

‘VIEWS FROM THE CITY’

OF THE

CURRENT NATURAL RESOURCES MARKETS

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“We have compiled these papers with the help of a number of our industry partners to help share insight and perspective across the wider natural resources markets. We hope you enjoy reading our ‘Views from The City’. If you wish to contribute an article for our next paper we would be happy to hear from you”.

Brian Martin, Managing Partner, Opus Executive Partners

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Lessons from the *Deepwater Horizon* tragedy



Picture courtesy of the U.S. Coast Guard and Wikimedia Commons

I have been somewhat reluctant to delve into the findings on the Deepwater Horizon tragedy as there is still more evidence, and more reports, to emerge but it does seem that one can say a few things. Whereas no doubt the CEOs of various other Majors have sound reasons in their minds for suggesting that the disaster was a 'BP problem', my personal view is that there seems to be an industry problem, at least as far as four aspects are concerned namely training, cement jobs, Blow Out Preventers (BOPs) and communications.

Nor – I think – can we really be comfortable with a position which says that regulation is that much tougher in the UKCS and NOCS than in the US OCS and that therefore things are OK.

Thus I want to make the case that we need to find technology solutions, as well as improving internal processes, setting new standards and so on.

Firstly, training:

I have heard it said that some deepwater rigs and deepwater wells are sufficiently complex that it is tough for anybody to fully comprehend what is happening and respond quickly enough when

something comes wrong. I am struck by the analogue with flying a modern military fast jet (those of you who know me well will know I have a family interest in this subject!) and by the extraordinary amount of time that pilots spend training, especially in simulators – simulators that can replicate more or less every eventuality that a pilot may face in flight and in combat. Isn't there a case for such intensive simulator-based training in our industry?

Secondly, BOPs:

Our industry has used the BOP as the ultimate fail-safe device for a number of years – to pursue my military jet analogue once more, it has been like the ejector seat!

The picture is still incomplete but I believe one can say the following:

1. The BOP emergency mode did not seal the well. Three methods for operating the Deepwater Horizon's BOP failed – the emergency disconnect sequence from the rig; the automatic function mode; the remotely operated vehicle (ROV) intervention. The latter likely resulted in closing the BOP's blind shear ram (BSR) but this failed to seal the well, probably because the BSR was unable to cut the piping wedged in the BOP.
2. BOP failures are not unknown. Indeed, in 2005, an analysis of incidents in the Gulf of Mexico by researchers from Texas A&M University showed that offshore blowouts had continued at 'a fairly stable rate' since 1960 despite the use of BOPs. In 2000, a US MMS notice said that the MMS considered a backup BOP actuation system to be an essential component of a deepwater drilling system and therefore expected OCS operators to have reliable backup systems for actuating the BOP. However, the MMS left it up to the companies involved to decide what sort of backup system to have.
3. Regulators in Norway and Brazil require drillers to use a remote-control shutoff called an acoustic switch as a backup system. However, in 2003, an MMS report said that acoustic systems could not be recommended because they tend to be very costly and because there is insufficient data available on their reliability in the presence of a mud or gas plume. Note that, in the Deepwater Horizon case, although the acoustic trigger could have activated the BSRs days earlier than the ROV, this would not have helped if the BSRs were indeed unable to cut the metal that was wedged in the BOP.

From the reports I have read, and in my humble opinion, regulators should draw a couple of lessons from them:

- Drilling contractors should be required to demonstrate that their BOP Blind Shear Rams can cut any reasonable amount and quality of metal that sits inside the BOP.
- Following the example of Norway and Brasil, it should be required that all BOPs are fitted with an acoustic trigger. Manufacturers of acoustic devices should be required to demonstrate that their equipment will work at all depths and under all conditions.
- Obviously, contractors will require time to implement these requirements, perhaps 2 -3 years would be appropriate?

Incidentally, there seems to be a substantial growth opportunity out there for these latter manufacturers, Kongsberg and Nautronix for example, with several hundred BOPs to equip!

