nor are there any fines in place for causing environmental destruction to key land and water resources.

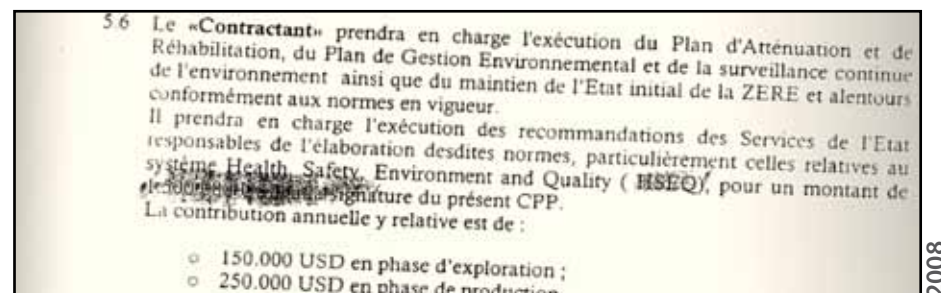
Deterrent fines are widely recognized as crucial to preventing regular and large oil spills. A US academic study found that a fine increase from \$1 to \$2 per gallon for large spills decreased spillage by 50%.²⁴ The 1990 Oil Pollution Act in the US laid out fines of up to \$1,000 per barrel discharged.²⁵ 18 That the contracts provide no basis for fines, while DRC simultaneously lacks an effective regulatory regime for the oil industry, clearly represents worst practice.

The companies are given the responsibility of carrying out 'environmental management plans' and audits; but these provisions are not integrated into a coherent legislative and regulatory framework. We still await the new oil code, the sums involved are tiny (just \$150,000 a year during exploration, \$250,000 during production) and there is as yet no indication that Kinshasa will have the capacity to monitor standards and demand improvements.

There are already significant concerns that the oil companies are not complying with good practice on the Ugandan side of the lake. In particular, the companies have not conducted a Strategic Environmental Assessment (SEA) of the likely impacts, even though Tullow will start production in 2010, while explorative drilling continues within Murchison Falls National Park despite the concerns of civil society groups. Local communities are consistently raising concerns about waste management and protection of water sources.

'DRC's Production Sharing Agreements carry no enforceable safeguards, nor are there any fines in place for causing environmental destruction to key land and water resources.'

“Health, Safety, Environment and Quality’ money was used to purchase military jeeps, delivered by H-Oil to FARDC commanders in Bunia, and naval boats and equipment handed to the Force Naval at Lake Albert by Divine Inspiration in March 2008.’



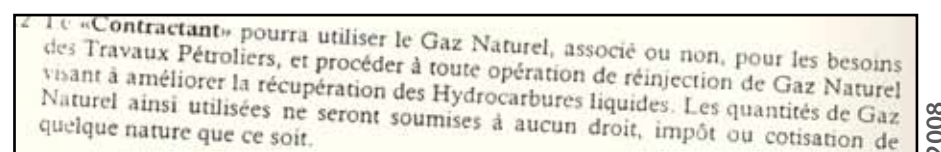
“The contracting parties will undertake execution of the State Service’s recommendations in establishing such standards, in particular those relating to Health, Safety, Environment and Quality (HSEQ), for an amount of 1.500.000 USD on the signature of the CCP contract hereby.”

To give an idea of the priorities of the parties, within the Environment and Development section of the 2008 contract, a key provision required an initial \$1.5m spend on ‘Health, Safety, Environment and Quality’. This money was in fact used to fund the purchase of military jeeps, delivered by H-Oil to FARDC commanders in Bunia, and naval boats and equipment handed to the Force Naval at Lake Albert by Divine Inspiration in March 2008.²⁶

Improving Congolese environmental legislation in 2010, as has been promised, will not affect environmental standards in relation to these oil operations, as the Stabilisation Clause in Article 28 (see section 8) excuses the oil companies from any developments in legislation.

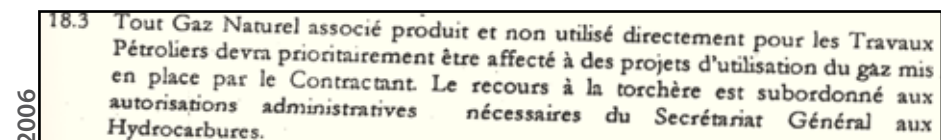
Currently, the DRC does not have adequate existing environmental regulations. In such a context, a contract could reference the applicable laws in other nations, such as Norway or Britain.²⁷ However, both the 2006 and 2008 contracts are notable for the absence of any substantive safeguards. By not ensuring that health and environment costs, especially restoration of the development area to its original condition, are borne by the oil companies, the government has handed them a large public subsidy.

5. GAS FLARING (Article 18)



“Associated gas” is natural gas which is extracted together with crude oil, from a primarily oil field. “Non-associated gas” is natural gas extracted from a primarily gas field.

Control over what happens with any associated gas lies almost entirely with the companies. If there is associated gas, the company is entitled to use as much as it wants for free, for its own operations, before there is a decision on whether using the gas for other purposes is viable (and thus reducing the likelihood that providing the gas to Congolese communities will be viable).



