Chapter 3

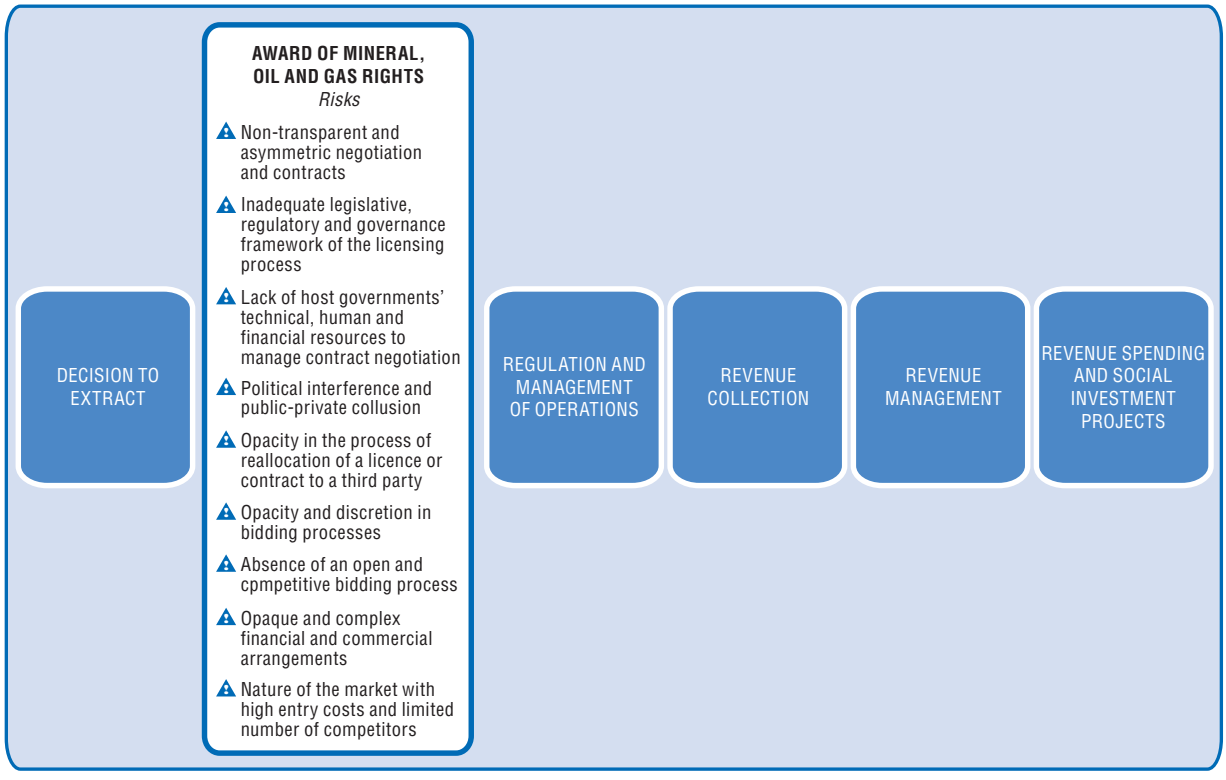
Corruption risks in the award of mineral, oil and gas rights

This chapter identifies corruption risks arising in the award of mineral, oil and gas rights through direct contract negotiations or a competitive bidding process. It further describes in detail the schemes, parties involved and mechanisms used to channel corrupt payments. Recommended mitigation measures are addressed to home and host governments, donors and extractive companies.

With the exception of the United States and some Canadian provinces, governments generally retain ownership over sub-soil natural resources. The acquisition of a licence or contract does not imply that the ownership of the sub-soil resources is also transferred. Governments retain the rights to their resource endowments and they decide who should undertake exploration and production of oil, gas and minerals and under what terms. Exploration and exploitation rights may be allocated through different mechanisms, depending on the type of resource and the size of the deposit.[1] The contractual form of the agreement can range from a concession, licence (permit for exploration and lease for exploitation) to a production sharing agreement in the oil and gas sector or a mineral development agreement in the mining sector. Rights can be granted by governments through open door mechanisms (first come, first served basis or direct negotiations with one or more interested investors) or through a competitive bidding process.

Regardless of the system used, the allocation of rights to explore and produce minerals, oil and gas is a heightened risk of corruption.

Figure 3.1. **Corruption risks in the award of mineral, oil and gas rights**



Contract negotiation

This section covers corruption risks in contract negotiation, regardless of the type of award and including instances where countries adopt an open door policy for the allocation of rights (either through a first come, first served basis or by entering into direct negotiations with one or more interested investors). These negotiations may take place at different stages of the extractive production cycle.

Corruption schemes

Trading in influence, political capture and interference

Corruption risks associated with contract negotiations may take the form of trading in influence, political capture and interference. Trading in influence is the process or act by which a person who has real or apparent influence on the decision making of a public official exchanges this influence for an undue advantage (OECD, 2008a). Political capture or interference refers to private interests significantly influencing decision-making processes of public officials to their own advantage.