Thirdly, President Obama's National Commission on the BP Deepwater Horizon Oil Spill and Offshore Drilling has published some findings⁽¹⁾ on the quality of the Halliburton cement job executed to seal the Macondo well and naturally Halliburton have posted a reply⁽²⁾.

The more I read on this subject, the more surprised I am to discover that, given that cementing wells is admittedly a complex endeavour, industry experts inform us that cementing failures are not uncommon even in the best of circumstances. Because of this, the industry has developed tests, such as the negative pressure test and cement evaluation logs, to identify cementing failures: it has also developed methods to remedy deficient cement jobs.

As I understand it, the interpretation of negative pressure tests can be ambiguous; and then a simple google search reveals that cement bond logs are themselves thought somewhat unreliable⁽³⁾ - "Two classes (sonic and ultrasonic) of cement bond log tools are run in tandem as part of ZADCO's standard cement evaluation program. The effectiveness of these tools and their evaluations are often challenged....."

Finally, we may need to introduce a step-change in communications and information flow between onshore 'command centres' and drilling rigs (and indeed any remote installation) as many things come down to people not knowing the right information at the right time. This implies getting better data to begin with, having systems to clean up data and make it easy to understand, systems to make this information easier to work with, for example more precise alarm systems, so that all available expertise can be brought to bear on remote operations, especially in anticipating and dealing with problems – NASA's Houston Mission Control and Apollo 13 come to mind!

I re-iterate that there seems to be an industry problem, at least as far as training, cement jobs, Blow Out Preventers (BOPs) and communications are concerned, and I will continue to make the case to my fellow oil and gas professionals that we need to find technology solutions for these. Our Finding Petroleum Forums will from time-to-time focus on such technologies, beginning with our event on 17th May⁽⁴⁾, as will our magazine Digital Energy Journal: we welcome presentations and articles on this and any other technology subject.

1. <http://thehill.com/images/whitepapers/letter%20from%20fred%20bartlit%20to%20commissioners.pdf>
2. [http://www.oilvoice.com/n/Halliburton Comments on National Commission Cement Testing/7c5888ee3.aspx](http://www.oilvoice.com/n/Halliburton%20Comments%20on%20National%20Commission%20Cement%20Testing/7c5888ee3.aspx)
3. <http://www.onepetro.org/mslib/servlet/onepetroreview?id=SPE-101420-MS&soc=SPE>
4. [http://www.findingpetroleum.com/event/Technologies to potentially help avoid another Macondo/93b.aspx](http://www.findingpetroleum.com/event/Technologies%20to%20potentially%20help%20avoid%20another%20Macondo/93b.aspx)

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Political Risk Management and Energy Security: Two Sides of the Same Coin?



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Two issues have come to the fore in recent years: the importance of political risk management for companies operating in an increasingly global and inter-dependent marketplace and the increasing economic and political significance of energy security. The recent unfolding crises in North Africa (particularly Libya), the Middle East and Japan have shown not only how these two phenomena have bounded up the political agenda but how closely related they have become.

This is obvious on a number of levels. Those companies who are not fully aware of the downside of geo-political risk, underestimate the risk or miscalculate are doomed either to potential failure or value destruction on a massive scale. Those western companies most exposed to the conflict in Libya for example, face ejection if the Gaddafi regime prevails and considerable difficulties even if it just survives. Russian and Chinese state companies, like Gazprom and SINOPEC, will step-in should the West fail to topple Colonel Gaddafi. For BP, Libya could represent another setback in its efforts to recover from the Gulf of Mexico oil-spill (both an economic and political disaster), given its present difficulties in pressing-on with the Rosneft share-swap and Arctic project. Arguably, the TNK-BP partnership has become a political risk too far for the oil major. BP's repeated failure to assess the degree of political risk of operating in Russia, and mitigate it, is a source of some bemusement to Russia-watchers like myself, and the Kremlin. It has twice been out-smarted by the Russian oligarchs who now in effect run TNK-BP.