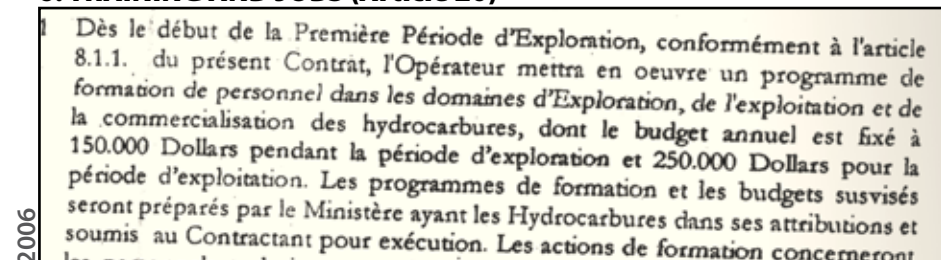
Gas flaring has been recognised as a human rights abuse that leads to severe health problems, environmental degradation, local toxic rain, as well as high levels of carbon emissions. In Nigeria, the government has struggled long and hard to compel Shell and other international oil companies to stop gas flaring, with the companies ignoring repeated court orders.

Article 18.3 in the 2006 contract (replicated in Article 18.2.1 of the 2008 deal) provides potential protection against the flaring of gas. In DRC, the flaring is subject to the companies obtaining ‘administrative authorisation’ – specified as through the energy ministry in the 2008 contract. This firstly implies that flaring may be allowed – but we do not know the criteria to be applied or the legislative framework within which the minister would make the decision. Secondly, if companies flare without authorisation, as occurs in other parts of Africa, DRC needs monitoring mechanisms in place independent of the companies.

However, the lack of clear existing guidelines for approval or denial of ‘administrative authorisation’ means that it is unlikely to be denied. Developing new legislation to guide decisions will not work, due to the stabilisation clause. There is also no opportunity for affected communities to input.

In Uganda, gas “may be flared with the consent of the Government, which consent shall not be unreasonably withheld or delayed”²⁸ effectively handing carte blanche to the companies. In any new licensing round in DRC, it is imperative that lessons are learned from Uganda’s mistake in this area.

6. TRAINING AND JOBS (Article 20)



The contracts specify lump sums of \$150,000 and \$250,000 during the exploration and production periods respectively (Tullow/Heritage), and \$100,000 and \$150,000 per year (South African consortium) to be deposited with the government to cover training of government personnel.

These amounts are extremely low and will ultimately be covered in large part by the government anyhow, as the company can expense training costs and be reimbursed with cost oil. Further, training will take the form

‘Gas flaring has been recognised as a human rights abuse that leads to severe health problems, environmental degradation, local toxic rain, as well as high levels of carbon emissions.’

'The oil exploration & production industry is capital intensive, but it employs proportionately far fewer workers than almost every other industry. While a number of unskilled workers will be needed during the development stages to construct roads, buildings and other infrastructure, these will mostly be short-term, insecure and low-paid positions.'

of internships or scholarships awarded to senior civil servants, and will not involve communities in Ituri.

There are currently unrealistic expectations in both Uganda and DRC about the employment opportunities the oil industry will bring. The oil exploration & production industry is capital intensive, but it employs proportionately far fewer workers than almost any other industry. While a number of unskilled workers will be needed during the early stages to construct roads, buildings and other infrastructure, these will mostly be short-term, insecure and low-paid positions.

Moreover, the major projects – particularly the \$3bn refinery and the pipeline to Kenya – will be on the Ugandan side of the lake, providing no benefits to Congolese.

L'Opérateur assurera, à qualification égale, l'emploi en priorité dans ses établissements et installations situés en République Démocratique du Congo, au personnel de nationalité congolaise. Dans la mesure où il ne serait pas possible de trouver des ressortissants congolais ayant les qualifications nécessaires pour occuper les postes à pourvoir, l'Opérateur pourra embaucher du personnel étranger après avis du Ministère du Travail et de Celui ayant les Hydrocarbures dans ses attributions. Cependant, l'Opérateur fera alors en sorte que son personnel congolais reçoive une formation dans les domaines de qualification sus-visés.

2006

This sets out a responsibility for the oil companies to train Congolese staff in oil operations.

In many oil producing countries, contracts will set out strict percentage targets for local versus foreign employment, specifying necessary quotas for unskilled, semi-skilled and skilled jobs. However, DRC's contracts contain no date timetable or quote targets, nor is there a broad commitment – as contained in Uganda's PSAs – to gradually replace expatriate workers.

7. SECRETS (Article 24)

7 Ce Contrat ainsi que ses Annexes et toutes les informations relatives à l'exécution de ce Contrat ou toutes informations obtenues d'une autre Partie à l'occasion de ce Contrat sont vis-à-vis des tiers, traités comme confidentiels par les Parties. Cette obligation ne concerne pas:

2008

DRC's contracts remain secret, despite slightly better access to information than in Uganda. The 2008 PSA has been discussed in the National Assembly and criticised by various actors; but the contracts themselves have not been released to the press and public in Kinshasa, nor have local communities in Ituri had access to them. The Tullow/Heritage contract has not until now been revealed, nor has Dominion Petroleum's in Block 5, while SacOil's PSA for Block 3 is likewise unavailable.