In contract negotiation the typology of corruption risks includes the exercise of undue influence to gain favourable contractual terms (including the application of favourable royalty rates in violation of national laws), or to get permit approvals, even in breach of national laws, or to gain access to commercially sensitive information. In doing so, companies may offer or be solicited to provide improper advantages in the form of anything of value, such as illegal commissions, gifts and entertainment (i.e. first class flights, expensive hotels, dining, school fees), job or business opportunities to public officials and politicians or their family members, with a view to unduly influencing the negotiation process.

In an iron ore producing country, the government granted mining rights over one of the largest untapped deposits in the world, with a potential for revenue generation estimated at about USD 140 billion over 20 years. The company paid nothing up front to obtain the rights and allegedly invested USD 165 million in exploration works before selling a 51% interest in the project to another company for USD 2.5 billion. The mining rights were later terminated following an administrative review of allegations that the company obtained its rights only after gifts and cash given to members of the then-president's family.

Local content requirements can be part of the corruption scheme during the negotiation phase. Local content requirements generally refer to obligations enshrined in law or included as part of licensing, procurement agreements or other contracts. This may include employment or inputs, goods and services procured from local sources, locally hired workforces, operations carried out in partnership with local entities, development of enabling infrastructure, the improvement of domestic capacity, or the improvement of local technological capabilities. Where the negotiation process is not transparent and highly discretional, public officials responsible for the award of contracts or licences may force companies wishing to operate in the country to enter partnerships or sign service contracts with particular companies (Martini, 2014). The associated risk in this case arises from favouring a particular company on the basis of family ties, party affiliation or ethnicity rather than on the basis of qualifications such as technical expertise, financial capability and reputation.[2] In the corrupt scheme, the local partner may make no significant contribution to the venture itself, with value accrued to the corrupt official, without any cash changing hands. Otherwise, the cost of the service, which may not be performed in practice, functions as a bribe.

Risks of trading in influence or political capture may also arise in the context of contract renegotiation as a result of a regime change. Companies may be prone to accommodate some of the demands of the new government while protecting the economic terms of the agreement by dumping old partnerships and accepting new local partners with strong links with the new government (Chêne, 2007). Companies may also make gifts or facilitation payments to influence political decisions and deter the government in place from renegotiating or changing the rules of the game (e.g. increasing the price of resources sold by the state).

Favouring companies in which public officials have an ownership stake

Several cases of conflicts of interest were reported by participants in the Working Group on Corruption Risks. These include for example the involvement in the decision-making process of high-level politicians who had previously provided consultancy services to the same companies. In another case, a public officer was holding a position both in the operating state-owned enterprise and in the overseeing body in charge of approving extractive projects. Similarly, a public official holding both the position of president of the board of a state-owned enterprise and the position of administration and financial manager of a private company was left with the task to arbitrate on contractual interpretation differences between the two companies. The dispute was ultimately solved in favour of the private company. Participants further reported the case of a president of a state-owned enterprise advising private companies with business activities with the state-owned enterprise and billing them for the services provided through third parties.[3]

Embezzlement and misappropriation of public funds

Contract negotiation may offer the opportunity to divert public funds for the benefit of private interests. The press and literature reports a case currently under investigation where public funds were allegedly misappropriated in the context of the acquisition of a licence by foreign companies from a government. It is alleged that the public funds generated by the deal were transferred to a company in which a former high-level politician held substantial beneficial interest. It is alleged that the licence had been previously awarded to that company by the high-level politician therefore implying that the company, not the government owned the licence. It is alleged that the money paid was then transferred abroad to multiple shell companies with hidden beneficial owners so as to conceal the proceeds of the transaction. The proceeds of the transaction were frozen in two foreign jurisdictions.

Lack of transparency in contract negotiation is conducive to corrupt conduct aimed at circumventing or violating existing legal provisions for the payment of royalties and taxes. Provisions negotiated in secret contracts may set ridiculously low corporate tax rates compared to the national rate. In a post-conflict country, the High Level Panel on Illicit Financial Flows reports the case of a company that had negotiated a corporate tax rate at only 1.43%. In another instance, a hidden contract set the royalty rate for the extraction of a mineral at 20% of the rate established by law. The disparity in the values illustrates the potential loss of revenues from secret and unbalanced contracts in the extractive sector (AUC/ECA, 2015). The review of contracts awarded in another country's principal gas producing area revealed that royalties were set below the percentage prescribed by law, following a different methodology. Similarly, a contractual clause setting a fixed percentage of royalties had been negotiated in violation of national legislation providing for variable royalty rates depending on technical and economic factors.[4] The revenue generation potential of the contract may be further undermined by asymmetries of

information between governments and companies, where companies often have more information about the quantity and quality of the mineral deposits covered by the contract. The UN High Level Panel on Illicit Financial Flows reports several cases where secret and unbalanced contracts severely eroded the revenue generation capacity of the host country.

Parties involved

Politicians and central or local government officials with conflicts of interest, local partners, consultants, advisors and intermediaries as well as foreign companies may act indistinctly as instigators or beneficiaries of corrupt acts. Officials of state-owned enterprises may also be involved in corrupt schemes that are tainted by conflicts of interest.