Instability in Algeria, Egypt, Syria, the Gulf states and Yemen all heighten the political risks for companies operating in the region, but it has often been said that providing Saudi Arabia, the world's largest oil producer, remains stable, it can replace exports from other troubled OPEC members. The House of Saud, facing the same problems of a disgruntled and unemployed or under-employed population and an un-reformed autocracy, cannot remain immune to the pressure to modernise itself and spread its wealth more widely indefinitely. Across the horizon, Iran's determination to develop nuclear weapons means that conflict is inevitable, unless the Ahmedinejad regime is overthrown from within. Given the strength of the Revolutionary Guards and their supporters, this remains unlikely.

Japan's earthquake and tsunami is not only a humanitarian and natural disaster, but one which is already having a profound impact on future global energy security, and more so than the spike in oil prices (well over \$100) caused by instability in the Middle East. Japan's nuclear disaster at Fukushima means that the Japanese are already sucking in more gas imports to replace the lost energy supplies, distorting the Liquefied Natural Gas (LNG) market and stimulating a second "dash for gas". Probable delays in new nuclear build programmes from the US, UK, Germany and possibly even China are already becoming apparent. In the UK, regulatory, design or investor re-thinks will put the country in danger of facing black-outs as early as 2014-15, as one-third of the country's existing generating capacity disappears through EU regulatory phase-outs or natural closure. A resulting domestic second "dash for gas" will ensure the UK misses its low carbon targets and *increases* the use of fossil fuels. The fall-out from Japan's nuclear catastrophe is likely to mean increasing dependence on gas and coal, with the concomitant deleterious effects on global warming. Those supporters of renewable energy, like myself, should have no illusions that intermittent wind or solar cannot make up the shortfall in baseload energy supply implied by the absence of further nuclear development. So the environmental and political risk of pressing on regardless with new nuclear is likely to impact on future energy security, and make the world even more dependent on the non-OECD countries which harbour most of the planet's hydrocarbons.

Hence Russia, which has world's largest gas reserves, the second largest coal reserves and is the planet's second largest exporter of crude oil (not including the potentially huge resources in the Arctic) and the Middle East- which contains the world's first, second and third largest oil reserves (in Saudi Arabia, Iran and Iraq respectively)- are set to become much more important sources of energy security for the rest of the world than they are already. So what's the answer: in short, an enhanced role for energy diplomacy, putting energy security at the top of nations' political agenda, and a much more sophisticated approach by governments and companies to assessing and managing political risk.

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Lord (Peter) Truscott of St James's - Associate Partner, Opus Executive Partners was the UK's Energy Minister, 2006-07. He has written reports on political risk management and European energy security for the Royal United Services Institute for defence and security studies, where he is an associate fellow. He is also a Non-Executive Director of AIM-listed Gulf Keystone Petroleum Ltd and a member of Advisory Board at Opus Executive Partners.

Silver

Despite Silver having materially out performed Gold over the past year, having increased in value by 54% compared to the value of Gold, which has appreciated by 20%, Silver remains cheap. And a recent mini sell off to around \$27 makes it even more attractive in my view. Our gold fund is thus heavily exposed to silver and indeed we have just launched an AIM company, Directex Realisations, which invests in silver equities.

For Millennia both Gold and Silver have been used as vehicles for monetary exchange, a store of, and show of wealth. This age long system denominated by a finite resource base was dramatically adjusted following the Bretton Woods agreement. The fiat currency system dominates our lives today; but as of recently its structural flaws are becoming glaringly obvious. A flight to hard, non Dollar denominated assets has ensued with Gold leading the way as the 'safe haven' investment. This has however slipped in the past couple of weeks with superficial investor sentiment towards the US situation turning bullish due to moderately positive manufacturing data prior to the Christmas period, and massively misleading unemployment figures which showed a fall in unemployment (real unemployment is, if using the same measurement as during the 1930s at similar levels to the Great Depression). Despite recent seemingly positive news the US situation is deteriorating. Therefore, Short term negative movements in the price of bullion should not be analysed too deeply, as taking a long term view the fundamental reasons behind why Silver, and Gold will continue to appreciate are compounding daily. The pull backs are healthy and provide buying opportunities.