Uganda currently has five Production Sharing Agreements, covering much of the Western border with Congo and the Northern border with Sudan. None of these were made public by the government or the companies, despite repeated requests to the relevant government departments by various actors.

PLATFORM published the terms of Uganda's PSAs in February 2010 in the report, 'Contract Curse: Uganda's oil agreement place profit before people' but there is no sign that the government will now commit to transparency for future contracts, or release amendments and addenda of existing deals.²⁹

Transparency of contracts is widely recognised as a "a necessary element of any effort to promote the responsible management of natural resources for growth and economic development." Those oil-producing countries blighted by the resource curse – Nigeria, Angola, Ecuador, Equatorial Guinea, Venezuela and many others were almost always marked by a lack of transparency over the contracts covering extraction of oil resources, and a resulting lack of public debate and accountability. The handful of states where oil has had comparatively positive impacts on local standards of living, such as Norway, have high levels of openness and transparency, with full contracts available for public examination.

Keeping oil contracts secret contributes to environmental degradation, human rights abuses, conflict, displacement of communities, corruption and mismanagement, while weakening the government's ability to negotiate a favourable deal.

A recent report by Revenue Watch International argues improved transparency would mean that

"Over the long term, governments will be able to negotiate better deals, as the information asymmetry between governments and companies closes. In the shorter term, contract transparency will help government agencies responsible for managing and enforcing contracts, of which there are many, work in tandem. With contracts publicly available, government officials will have a strong incentive to stop negotiating bad deals, due to corruption, incompetence, or otherwise. Citizens will better understand the complex nature of extractive agreements if they are out in the open and explained by the contract parties. [...]

"States and companies blame each other for the blanket secrecy that covers agreements; specific claims about trade secrets or commercially sensitive information are not typically supported in fact; and none of the major actors openly discusses issues of corruption, power dynamics or raw incompetence, all of which the disclosure of contracts has been known to expose."³⁰

This avoidance of openness and accountability will prevent positive development outcomes while enabling corruption and environmental degradation on the part of the oil companies. Past experience indicates that without public debate, the "resource curse" is largely inevitable.

DRC's commitment to the Extractive Industries Transparency Initiative (EITI) will be tested when the validation decision is made in 2010 but, regardless, it does not cover the release of extractive industry contracts themselves so technical 'full compliance' and disclosure of some payments will not ensure Congolese have the information they need to hold the government and companies to account.

'Keeping oil contracts secret contributes to environmental degradation, human rights abuses, conflict, displacement of communities, corruption and mismanagement.'

'Even if the new oil code is passed rapidly, it is likely that the companies would argue the regulatory context referenced in the contracts is that which existed upon signing (ie in 2006 or 2008).'

8. FREEZING CONGOLESE LAW: STABILISATION CLAUSES (Article 28)

Article 28 - Stabilisation du Régime Minier et Fiscal

« Sans préjudice de l'article 84 de la Loi, pendant toute la durée du Contrat, la RDC garantit au Contractant, la stabilité des conditions générales, juridiques, financières, étatiques, fiscales, douanières et économiques dans lesquelles chaque entité exerce ses activités, telle que ces conditions résultent de la législation et de la réglementation en vigueur à la date de la signature du Contrat. »

Both DRC contracts contain identical 'stabilisation clauses' – meaning that if DRC changes or develops new and improved regulations which increase costs for the oil companies (the "general legal, financial, petroleum, tax, customs and economic conditions under which each entity exercise its activities"), the companies will not be subject to them. Stabilisation clauses effectively immunize an investor from future changes in both fiscal terms and legislation. Investors claim that such changes constitute political risks, but to they state they constitute exercise of its sovereignty.

The new oil code released in 2010 by the Ministry of Energy³¹ has reportedly been passed by the Senate and is currently being debated by the National Assembly. It contains important revisions to the regulatory regime and recommends changes to future PSAs, making implicit criticism of the terms of deals already signed. But if President Kabila approves existing contracts, then the changes will not apply. Sequencing will be important – the government looks keen to move ahead with exploration in 2010 but if, as in Uganda, contracts are approved before new laws are finalised, then the companies can escape additional obligations. Even if the new oil code is passed rapidly, it is likely that the companies would argue the regulatory context referenced in the contracts is that which existed upon signing (ie in 2006 or 2008), as opposed to that when the contract was approved by the President.