Some cases demonstrated that corruption schemes can be linked to broader foreign policy interests involving for example high-level officials and politicians from the company's home country (OECD, 2012).[5] The involvement of home country governments or politicians can either be driven by security concerns or out of economic and commercial interests in promoting their companies abroad. In such cases, the corruption scheme may not only involve money but also promises of economic assistance and/or political or military support (World Bank, 2007).[6]

Vehicles and mechanisms

Shell companies and fronting to comply with local content requirements

When companies are obliged to enter into joint ventures with local companies to operate in a country, local content requirements may be used as a mechanism to perpetuate elite capture and rent-seeking, and to generate revenues for government-affiliated individuals or government-favoured partners, based on their ethnicity, loyalty or close ties with public officials. In this case, shell companies may be used as a way for politicians to disguise the award of contracts to companies in which they or their proxies hold interests (Martini, 2014). The literature reports the case of a country where companies owned by government officials would commonly bid for licences in consortia with foreign groups and would receive a percentage of the total contract the company gets if successful (World Bank, 2007).

Shell companies can also be used as a conduit to divert public funds and channel payments to the real beneficiaries of the transaction. On the other hand, foreign companies may use shell companies to circumvent local content requirements or simply give the appearance of compliance through the use of "fronts" with a PO box registered locally in order to secure the contract. Companies can also pay illegal fees to contract front companies in order to pay lip service to host country laws (World Bank, 2007).

Signature bonuses and intellectual services

Signature bonuses can constitute a pool for bribery payments and embezzlement of public funds. The signature bonus is commonly used in contracts and licences in the oil and gas sector. It consists of a one-off payment made by the company up front to the host country for the right to develop a block. This system is a widely recognised and legally accepted way for an oil company to secure the right to explore a certain field or block (Global Witness, 2009).

However, signature bonuses might be prone to corruption due to the non-uniform criteria used to define their size. The amount of the bonus varies according to the block's

size and prospective wealth. In addition, the signature bonus' level is set relative to the royalty rate, which renders it difficult to predict and calculate (McMillan, 2005). In recent years, the size of signature bonuses has skyrocketed particularly in major oil and gas producing countries (Niekerk and Peterson, 2002). Considering the amounts potentially at stake, signature bonuses may be used as a mechanism to conceal big corruption schemes.

In fact, a problem with signature bonuses, apart from their size, may regard their destination. In several major corruption scandals, a share of the signature bonus was assigned to an offshore account and did not appear in the public financial accounts (Global Witness, 2009). Furthermore, signature bonuses may not clearly appear in corporate financial reports, as expenditures may be disaggregated into broad categories in annual reports.

Other contractual terms may serve as possible vehicles to disguise improper payments. These include provisions on cost recovery or on profit sharing. Typically used in profit sharing agreements in the oil sector, cost recovery and profit sharing clauses define respectively the share of profit used to recover capital and operational expenditure, also known as "cost oil" and the split of the remaining profit, also known as "profit oil" between the government and the company. Given the difficulty of estimating the volume of recoverable oil in a particular field, and the substantial risks associated with exploitation, most operators serve under a cost recovery basis rather than seeking complete compensation for these risks. The ceiling amount and nature of items that can be included in the cost recovery scheme vary significantly, and are therefore central to the negotiations of contracts and will vary depending on a variety of factors, including characteristics of the block, local conditions to extract, international market prices, etc. Since the percentage share of profit to the oil company is fixed in the contract, risk of corruption may arise when determining how the cost should be calculated as this will impact upon operators' real profits (Al-Kasim, Søreide and Williams, 2008).

The provision of intellectual services by local consultants to the company can also be used as a vehicle to channel illegal payments. The selection of local consultants may be tainted with conflicts of interest where they present close ties with public officials and decision makers in the negotiation.[7]

Corruption risks

Non-transparent and asymmetric negotiations and contracts

Asymmetries of information between the negotiating parties as well as the lack of transparency in contract negotiations (Transparency International, 2012) constitute major risk factors for corruption in the negotiation phase. Indeed, opportunities for corruption may arise when no document is produced to support each party's proposals, report on parties' positions throughout the negotiation process, and compare the outcomes of the negotiation against the initial objectives.[8]

Non-transparent negotiations provide the ideal setting for the exchange of abnormal and non-traceable cash payments (e.g. for fees and commissions) by exempting parties from justifying their size and destination. Moreover, the disclosure of the list of awarded licences and contracts (e.g. cadastral survey map of the rights and applications, etc.) is still not common practice in many producing countries. Where transparency rules and disclosure standards exist, they may not be enforced or fall short of international disclosure standards. Finally, host governments may not provide incentives, and in some cases clearly

disincentivise the disclosure of contracts. It is alleged that the government of an oil producing country threatened to cancel the production sharing agreement of a company that had started disclosing its annual production and payments data (McMillan, 2005).

Inadequate legislative, regulatory and governance framework of the licensing process

Corruption risks may arise from inadequate, ill-designed legislation and regulations that govern the different aspects of the contract under negotiation. Legislation granting discretion to select the mechanisms for the award of rights may be a source of risk. Similarly, the lack of expertise and capacity of local businesses that deviate a long way from industry or international standards presents some risks when national legislation requires companies to partner with local entities.

Governance arrangements overlooking the need for independent oversight and monitoring of the licensing process and parliamentary scrutiny may also introduce governance vulnerabilities that allow corruption to thrive.