Initially seen as an industrial metal, like Gold, Silver also has solid investment credentials, and the past year has seen investors realise this. The reasons behind why Silver lends itself perfectly to investment are due to both its similarities with and differences to its richer cousin Gold. Gold has been the first port of call in regards to safe haven asset classes, whilst Silver has been seen as second rate, more of an industrial metal. The mistake is now being realised.

The financial stability of the World economies is one of the underlying factors that will see Silver continue to shine in 2011. Starting with the US, the level of the World Leader's debt is simply unsustainable; currently estimated at \$14 trillion (this however is incorrect as it does not account for off balance sheet liabilities such as Medicare and Social Security), equating to roughly \$44,292 per citizen, or \$124,779 per employed citizen paying tax. Immediately concerning is the fact that the majority of US creditors are due to be settled within 10 years. Simply put, this means the US will be forced to take on more debt to refinance its unsustainable livelihood in the immediate future. Temporary containment. Recent GDP growth illustrated how Government spending continues to rise in the US despite the fact there is not enough capital to sustain it. The most recent Bush era tax cut retention has simply served to show that the US debt will not be dealt with in the foreseeable future.

Containing the issue, and creating a perception of financial stability is the main focus of the current US administration. Initiatives such as Quantitative Easing have been the Federal Reserve's most recent economic stimulus of choice to serve this aim. Two bouts have been agreed upon so far. In a recent interview Fed Chairman Ben Bernanke explained that more money creation could be justified in the future as a means of dealing with the massive levels of US unemployment (the justification is that this will enhance lending, in turn helping employees expand, i.e. create more positions for staff). QE has however so far failed.

The short term plan of the US, and the underlying justification for further QE, is the debasement of the Dollar. It is hoped that in turn this will create more cost efficient US goods. This will be the ruin of the

US currency. One main issue is that it will serve to aggravate the country's largest independent creditor, China. China's Dagong has already downgraded the quality of US Treasuries highlighting the current account deficit and loose fiscal policy as major short, medium and long term concerns. This is very good news for Silver as portfolios will continue to be moved out of weakening Dollar assets into safe haven hard investments.

The US Debt market itself is currently worth approximately \$14.5 trillion, theoretically an influx of a further \$900 billion (estimated in the Fed's last minutes) will see the market distorted by circa 6%. The Gold market is worth roughly \$2.4 trillion, an influx of a further \$900 billion will distort the market by approximately 36%. Most excitingly if the \$900 billion found its way into the tiny Silver market, which is worth around \$24.3 billion, will see a serious distortion of 3703%. QE has created a fake demand for US Treasuries, underpinned using fake money. This fundamentally distorts true Adam Smith market economics. Furthermore, with new Dollar Bills being printed Inflation will ensue. We are already seeing wholesale prices increasing. The key aspect to note is how long will producers be able to mask these inflation effects by keeping prices stationary before they trickle through to consumer level? We can, for a start, expect to see producers raise prices masked by the VAT rise in the UK. As of 18th January 2011 UK inflation was confirmed at 3.7% in December, with food prices appreciating by a massive 0.8% between November and December of last year. Personal finance website Money.net estimates that higher rate tax payers will currently need returns of 6.17% to simply avoid losing money on their savings once inflation and tax are accounted for.

What the US has failed to understand however is that debt cannot be rolled over for ever. At some point in the future creditors will look less and less favourably on a country that over extends itself and has not implemented tighter spending plans and internal economic policies to tackle the real issues at hand. The likelihood of a default will begin to rise. The elephant in the room is the country's unemployment, until this is addressed, something that is an unattainable goal, the US problems will compound further. A simple reason behind why unemployment is unlikely to be materially reined in is that financial fallout has meant that companies are driving to become increasingly more profitable within the tighter economic environment. This has meant increased measures to promote efficiency, i.e. redundancies. Will companies that are now running profitably on lower costs really spend more to decrease unemployment?