Stabilisation clauses reduce DRC's legislative sovereignty – removing the ability of the country to improve its environmental regulations, laws governing workers' rights or health standards in relation to the oil operations. They allow companies to profit from undeveloped regulation and legislation; particularly significant given the major impacts that oil extraction operations have locally. Stabilisation clauses are thus detrimental to protection of democracy, environment,³² human rights and workers rights, and are an obstacle to development. Amnesty International has argued that stabilisation clauses like that covering the Baku-Ceyhan pipeline are likely to create a "chilling effect" on governments' abilities and intentions to legislate to protect human rights and the environment. These provisions "effectively freeze a 'chaotic' present" – and not for a few years until the oil company's investment has been recouped, but for the life of the contract.³³

According to Greg Muttit, "the use of the term 'political risks' in infrastructure and extractive projects can commonly be characterized as a somewhat patronizing 'We don't trust the government not to change the rules'. By definition, this risk is carried by the foreign investor, rather than the state party. However, far from remaining open to potential

renegotiations, companies aim to reduce political risk by contractually tying the hands of the government as firmly as they can. This is investment colonialism at its most extreme."³⁴

9. UNDERMINING SOVEREIGNTY / RESOLUTION OF CONFLICTS (Article 30)

« 1. Tous les différends découlant du Contrat, à l'exception de ceux visés aux paragraphes 30.5 et 30.6 ci-dessous, qui surgiront entre la «RDC» d'une part, et les entités du «Contractant» d'autre part, qui ne pourront pas être résolus à l'amiable, seront tranchés définitivement par arbitrage conformément aux Règlements d'Arbitrage de la Chambre de Commerce Internationale de Paris. »

A conflict between the DRC government and a private oil company operating on Congolese soil will be resolved not in Congo's courts, but by an international investment tribunal. Moving the resolution of disputes to Paris undermines Congolese sovereignty, and treats the Congolese state as a commercial entity of equal standing to a private corporation, removing concepts of public interest, responsibility or sovereignty.

The conflict shall be resolved (including possibly through an "arbitral sentence passed by a Court of Arbitration) according to the rules and established by the International Chamber of Commerce (ICC), But the ICC is not a neutral body, describing itself as "the voice of world business" that is "assertive in expressing business views", "makes the case for business self-regulation" and "feeds business views into intergovernmental organizations".³⁵ It has around 160 members, all of whom are large multinational corporations, including Shell, Chevron and Exxon.³⁶ In other words, the ICC is a powerful lobby group on behalf of private companies.

Arbitration is used by international oil companies to gain favourable decisions outside of the host country's jurisdiction, with international investment law and oil industry interests privileged over domestic laws and community priorities. The ICC makes this clear on its pages promoting the services of its privately-run International Court of Arbitration. Companies choose the ICC as "they want to avoid litigation because they fear bias by national courts, are unfamiliar with national court procedures and want to be spared damaging publicity. ICC arbitration is an attractive alternative because it is international and confidential."³⁷ "In contrast with ordinary courtroom proceedings under public and media gaze, ICC does not divulge details of an arbitration case."³⁸ In other words, corporations select ICC arbitration because they want to avoid accountability to local courts, do not want to learn about the national judicial system and want to hide from public awareness and media attention. They a secret judgement far from the "public gaze" of those affected by the decisions and the flexibility of choosing "which rules of law should apply".³⁹

The website of the ICC and its International Court of Arbitration is upfront about who it is serving – "ICC arbitration is there for everybody in business. It is accessible to companies of all sizes, not just major corporations."⁴⁰ There are no references to the court providing any benefits to national governments, which are represented primarily as obstacles to profits and the bottom line.

'Corporations select ICC arbitration because they want to avoid accountability to local courts, do not want to learn about the national judicial system and want to hide from public awareness and media attention.'

'There are no publically accepted "customs and usages of the international petroleum industry" by which to construe and interpret contracts, and the ICC has no established policy code for oil.

Even though according to Article 27 "The interpretation and performance of this Contract shall be governed by the Laws of the Democratic Republic of Congo", the arbitration tribunal may rule that the law is only applicable in so far as it does not conflict with 'international law' (specifically investment law), and in case of conflict, the applicable law would be international law.

10.3 L'arbitrage aura lieu à Paris, en France, ou en tout autre endroit décidé par le «Contractant» et la «RDC». La procédure se déroulera en langue française. L'interprétation de ce Contrat par l'arbitre doit correspondre aux us et coutumes acceptés en général dans l'industrie pétrolière internationale.

"In construing and interpreting this Contract the arbitrator shall apply the generally accepted customs and usages of the international petroleum industry."

There are no publically accepted "customs and usages of the international petroleum industry" by which to construe and interpret contracts, and the ICC has no established policy code for oil. It is unclear what customs of the international petroleum industry the contract refers to - maybe standards of poverty in the Niger Delta, violence in Colombia, pollution of Exxon Valdez in Alaska or corruption in Azerbaijan?