Lack of host governments' technical, human and financial resources to manage contract negotiation

The insufficient technical, human and financial capacity of host governments managing negotiations is among the factors that render government's susceptible to corruption risks. For example, the lack of supporting technical and economic baseline documents may undermine the government's position. Weak administrative capacity may also result in unreasonable delays in licensing approvals that corruption may exacerbate or avoid.

Political interference and public-private collusion

Political interference and public-private collusion in the negotiation phase are also enabling factors for corruption, and typically rely on informal clientelistic networks between public officials, civil servants, traditional leaders and business elite (McMillan, 2005) at both local and central levels (McMillan, 2005). The so-called "revolving door" phenomenon may also foster collusion and political interference with individuals frequently switching between high-level positions in the public and private sectors.[9]

Opacity in the process of reallocating a licence or contract to a third party

Risks associated with acquiring a licence or contract by a third party include the lack of effective corporate anti-corruption compliance and due diligence to verify the conditions and circumstances under which the licence or contract was initially acquired. For government, risks may include the lack of clear guidance and procedures to address allegations of corruption on a licence initially acquired under opaque conditions before reallocating it to a third party.

Recommended mitigation measures

RISK FACTORS	RECOMMENDED MITIGATION MEASURES
Non-transparent and asymmetric negotiation and contracts	***What host governments can do*** ● Involve technical and legal experts from all relevant ministries and other relevant public bodies in the negotiation team (ECDPM, 2013). Publish the list of the negotiation team members, with full description of members' curriculum and profile.[10] ● Enable access to critical data including, for example, on geological potential, for all parties involved in the negotiation. ● Draw up and publicly disclose a list of criteria under which contract renegotiation is possible.[11] ● Develop standardised models or guidelines for licence and contract terms in order to minimise discretion in contract negotiation (Chêne, 2007; OECD, 2015). ● Require that contracts, annexes and licences detail the specific rights associated with the licence and ensure that the specific location of the assets covered by the licence are fully disclosed and open to scrutiny in publicly available registries, with any exceptions or limitations defined by law. Make this information available online in open electronic formats where capacity exists (EITI, 2015b). Where the contracts, annexes and licences affect a local community, make sure that they are translated into the local community's language, if it differs from the national language.
Inadequate legislative, regulatory and governance framework of the licensing process	***What host governments can do*** ● Clearly stipulate in law the rules and procedures governing the choice of the mechanisms for the award of extraction rights (direct negotiation or bidding process) as well as roles and responsibilities. ● Strengthen existing institutions and regulatory frameworks or consider establishing a separate, autonomous and effective body or regulatory institution that oversees the allocation, renegotiation and implementation of contracts (Chêne, 2007). ● Ensure appropriate mechanisms for parliamentary oversight are in place. These may include review of key contracts by parliament for final approval (ECDPM, 2013). ● Mandate independent audit and monitoring of contract implementation, which may involve assisting local communities in developing specific community-based monitoring tools.[12]
Lack of host governments' technical, human and financial resources to manage contract negotiation	***What host governments can do*** ● To the extent possible, favour automation of administrative services in order to reduce permitting and approval delays.
Political interference and public-private collusion	***What host governments can do*** ● Enact strict rules to prevent or limit the "revolving door" phenomenon between government and the private sector, for example by introducing a cooling-off period preventing former high-level officials taking employment with any company with which they have been negotiating deals during a certain period after they left office (OECD, 2004; OECD 2010).[13] ● Ensure that extractive projects carried out through joint ventures are subject to rigorous anti-corruption safeguards, including due diligence on business partners for the purpose of preventing conflicts of interest.[14]
Opacity in the process of reallocation of a license or contract to a third party	***What host governments can do*** ● When the awarding of a licence is allegedly tainted with corruption, define a process for re-awarding the licence in a transparent manner so as to ensure that the new licensee will not bear responsibility for wrongful acts committed by the former licensee. ***What companies can do*** ● Undertake comprehensive due diligence to understand the past history of extraction rights and assets at stake, including how these were first acquired and under what conditions they were transferred to other owners afterwards.[15]

Award of mineral, oil and gas rights through a bidding process

Corruption in the award of mineral, oil and gas rights through a bidding process may serve diverse objectives. First, it can be intended to secure favourable treatment in the bidding process by bypassing or rigging control and evaluation procedures or by disqualifying legitimate bidders. Second, it can be used to simply avoid a public bidding process or circumvent specific bidding requirements such as local content obligations. Third, companies' executives may bribe government officials in order to access confidential information on competitive bids and revise their own bids accordingly.

Corruption schemes

Different types of schemes can be observed to achieve these objectives. These include favouring in the bidding process companies in which public officials or their affiliates have

a stake through tender evaluation criteria or pre-qualification of bidders. There is also the potential to bribe for bid exclusion, with companies paying to have a competitor somehow disadvantaged in the competitive process. The performance of bidders in the bidding process can further be assessed against a range of local content criteria, including the score attributed for the implementation of government programmes aimed at benefitting disadvantaged groups.