The further worrying aspect is that at current all time low interest rates, US interest expense amounts to roughly 17% of all tax revenue generated. The ongoing plan is for the Fed to continue to buy US Debt, which will in turn keep the interest levels at historic lows. The alternative is for rates to rise which will put a serious level of pressure on the US finances. The government know this, and investors will also begin to realise this. Until the time when the World is willing to accept another currency as the World's paper, for example the Chinese Renminbi (with the current inflationary pressures this is unlikely), due to the US arguably being in a state of critical decline, there is no other option but to store and guarantee wealth within hard asset classes like Silver and Gold. The alternative is to see cash whittled away by inflation.

There is however no safety back in Europe. Deplorable levels of toxic debt are being moved from one balance sheet to another with no analysis of the underlying issues. Again this will not continue forever. In time speculation will see the debt bubble passed from one PIG to another until it bursts and shakes the foundations of the European political experiment. The yield on the most recent Portuguese 6 month Bond offering was 3.686%, up from 0.592%. This was a debt auction, like that of Spain that was materially secured by ECB money – borrowing from Peter to pay Paul or market abuse, call it what you want, the ECB will meet the same fate as King Canute in the end.

The current macro economic factors pushing both Gold and Silver provide one compelling investment argument, but justifiably more important are not Silver's similarities with Gold, but its differences. Gold's applications are limited, with a small amount used for jewellery etc. Its main characteristic is as a currency, a safe haven for wealth. Silver however has both investment qualities and serious industrial and practical attributes. Safety from currency debasement, maturing extravagant debt refinancing, monetary dilution, inflation and currency collapse are one thing, but Silver has many more strings to its bow. The underlying supply and demand matrix will push Silver further and further, due to the fact that supply is materially faltering. In 1940 Silver inventories were recorded at 10 billion ounces, today this is estimated to be 1 billion. A big issue that is causing this decline is that pure Silver producers are few and far between. On top of this roughly 709.6 million ounces of the metal are produced a year, with a demand of approximately 729 million ounces outstripping supply. Surface inventories have up until now managed this demand, but are now coming to an end.

The reason for this demand is that Silver hungry products are being desired more and more. Photography, high tech industries (Silver is the World's best conductor of heat), medical applications, plus a myriad of other products are all whittling away at the Silver being produced across the Globe. The developing middle classes of the East in time will all want a camera, jewellery and require more and more medical treatment, and unlike paper currencies, which are being printed at an alarming rate, the maximum supply of Silver is finite. 80% of Silver is actually created as a by product of mining other minerals such as copper. The rate of supply is therefore inelastic in respect to the level of increasing demand.

As seen in the figures above, the Silver market is much smaller, and less liquid compared to Gold and other asset classes. Silver therefore finds itself much more susceptible to over shoots in price, both positively and negatively, and behaviours which arguably manipulate the price itself. Rumour has it that there are currently 8 open short positions on COMEX encompassing more than all the World's supply of silver. Both HSBC and JP Morgan have found themselves investigated in regards to this. What needs to be understood is that this may well be the status quo as of now, but this will not last forever. At some point these shorts will be closed out, benefiting the rise of Silver profoundly.

Irrespective of the transient vagaries of the differing markets the key drivers of Silver's growth will remain and crystallise as time passes. I am the senior Fund Manager for, as of 2010, the UK's best (across all sectors and Fund, there are almost 3,000) performing Unit Trust with a one year return of 127%. This massively beats the 6.17% needed to retain your wealth. The SF T1ps Smaller Companies Gold Fund is predominantly Gold focused, however up to 20% of the portfolio can be invested in Silver. Over the past year we have been heavily weighted in Silver with investments into pure Silver producers where we see clear value. Evidently this has contributed to our success, and will continue to do so. We are confident that as monetary dilution through Quantitative Easing strategies continues, inflation will ensure further, destroying the value of paper currencies. In time the debt spiral in the US and the Eurozone will continue to deepen eventually shaking the financial world more dramatically than has been seen already. What this leaves us with is Silver, and to the same extent Gold. In these uncertain times the quality of having both investment and industrial uses will see Silver shine in 2011.