Foreign arbitration was used effectively by French company Total to override regulation of its development of the Kharyaga field in Siberia, under a production sharing agreement (Russia's third) signed in 1995. That PSA specified that the development required regulatory approval of its budgets and development plans – a common provision in many contracts. In December 2003, the regional and federal governments did not approve Total's expenditure budget for the previous two years, objecting to the inflation of costs on the project. The regional governor warned, "The state should control investment and the state should know exactly how much and where investments have been made. I am against investments planned in order to avoid taxes". Total took the case to the Stockholm Arbitration Court. Although Total later admitted that some of its costs were indeed inflated, eventually the Russian authorities backed down in August 2005, and approved the two disputed budgets, in exchange for Total dropping the arbitration case.⁴¹

10. HUMAN RIGHTS, CONFLICT AND SECURITY

The contracts PLATFORM has obtained contain no clauses clearly claiming to cover security provision. However, a buried clause in Article 29 could be read as a blanket commitment by the Congolese government to provide militarised security whenever requested by the oil companies:

Article 29: The "DRC" will take all necessary measure to facilitate the performance of the activity of the "Contracting Party" [including] any other kind of assistance from the "DRC", in particular in the field of safety and operations."⁴²

Apart from this, there is no public agreement setting out the relationship between the oil companies and the military or police forces. Thus it is unclear what promises and guarantees the DRC government has made to ensure security and what rights the oil companies have been or will be awarded.

Given the fragile situation in Ituri,⁴³ the still limited and problematic role of the FARDC, the reliance on the United Nations mission (Monuc) for coordination and logistics, and the recent history of neighbouring states occupying strategic parts of eastern DRC to pursue their interests - including natural resource extraction - the issue of security will be paramount as exploration starts.

Private Military Companies (PMC) are already seeking to arrange contracts for oil security.⁴⁴ Observers think it inconceivable that the FARDC will be tasked with "protecting" camps, wells and installations. It is almost certain, then, that oil exploration will bring a re-militarisation of Ituri.

This leaves open critical questions, including:

- Do oil company security or private military contractors have the right or authority to arrest, injure or kill those they perceive as a threat?
- Do oil company security have the authority to deal with protest or opposition to oil extraction projects? Do the agreements exist providing indemnification of the company against liability for any human rights abuses arising?
- Do military contractors have the right or authority to interact with foreign forces?
- Has the DRC government promised to ensure security?
- Is the DRC government financially liable if there is a breach in security?
- Is the DRC government incentivised to prioritise security interests over the human rights of local populations?
- What role will "military trainers" from foreign governments play in coordinating security for the companies?

Military support for oil extraction operations by private companies has already begun in Uganda. Currently, a battalion of the elite Presidential Guard Brigade is responsible for the Uganda oil region. This military capacity is to be bolstered through imminent construction of a new military base on ten square miles at the top of the escarpment at Kyangwali, Hoima District. The site of the proposed base is currently occupied by 4,000 refugees, whose residents oppose eviction.

It appears that the UPDF will handle most, if not all, of the security in Uganda with training and assistance provided by Private Military Contractors and security companies, who currently include Saracen and Group4. The Ugandan army's presence in Ituri from 1998 to 2003 raises the prospect that Kampala might seek to protect its oil interest from instability by crossing the border – especially since a joint production area is likely.

The past record of oil companies shows that they are able to operate in conflict zones – although with a devastating impact on local people. For example, operating in Colombia in the 1990s during the civil war, BP funded army units implicated in serious human rights abuses, which employed a US-designed counter-insurgency strategy of dirty war, known as "draining the fish tank". Instead of fighting the guerrillas, the army and

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Will oil benefit the DRC?

'Heritage admitted to seeking consent to the [2002] deals in writing from the rebel leaders then in control of Ituri and North Kivu.'

pro-government paramilitary death squads targeted civilians considered sympathisers.⁴⁵

The oil companies operating at Lake Albert have themselves played an active role in conflicts on the African continent. Heritage Oil employed Executive Outcomes, composed primarily of white mercenaries previously in the apartheid South African Military, to drive UNITA rebels out of the Soyo region in north-western Angola where Heritage was extracting oil. Tony Buckingham, who remains the Director of Heritage, became a business partner in Executive Outcomes with South African Eeben Barlow. Executive Outcomes went on to spearhead Angolan military assaults onto UNITA-controlled oil areas.⁴⁶

Concerns over the oil companies' impacts on conflicts & human rights elsewhere appear to be well founded, given their activities since arrival in the region. If the Health, Safety, Environment and Quality (HSEQ) spending in the 2008 contract was used to provide support to the FARDC, it raises questions about where the stipulated annual payments of up to \$250,000 will go.

Heritage's activities in the area have been more complex – including alleged security and intelligence cooperation with the UPDF during the Ugandan occupation of Ituri (1998-2003).⁴⁷

Already in 2002, as the company signed a first memorandum of understanding with the DRC government, Heritage admitted to seeking consent to the deals in writing from the rebel leaders then in control of Ituri and North Kivu: the MLC (Mouvement de Libération du Congo) of Jean-Pierre Bemba, and the RCD-Kis/ML of Mbusa Nyamwisi. Both groups had Ugandan troops at strategic locations on their territory.⁴⁸

Also in August 2007, the Congolese government accused Heritage Oil of opening fire on its forces and "carrying out illegal exploration".⁴⁹ Throughout 2008 the Congo government claimed that "Tullow and Heritage Oil had breached the border on Lake Albert, with support from the Ugandan army, leading to eight Congolese fatalities", according to the BBC.⁵⁰

Even prior to exploration beginning in DRC, worrying trends are already emerging: secrecy, cooperation with militias, the arming of security forces by companies, and clashes at borders and extraction sites. In this context, these tensions are likely to accelerate and escalate further once the oil is being pumped and enormous revenues are at stake.