Favouritism and political capture through tender evaluation criteria and pre-qualification of bidders

Bidding processes may be rigged by political capture, patronage and conflicts of interest. There are instances in which tender evaluation or the rules for contract award provide for eligibility thresholds or criteria rewarding the offer of local content. For example, the award of an oil licence through a bidding process may require the formation of consortia or joint ventures between the foreign company and a local firm (or a businessman) or a state-owned enterprise. The obligation to form a joint venture with a local partner may be diverted from its initial objective of local capacity development to favour companies owned by or connected to public officials and serving in politicians' interests. For example, Transparency International reports the case of an oil and gas producing country where a foreign company entered into a consortium with two local companies to bid for certain oil blocks. It turned out that the real owners of one of these local companies were the former chairman and CEO of the state-owned enterprise and a minister of state (Martini, 2014).

In some countries, indigenous companies are also pre-qualified to bid for shares in such licences, even though the beneficial owners remain undisclosed. In some instances, senior public officials turn out to be the ultimate beneficiaries of valuable shares in the project.

In another pending case involving a bidding process for the award of exploration rights in oil blocks managed by a state-owned enterprise, the formula used for the qualification of oil enterprises and the selection of the best offer was modified to favour one company in the bidding contest. The change in the weight of scores downplayed the importance of royalties, despite a scenario of rising oil prices. Moreover, the qualifications and capacity of the company with regard to high-risk investment in exploration had not been verified by the government and their evaluation was solely based on a sworn unilateral declaration by the company.[16]

Abuse of office in the bidding process

The bidding process may be rigged by corrupt practices resulting in the biased selection of one bidder over others. This can result from crafting the bidding terms so as to favour one particular company over its competitors. Another typical corruption scheme involves the disclosure of confidential information on competitive bids to allow the company to revise its own bid accordingly. Abuse of office by politicians or high-level officials or bribery payments may also serve to circumvent the bidding process. The literature reports the case of a country where companies owned by government ministries commonly bid for licences in consortia with foreign groups receiving a percentage of the total contract secured (World Bank, 2007). After the awarding and the signing of the contract, some of the contractual obligations (provision of services, hiring of local people) incumbent on the winning bidder may also be modified to his benefit. These changes may be due to dealings between public officials and the winning bidder prior to the bidding process, or even after the award. In either case, this violates the principle of equal treatment of the bidders.[17]

Corruption associated with bid rigging (collusive bidding or bid exclusion)

Collusive bidding occurs when conspiring bidders manipulate a competitive public bid in such a way that a preselected bidder wins the bid. Colluding companies submit defective bids in order to allow a preselected bidder to win the bid while giving the appearance of competition. Collusive bidders may also submit complementary bids from shell companies or affiliates to further give a semblance of competition (OCDE, 2009a; World Bank, 2007).

Unlawful bid exclusion prevents potential bidders from bidding through pressure and threats. Bribe payments may also be made to companies in exchange for withdrawal, or to government officials in exchange for disqualifying legitimate bidders or providing confidential information about competitive bids (FATF, 2012b).

Parties involved

The instigator of a corruption scheme during the bidding process can either be the private agent, the public or state-owned official exerting pressure and trading its influence over the decision-making process or an intermediary/third-party, agent/subsidiary facilitating the deal. In the case of collusive bidding, bid rigging takes place among conspiring bidders without the knowledge of the public officials who are in charge of overseeing the bidding process itself. Yet, in some instances, collusive bidding may involve corrupt public officials, in particular when the size of the project requires government backing to conceal the reduced cost of access to resource and to preserve a semblance of competition. The cartel or chosen company may also bribe public officials to overlook any instances of collusion.

In several cases, particularly in the oil and gas sector, the officials involved are executives of state-owned enterprises. Yet, they may also come from ministries and/or central or local government authorities that oversee the bidding process or have a say in the final approval of the bid. In some cases, the corruption scheme involves politicians at the highest level (president, minister, etc.) abusing their authority and accepting gifts or bribes. However, illegal payments may also be made to lower-ranking officials such as engineers responsible for the technical evaluations of bids. In the different bid-rigging schemes described above, the government officials involved may receive compensation in the form of cash payments, in-kind contributions or a share of the contract value over a certain period of time, and in return for awarding the contract.

On the private side, top executives from the private entity (CEOs, country managers, etc.) are typically involved in complex deals. More specifically, the company's entity involved or initiating the bribery is often the subsidiary operating in the country or a foreign subsidiary. Furthermore, there might be the risk for third companies that have previously acquired a licence or concession through an opaque processes of being held liable or subject to threats and pressure by corrupt officials to perpetuate the corruption scheme.

Vehicles and mechanisms

The use of third parties including intermediaries

The use of third parties to facilitate an improper deal is a common feature in the different cases documented above. An intermediary "can act as a conduit for legitimate economic activities, illegitimate bribery payments, or a combination of both" (OECD, 2009b). Third parties can refer to a diverse range of actors, including agents, consultants or consulting firms, providers of intellectual services, joint venture partners, subsidiaries, business partners such as lawyers and accountants (OECD, 2009b). The role played by the

intermediary in the corruption scheme, whether it is active or passive, may depend on the circumstances. It could either be as facilitator or the mastermind behind the corruptive behaviour. The decision to hire or operate through an intermediary may be made by public officials or the company itself. It can also be imposed by the jurisdiction requiring the employment of a local agent for any business transaction in the local market. In some cases, the intermediaries may even be designated by government officials. In this type of situation, it is possible that the intermediary is the mastermind of the criminal enterprise, operating without the company's knowledge (OECD, 2009b).