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Tom Winnifrith - Fund Manager

Tom started his career in the City at County NatWest (now part of Deutsche Bank). He then moved to the Investors Chronicle and subsequently to the London Evening Standard, AFX News and UK-Invest. Additionally, Tom founded the popular tipster service Red Hot Penny Shares and was contributing Editor for Shares magazine. In 1999, he fronted the ground breaking TV programme Show Me The Money on Channel 4. Having finished as a presenter, Tom launched t1ps.com part of Rivington Street Holdings Plc ('RSH') in 2000.

BP's Rosneft deal will be delayed but not derailed

The main talking points in the business media in Russia at the moment are not the effect of the Middle East conflicts on the oil price but Rosneft's proposed strategic deal with BP which is being attacked by BP-TNK in the courts and the on going shareholder conflict in Norilsk Nickel between the management and UC Rusal.

Outside of Russia however it's the Rosneft-BP deal that has been making all the headlines and much has been made about the court action of BP-TNK and its chances of success. So far it has managed to temporarily block the deal through the courts outside of Russia. However if one looks at the logic behind the proposed deal then it certainly makes sense. BP's recent well chronicled troubles in the Gulf of Mexico and the sustained attacks on the company by Barrack Obama were certainly good reasons for it to look to other areas for growth, a friendlier business climate and, given Russia's need for its knowledge and experience in difficult oil extracting terrain, the Rosneft deal looks to be a good one for them.

The BP CEO, Robert Dudley, certainly knows Russia and the opposition. As the former head of BP-TNK for a number of years, he presided over the company during the shareholder conflict battling with the very same oligarchs (AAR who own 50% in BP-TNK) who are now trying to derail the strategic alliance with Rosneft. It goes without saying that Dudley would not have embarked on these negotiations with Rosneft without having had assurances from the very highest level in the Russian government that the outcome would be successful.

The opposition to the deal of AAR, BP's Russian partners in BP-TNK was not totally unexpected but the real question is, are the actions of AAR really trying to completely block the whole deal or looking to extract concessions from BP? After all BP and Rosneft have been working successfully together at the Sakhalin shelf for more than a decade and this deal was excluded from the shareholder agreement with BP-TNK so the new deal is not unprecedented plus BP-TNK could not replace BP in the new deal as its shares are not internationally listed nor does it have the relevant experience to be able to do so. Moreover, the recent comments made by influential figures including the Russian Energy Minister, Sergey Shmatko, the chairman of Rosneft and Russian Deputy Prime Minister Igor Sechin, plus the top Kremlin economic aide, Arkady Dvorkovich who all stated that they hope that the conflict between BP and BP-TNK will be resolved amicably and soon do point to a solution being reached.

After all, this is a deal that the Kremlin wants. Rosneft is Russia's largest oil company, it is majority state owned, its share price lags behind its foreign peers, it lacks the experience to develop the Kara sea deposits on its own and needs a strategic partner. Those familiar with Russia know that when the Kremlin decides it wants to pursue a particular path it invariably gets its way so the question now is how soon will this situation be resolved and what concessions do AAR extract from BP for agreeing to the deal going ahead?

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The Bribery Act 2010: Guidance on “Adequate Procedures”

Jane Marsden and Nicholas Scott explain the key provisions of the long awaited Guidance on “adequate procedures” that might afford a defence to the Bribery Act’s strict liability offence of failing to prevent bribes being paid on behalf of a company or partnership.

The Bribery Act (“the Act”) has been exercising the minds of senior management in the extractive industries since it was enacted in 2010. Of greatest concern was the strict liability offence (“the Corporate Offence”)¹ of failing to prevent bribes being paid on behalf of a relevant commercial organisation (companies and partnerships) as this creates potential liability for bribes paid by local agents or similar whether or not the organisation had knowledge of it.

The Ministry of Justice has finally published its long awaited Guidance on the ‘adequate procedures’ that might afford a defence to the Corporate Offence (“the Guidance”).