The oil contracts in DRC do not provide enforceable protection standards regarding the environment or human rights of Congolese citizens, relying on the oil companies to operate reasonably and altruistically. Yet despite their promises of corporate responsibility, the oil companies' foremost legal responsibility is to maximize profits for their shareholders – other commitments can be sacrificed to achieve this. The failure of the contracts to protect DRC interests is compounded by the weakness of the central government, the absence of a robust regulatory regime and the political and social fragility of Ituri itself.

Internationally, there is a wealth of evidence that most oil-dependent economies tend to show poorer economic development outcomes than those of countries without oil; the key determining factor as to whether positive or negative outcomes are achieved is "the type of pre-existing political, social and economic institutions available to manage oil wealth as it comes on-stream"⁵¹. Thus if there is a lack of public sector capacity to develop the oil, this will almost certainly extend also to environmental and economic regulatory functions, negotiating contracts and monitoring and regulating performance – all crucial elements in obtaining any positive developmental, social and environmental outcome from investment.

In this context, it is clear that extracting the oil discovered in the Albertine Graben is highly unlikely to bring overall benefits in terms of economic development, let alone environmental protection or human rights to the region. The DRC government and companies involved dislike comparisons with Nigeria, Angola, Ecuador or other oil-producing countries in the global south, asking why the focus is on those countries with negative social & economic outcomes from oil. Instead communities around Lake Albert should apparently wait to be transformed into Africa's new Norwegians. But the reality is that the political, economic & social context of both eastern DRC and Uganda is not that of Norway – and development outcomes will differ accordingly.

The honest reality is that extracting the millions of barrels of crude is most likely to exacerbate poverty, distort the economy, weaken other more labour-intensive sectors of the economy including agriculture[iii], increase human rights violations, entrench the power of military forces, escalate tensions across borders, create new health problems for local communities, increase both intentional corruption and revenue mismanagement, reduce wildlife stocks and pollute the land, water and air.

Extracting the oil will not lead to a "win-win" situation – unless expectations of "winning" are limited to increased profits for the oil companies and local elites. Talk of a possible "win-win" situation contributes to building up a false and unrealizable hope, while distracting from the far more likely negative impacts.

As crude is being extracted from Lake Albert on the Ugandan side, and exploration is expected to begin in Congo, the task at hand is to reduce the negative impacts of these operations. This involves both renegotiation

'Extracting the oil discovered is highly unlikely to bring overall benefits in terms of economic development, let alone environmental protection or human rights to the region.'

‘The terms of DRC’s Production Sharing Agreements should be renegotiated, to reduce the likelihood that these contracts will undermine the economy, sovereignty, stability, environment and human rights.’

of existing contracts,⁵² and ensuring that future contracts for new blocks and the model PSA used in talks with investors are changed to better protect communities’ interests.

Given that DRC has now announced that it will open up 16 licenses for oil exploration at Lakes Tanganyika and Kivu , and the PSAs for SacOil in Block 3 and Dominion Petroleum at Block 5, remain undisclosed, this report makes the following recommendations:

- Urgent changes should be made to the contracts, legislation and regulatory regime covering oil, to achieve some level of environmental protection, ensure accountability for military forces enforcing security, to protect a degree of Congolese sovereignty, minimize economic distortion through revenue flows, and capture a more appropriate share of the revenues and to re-apportion the economic risks.
- The proposed new oil code seems to provide a broad framework for contractual terms but the key provisions in particular licenses will still be left open to negotiation between the government and companies in any particular block. It should be made public and open to local communities’ views.
- The terms of DRC’s Production Sharing Agreements should be renegotiated, taking into account the above analysis of each clause, to reduce the likelihood that these contracts will undermine the economy, sovereignty, stability, environment and human rights.
- Such a renegotiation must ensure that environmental protection is prioritized during both exploration and production, with clear lines of accountability, high enough fines to act as deterrents against failures and pollution and enforced reinstatement of land and water to prior conditions.
- Economic terms of the oil contracts must be revised to ensure that DRC benefits from ‘upside’ including high oil prices and does not carry disproportionate risks from increased costs. The
- Congolese government should receive a greater and appropriate portion of economic rent; the oil companies should not make excessive profits at the country’s expense.
- Reducing the developmental impacts requires a systemic improvement in transparency on the part of the government and the companies, and an end to secrecy covering contracts, revenue and democratic involvement of DRC’s citizenry is crucial. There need to be clear practical lines of accountability for the government, in which local communities and citizens have a say and an impact.
- Minimising the negative impacts of sudden major revenues flows requires a public, thorough and long-term plan for oil revenues, in which the revenues do not merely enter the standard national budget.
- “Security” arrangements for all oil operations, including sites of extraction and any pipelines, must have the support and involvement of local communities (footnote to cadre de concertation stuff CHECK). They must not be controlled by forces with a history of human rights abuses, whether national, militia or private military contractors.
- The exploration of oil may start as soon as the end of 2010 and the government is seeking a rush to production within five years; but going slower now and putting the right contracts, regimes and regulations in place is more important than early bonus payments and political capital.