The improper use of intermediaries by the parties (the company or foreign officials) may have distinct objectives. They can be used to make payments, convey the offer or promise to bribe or influence the decision-making process. In this case, intermediaries will generally be local agents or business consultants more familiar with the local business environment and with close political ties, sometimes belonging to the circle of friends or family members of the corrupted public officials purportedly hired to provide consultancy and advisory services to the company. Instead, they use their personal relationship with government officials to influence the decision-making process, and to obtain favourable treatment or confidential information about the bidding process. They may not provide any identifiable or economically justifiable services or, alternatively, perform a combination of legitimate and illegitimate services (OECD, 2009b). In the former case, the consultant charges the company using false invoices for sham services; forwards the funds to the official and receives a fee or retains a certain percentage of the funds transferred. When intermediaries trade their influence in return for an undue advantage from the company, the public official may not receive any advantage personally and be unaware of the corrupt deal (OECD, 2008b). In all these instances, false invoicing and fake documentation are often used to provide a seemingly legitimate cover for the payments such as the provision of legal, administrative or consulting services. This allows the company to disguise such payments on their books or records as loans, consultancy fees, and payments for legal services. Such payments are referred to as broad categories of expenditures using general, vague and non-descriptive language such as "supporting the company's business in country X", "conducting (market) research", or "establishing necessary contacts" (OECD, 2009b).

Third parties, including intermediaries, can also be used to conceal such payments and distance oneself from the crime. In some cases, the bribe is conveyed to a third party beneficiary, such as a spouse or other family member, business party, political party, charity or company in which the public official has an interest.

A number of alternative or complementary techniques may be used to further increase opacity of corrupt relationships. Though intermediaries are commonly locally based in the country, the parties involved may sometimes rely on a third-country agent to make improper payments more difficult to track. The corruption scheme may also involve multiple layers of transactions between related companies in order to add complexity and increase the difficulty of gathering evidence.

Joint ventures

Joint ventures may add another layer of complexity and opacity in the chain of payments: i) by making each partner dependent on the level of integrity of the other joint venture partner(s), in particular of the leading partner dealing with the host government and/or operating the joint venture, ii) by using themselves as intermediaries. This may render transactions more vulnerable to corruption risks if proper due diligence is not

carried out across the chain. In the latter case, improper payments are typically made by the joint venture through the intermediary and generally disguised as commissions.

Joint ventures constitute particularly effective instruments for concealing bribery payments, particularly in the case of a joint venture with a state-owned enterprise or a local partner, which provides a safe space for potentially less transparent interactions between the company and government officials.

Misuse of corporate vehicles

This type of structure provides an efficient and flexible instrument to conceal the proceeds of corruption by introducing greater opacity and making the identification of the beneficial owner difficult.[18] They can be easily created and dissolved in most jurisdictions, and may form part of a multi-layered chain of inter-jurisdictional structures whereby an entity in one jurisdiction will be controlled and owned by a trust or corporate vehicle in another jurisdiction. This has the effect of blurring the lines of ownership, and makes it challenging to go up the chain and identify the ultimate beneficial owner. This type of multi-layered scheme can help ensure that beneficial owners are located in a jurisdiction that does not require public disclosure of information about beneficial ownership (OECD, 2009b). Corporate vehicles may be used in combination with additional mechanisms in order to further obscure beneficial ownership. Examples of such mechanisms include exercising control through contract instead of standard ownership and control positions (World Bank, 2011). And finally, the beneficial owner may also be disassociated with formal control through the use of surrogates (the name in which the corporate vehicle will be registered) such as specialised intermediaries, professionals, or nominees hired to hold *in name only* a position or assets on behalf of the beneficial owner; or "front men" with rather informal connections to the beneficial owner and usually selected in the close circle of friends, relatives and family members (OECD, 2014b).

Bearer shares can constitute another mechanism by which transparency on the ultimate beneficiary is further obstructed.[19] Bearer shares are company shares that exist in certificate form, and whoever is in physical possession of the bearer shares is deemed to be their owner. Transfer requires only the delivery of the instrument from person to person (in some cases, combined with endorsement on the back of the instrument). Unlike "registered" shares (for which ownership is determined by entry in a register), bearer shares typically give the person in possession of the certificate (the bearer) voting rights or rights to dividend. For these reasons, this type of instrument facilitates anonymous transfers of control and can be used for money laundering purposes (World Bank, 2011).

Corporate vehicles to conceal bribe payments. Corporate vehicles can be used to conceal bribery payments in contract negotiation. The Trace Compendium database features a particularly complex bribery case involving the acquisition of shares in a company located abroad with no apparent connection with the case. The entity appeared to be owned by an official from a country in which the investor had interests and operations. Investments in the official's company abroad served to induce the latter to use his influence with the government to assist the investor in getting favourable terms in a contract negotiation. This particularly complex scheme aimed at fostering transactional decoupling between the giver and the receiver and making illegal payments more difficult to track.

Fronting to comply with local content requirements in the bidding process. There have been some instances in the oil industry where foreign companies allegedly paid illegal fees to contract with front companies with opaque ownership and shareholding structures in order to comply with host-country laws. For example, joint ventures may be created for fronting purposes to respond to bidding requirements (Martini, 2014).