‘There need to be clear practical lines of accountability for the government, in which local communities and citizens have a say and an impact.’



Lake Albert. Photograph by Taimour Lay

Production Sharing Agreements

The PRODUCTION SHARING AGREEMENT (PSA) is a complex contractual structure. In theory, the state has ultimate control over the oil, while a private company or consortium of companies extracts it under contract. In practice, however, the actions of the state are severely constrained by stipulations in the contract. In a PSA, the private company provides the capital investment, first in exploration, then drilling and the construction of infrastructure.

The first proportion of oil extracted is then allocated to the company, which uses oil sales to recoup its costs and capital investment – the oil used for this purpose is termed ‘cost oil’. There is usually a limit on what proportion of oil production in any year can count as cost oil. Once costs have been recovered, the remaining ‘profit oil’ is divided between state and company in agreed proportions.

The company is usually taxed on its profit oil. There may also be a royalty payable on all oil produced. Sometimes the state also participates as a commercial partner in the contract, operating in joint venture with foreign oil companies as part of the consortium – with either a concession or a PSA model. In this case, the state generally provides its percentage share of development investment and directly receives the same percentage share of profits.

An ingenious arrangement, PSAs shift the ownership of oil from companies to state, and invert the flow of payments between state and company. Whereas in a concession system – a model adopted in Bas-Congo by French oil producer Perenco - foreign companies have rights to the oil in the ground, and compensate host states for taking their resources (via royalties and taxes), a PSA leaves the oil legally in the hands of the state, while the foreign companies are compensated for their investment in oil production infrastructure and for the risks they have taken in doing so.

When first introduced in Indonesia in the 1960s, many in the oil industry were initially suspicious of Indonesia’s move. However, they soon realised that by setting the terms the right way, a PSA could deliver the same practical outcomes as a concession, with the advantage of relieving nationalist pressures within the country. In one of the standard textbooks on petroleum fiscal systems, industry consultant Daniel Johnston comments:

“At first [PSAs] and concessionary systems appear to be quite different. They have major symbolic and philosophical differences, but these serve more of a political function than anything else. The terminology is certainly distinct, but these systems are really not that different from a financial point of view.”

So, the financial and economic implications of PSAs may be the same as concessions, but they have clear political advantages – especially when contrasted with the 1970s nationalisations in the Middle East.

Professor Thomas Wälde, an expert in oil law and policy at the University of Dundee, describes them as:

“A convenient marriage between the politically useful symbolism of the production-sharing contract (appearance of a service contract to the state company acting as master) and the material equivalence of this contract model with concession/licence regimes in all significant aspects... The government can be seen to be running the show - and the company can run it behind the camouflage of legal title symbolising the assertion of national sovereignty.”

Input Data

PLATFORM’s models are based on the fiscal terms of the 2006 Tullow/Heritage contract for Block 1 & 2, and the 2008 Divine Inspiration/H Oil contract for Block 1. The Uganda comparison is based on Tullow’s PSA for Block 2, and the Iraqi Kurdistan model on Heritage’s PSA for Miran.

If not stated otherwise, we are assuming a field size of 1,032 million barrels of recoverable oil, capital expenditure of \$2,319 billion, fixed operating costs (excluding variable operating costs, transport costs and development costs) of \$2.5 per barrel and a discount rate of 12%.

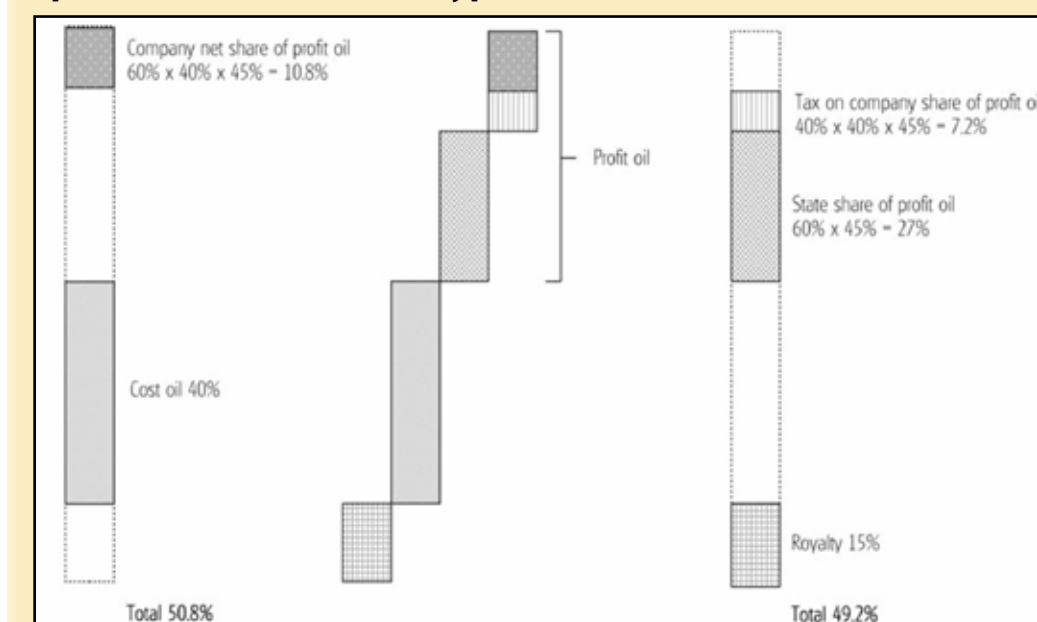
Following public statements by the DRC government that they aim to finalise approval of contracts in 2010 and are pushing for oil extraction to begin within 4-5 years, the model assumes first oil in low volumes in 2015, followed by a ramp-up and plateau from 2021. Following Credit Suisse, we have assumed a pipeline tariff of \$7 per barrel.