Corporate vehicles to conceal the proceeds of corruption. On the receiving side, government officials may resort to complex and opaque money laundering schemes in order to conceal the proceeds of corruption, especially when these are high. The mechanisms usually consist of creating or using a whole web of corporate vehicles (i.e. shell companies,[20] trusts, foundations, etc.) in order to conceal the official's involvement in corruption, create a disconnect between the official and his illegally acquired assets and provide the appearance of legitimacy for illicit activities (OECD, 2014b).

Rubber stamping approval of compliance with local content requirements in the bidding process

The Trace Compendium database reports a case where illegal fees were paid in exchange for a rubber-stamp approval by government authorities in respect of the company's compliance with local content requirements so as to be granted the mining licence.

Barter contracts

Barter contracts, where investments in infrastructure are made in exchange for granting rights, present risks of corruption. Corruptive behaviours are more difficult to demonstrate in these cases due to the difficulty of balancing the value of rights awarded with the value of the investment. The level of risk is also associated with the modalities through which the investment is carried out, whether through financing or through the development of infrastructure, which in the latter case involves proper selection, qualification and monitoring of suppliers.

Corruption risk factors

Opacity and discretion in bidding processes

Opacity and discretion in bidding processes with regard to evaluation criteria, roles and responsibilities of key actors may account for increased corruption risks in this phase of the value chain. In many cases, information related to the bidding process is not made publicly available (e.g. number of bids received, requirements, winning bids, etc.) (OECD, 2012). Moreover, blurred divisions of responsibility and conflicts of interest sometimes lead a single government agency to play the dual role of administrator and regulator of the sector (Global Witness, 2012), which tends to increase the vulnerability of the bidding process to corruption. Additional vulnerabilities may stem from the administrative, human resource and financial aspects of the process including excessively complex and bureaucratic tender procedures, insufficient turnover of personnel in charge of managing tender procedures, or inadequate level of transparency and accounting for payments in public financial records.

In some instances, it may even be that the legislation is vague on the choice of the process for the allocation of extraction rights. For instance, as reported by a participant in the Working Group on Corruption Risks, the country law establishes that hydrocarbon blocks can be awarded either through a bidding process or by direct negotiation. Yet,

subsequent regulations do not provide any specific criteria to make a choice leaving a wide margin of discretion to decide which option to apply for each block.[21]

Absence of an open and competitive bidding process

In other cases, opacity and discretion may come from the mere absence of an open and competitive bidding process in the allocation of the contract. This may be observed in the context of a contract renewal or extension. Barter contracts are particularly subject to such risks. Opacities surrounding the terms of this type of contract (e.g. mechanisms of financing and reimbursements down to the project level, pledged resources and the value of payments, investments and infrastructure projects, etc.) increase exposure to corrupt behaviours (EITI, 2015a).

Opaque and complex financial and commercial arrangements

Opaque and complex financial and commercial arrangements involving multi-layered schemes of offshore companies, joint ventures, public-private partnerships or partnerships with local companies enable corruption to thrive. Such complexity and opacity may help conceal, for example, the abuse or circumvention of bidding requirements in favour of politically affiliated local entities or select front companies with no technical and financial capacity. This is facilitated in particular by the lack of comprehensive and harmonised legislation in host, home and third party countries on the disclosure of beneficial ownership information, which would enable governments to identify the beneficial owners of bidding entities, corporate vehicles, local partners, joint venture partners, etc. When information on beneficial ownership is disclosed, the lack of proactive data management by government authorities hosting companies' registry systems contributes to further eroding governments' capacity to detect and prevent risks of corruption and money laundering (World Bank, 2011).

Nature of the market

The intrinsic nature of the market characterised by high entry costs and limited competition may also increase the chances of collusive bidding and other forms of corruption.

Recommended mitigation measures

RISK FACTORS	RECOMMENDED MITIGATION MEASURES
Opacity and discretion in bidding processes	***What host governments can do*** ● Make information related to all stages of bidding processes publicly available to all stakeholders. Such information may include timelines for submitting bids, selection and evaluation criteria, contract award decisions as well as other critical information such as geological potential, cost recovery, length of operations (OECD, 2014a). ● Appoint independent bodies responsible for the technical design of the bid and the oversight of the bidding process (ICAC, 2013). ● Ensure effective management of possible conflicts of interest and clear segregation of roles (design, evaluation and selection of the bid). ● Where possible, put in place an online submission process to increase transparency and limit interaction between public officials in charge of the bidding process and bidders. ● Debrief bidders on how the award decision was made. ● Establish dispute mechanisms to enable losing bidders to challenge the results in case of discontent. ● Mandate that awarded contracts and licences are fully disclosed in publicly available registries and open to scrutiny.
Absence of an open and competitive bidding process	***What host governments can do*** ● Provide for an open and competitive bidding for the allocation of extraction rights, particularly for barter contracts and contract renewals or extension.

RISK FACTORS	RECOMMENDED MITIGATION MEASURES
Opaque and complex financial and commercial arrangements	***What host governments can do*** ● Conduct technical and financial analyses of companies enjoying preferential treatment to determine if they have the technical expertise and financial capacity to undertake the required activities (ICAC, 2013). ● Ensure that extractive projects carried out through joint ventures with private firms, are subject to rigorous anti-corruption safeguards, including due diligence on business partners for the purpose of preventing conflicts of interest.[22] ● Require bidders to disclose information and documentation on the natural persons who are the beneficial owners of the company applying for the licence as part of the tendering process; and declare any real or potential conflicts of interest.[23] ***What companies can do*** ● Conduct due diligence on public or local private partners in joint ventures, public-private partnerships, or partnerships with local businesses for the purpose of determining if they have the technical and financial capacity and to prevent conflicts of interest.[24]

Notes

1. Global Witness (2012), "Rigged? The Scramble for Africa's Oil, Gas and Minerals", London, January, *www.cabinda.net/RIGGED%20The%20Scramble%20for%20Africa's%20oil,%20gas%20and%20minerals%20.pdf*: "For example, licenses to explore for oil and gas (which can then be converted into production rights) are often awarded on the basis of auctions. In mining countries, by contrast, a "first-come-first-served" system is more usual. Mining exploration often takes place across vast areas where the chance of finding commercially exploitable mineral deposits may be quite small. For this reason, it may be difficult to attract enough bidders at one time to offer exploration rights by auction. But where a commercial-sized mineral deposit is already known to exist, bidding is appropriate."
2. Comments received from participants in the Working Group on Corruption Risks during the consultations between January and May 2015.
3. See note 2.
4. See note 2.
5. OECD (2012), *International Drivers of Corruption: A Tool for Analysis*, OECD Publishing, Paris, *http://dx.doi.org/10.1787/9789264167513-en*: pp. 46 "There is evidence of large-scale corruption in the oil sector in the 1980s and 1990s, mainly centred on manipulation of the process of awarding concessions. [The case in point] revealed a well-established system of corrupt payments to [host countries'] leaders in exchange for securing oil concessions that was linked to […] broader foreign policy interests [of the company's home country]".
6. World Bank (2007), *The Many Faces of Corruption - Tracking Vulnerabilities at the Sector Level*, edited by J.E. Campos and S. Pradhan, The International Bank for Reconstruction and Development/The World Bank, Washington DC. : pp. 199 "Consuming-country governments are rarely blameless either. As suggested earlier, driven by supply security concerns, or simply out of an interest in promoting the commercial success of their companies abroad, they may use simple bribes or their leverage – economic, political, or military – in the form of either carrots or sticks to influence outcomes in producing countries in their favour. […] Bribes [can be] more broadly interpreted to include not just money but promises of economic assistance and political or military support […]."
7. See note 2.
8. See note 2.
9. Comments received from participants in the Working Group on Corruption Risks during the consultations between September and November 2015.
10. See note 2.
11. See note 10.
12. *www.ucmc.ug/*.
13. See note 10.
14. Factors to be taken into account include whether the partner is a legitimate entity, is qualified and has the necessary resources to fulfil its part of the contract, whether it has an effective anti-bribery

management system, whether it has been investigated, prosecuted or convicted of fraud or bribery, and whether it has direct or indirect links to an authority involved in the decision to award the contract.

15. See note 10.

16. See note 2.

17. See the Business Anti-Corruption Portal country profiles available at *www.business-anti-corruption.com/country-profiles*.

18. According to the Financial Action Task Force (FATF), the beneficial owner is defined as "the natural person(s) who ultimately owns or controls a customer and/or the person on whose behalf a transaction is being conducted. It also incorporates those persons who exercise ultimate effective control over a legal person or arrangement." See FATF (2012), "International Standards on Combating Money Laundering and the Financing of Terrorism & Proliferation – The FATF Recommendation", Financial Action Task Force FATF-OECD, Paris, February 2012. *www.fatf-gafi.org/media/fatf/documents/recommendations/pdfs/FATF_Recommendations.pdf*. Similarly, the OECD defines beneficial ownership as "the ultimate beneficial ownership or interest by a natural person. In some situations, uncovering the beneficial owner may involve piercing through various intermediary entities and/or individuals until the true owner who is a natural person is found. With respect to corporations, ownership is held by shareholders or members. In partnerships, interests are held by general and limited partners. In trusts and foundations, beneficial ownership refers to beneficiaries, which may also include the settlor or founder." See OECD (2001), Behind the Corporate Veil: Using Corporate Entities for Illicit Purposes, OECD Publishing, *http://dx.doi.org/10.1787/9789264195608-en*.

19. See note 2.

20. A "shell company" is a non-operational company, i.e. a legal entity that has no independent operations, significant assets, ongoing business activities or employees.

21. See note 2.

22. See note 2. Factors to be taken into account include whether the partner is a legitimate entity, is qualified and has the necessary resources to fulfil its part of the contract, whether it has an effective anti-bribery management system, whether it has been investigated, prosecuted or convicted of fraud or bribery, and whether it has direct or indirect links to an authority involved in the decision to award the contract.

23. See note 10. See also *https://eiti.org/pilot-project-beneficial-ownership*.

24. See note 2. Factors to be taken into account include whether the partner is a legitimate entity, is qualified and has the necessary resources to fulfil its part of the contract, whether it has an effective anti-bribery management system, whether it has been investigated, prosecuted or convicted of fraud or bribery, and whether it has direct or indirect links to an authority involved in the decision to award the contract.

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