Given the early pre-exploration stage it is difficult to predict costs or field size. The assumptions made in this report do not form a prediction by PLATFORM of the likely outcomes. Our input data is based on figures for Ugandan Blocks 1, 2 and 3 obtained from Tullow Oil and Heritage Oil reports to their shareholders and stakeholders, and detailed analyst reports to investors. While reserves and costs in Congo’s Block 1 & 2 will not necessarily be the same as in Uganda, the fact that the blocks are adjoining means that geological structures, infrastructure, cost contexts and geography are comparatively similar.

We have tested our models with a variety of field sizes, development & operating costs and discount rates.

Wherever there was an option or a doubt over terms or data, we have opted to make conservative assumptions – those that will lead to lower profits for the companies and higher revenues for the government. This means that our conclusions represent a best-case scenario for the DRC government, and a worst case scenario for the oil companies involved.

Split in revenues from a hypothetical PSA



Endnotes

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- 4** "How to negotiate the 'right' Mining Agreement", Jenik Radon, Colombia University.
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- 7** Final validation in 2010 is not a foregone conclusion. The latest release of revenues under the EITI process gave an incomplete picture. <http://www.eiti.org/news-events/dr-congo-publishes-its-first-eiti-report>
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- 9** "Best of the Worst", The Independent, 22.12.09, www.independent.co.uk/index.php/.../2297-best-of-the-worst
- 10** 'Contract Curse: Uganda's oil agreements place profit before people', February 2010. Full report and Uganda's Production Sharing Agreements available in English at www.carbonweb.org/uganda.
- 11** For a more detailed explanation of Internal Rate of Return and how it is calculated, see PLATFORM's report "Crude Designs" http://www.carbonweb.org/documents/crude_designs_small.pdf
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http://www.norad.no/en/_binary?download=true&id=49168
- 15** Congo Petroleum & Gas and Sud Oil lose \$47 million in revenue in the high-cost scenario.
- 16** Confidential source interview with Taimour Lay, March 2010
- 17** Confidential source interview with Taimour Lay, March 2010
- 18** <http://www.tulloil.com/corporate-social-responsibility/casestudies/casestudies.asp>
- 19** Heritage Oil & Gas, Cost recoverability audit, conducted by Ernst&Young, available at http://www.platformlondon.org/carbonweb/documents/uganda/090407_Heritage_Oil_Audit_MEMD_Ernst&Young.pdf
- 20** <http://www.chevrontoxico.com> (ecuador)
- 21** <http://www.sakhalin.environment.ru/en/> (russia)
- 22** <http://www.eraction.org> (niger delta)
- 23** "How to negotiate the 'right' Mining Agreement", Jenik Radon, Colombia University.
- 24** "Oil Spills: The deterrent effect of Monitoring, Enforcement & Public Information", Mark A. Cohen, Resources for the Future, 20.04.2009.
- 25** "Oil Spills: The deterrent effect of Monitoring, Enforcement & Public Information", Mark A. Cohen, Resources for the Future, 20.04.2009.
- 26** This \$1.5m spending was reported at the time by the UN and other local sources, though misattributed to Heritage Oil & Gas. Divine Inspiration have since confirmed to PLATFORM that they were responsible for the HSEQ deal.
- 27** Although it is important to note, as Jenik Radon has, that "even these nations have still not fully addressed the issue of mandating the corporatization of public external costs caused by a company,

leaving many matters to be resolved by the vagaries of tort laws."

- 28** Heritage's Production Sharing Agreement for Block 3A in Uganda has been made available online at www.carbonweb.org/uganda
- 29** Available in English at "Contract Curse"
- 30** "Contracts Confidential: Ending Secret Deals in the Extractive Industries". Revenue Watch International, September 2009
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DEMOCRATIC REPUBLIC OF CONGO

0 100km

LEGEND

- Permits
- Albert Graben
- Country Border