The Bribery Act will come into force on 1 July 2011. This gives companies three months to put in place the necessary adequate procedures.

This article will explain the key provisions of the Guidance as they affect the extractive industries and what practical steps companies in those industries should be implementing in response to the Guidance. There is nothing in the Guidance which only affects oil or mining companies because of the resource they are extracting and therefore this article will refer to both industries.

Readers should note that the Guidance is not prescriptive and it is not legislation that can be directly relied on. The Government has said that the Guidance’s key principles are common sense and proportionality. Our view is that the Guidance appears intended to allay fears that the Act is too strict. However, the legal impact of the Act remains unchanged.

The Corporate Offence

Relevant Commercial Organisation

The Act creates a “strict liability” offence (section 7) for any UK company or partnership (or foreign incorporated company/partnership carrying on



¹Our article in the June 2010 edition of [Views from the City](#) explained how liability for the Corporate Offence could arise and also explained the key provisions of the Act.

Foreign companies and partnerships can only commit the corporate offence if carrying on all or part of their business in the UK.

business in the UK) (collectively "RCO") where anyone associated with the RCO and performing services on its behalf bribes another person, intending to obtain or retain business or a business advantage for the RCO.

The only defence against this offence is for an RCO to show it had "adequate procedures" in place to prevent bribery.

We deal later in this article with what 'adequate procedures' could be, but first we discuss (i) whether foreign incorporated companies listed in England are RCOs and (ii) some of the potential 'associated persons' whose acts could create liability for the Corporate Offence.

Are foreign incorporated but London listed corporates 'Relevant Commercial Organisations'?

Foreign companies and partnerships can only commit the Corporate Offence if carrying on all or part of their business in the UK. One of the concerns most voiced by foreign corporates whose only connection to England is an AIM or full listing on the London Stock Exchange, is: am I subject to the Act?

The Guidance states expressly that:

"the mere fact that a company's securities have been admitted to the UK Listing Authorities Official List and therefore admitted to trading on the London Stock Exchange" does not mean that a company is carrying on a business or part of a business in the UK.

This is good news for foreign incorporated companies whose only link to the UK is that their shares are admitted to, for example, AIM.

However, the devil is in the detail here and the Guidance is clear that, if there is a dispute about business presence in the UK, the final arbiter will be the Court. What if, for example, a foreign company regularly holds board meetings in the UK and meets its brokers here? Is it carrying on part of its business here? In view of this possibility, we think many foreign incorporated companies will be better advised to put in place the sort of 'adequate procedures' described below or they may be caught unexpectedly by the legislation.

Associated Persons

Corporate Offence

Joint Ventures and Joint Operating Agreements

Joint ventures, both in the form of a joint venture vehicle and contractual joint ventures (e.g. a joint operating agreement) are a common feature of the extractive industries' landscape. The Guidance is helpful in relation to whether joint venture partners are "associated persons".

Facilitation payments remain illegal and, contrary to the hopes of many in the extractive industries who face difficult commercial decisions caused by demands for facilitation payments, there is no exemption for such payments, unlike under the US Foreign Corrupt Practices Act.

Specific Joint Venture Vehicle

The Guidance states that a joint venture vehicle is not, of itself, an associated person of its members. Therefore, a bribe paid on behalf of the joint venture entity by one of its employees or agents will not trigger liability for members of the joint venture simply as a result of them benefiting indirectly from the bribe through their investment in or membership of the joint venture vehicle.

Contractual Joint Venture

An example of a contractual joint venture would be a joint operating agreement ("JOA") of the sort commonly signed after award of a Production Sharing Contract.

The Court would consider the degree of control a participant in a JOA had over its affairs in determining whether a person who had paid a bribe in the course of that arrangement was "performing services for or on behalf of" a participant in that arrangement.

The Guidance states that, where an employee of one participant to a contractual joint venture pays a bribe to benefit his employer, then he should not generally be regarded as an "associated person" of all the other participants in the joint venture.

Similarly, the Guidance provides that an agent engaged by one participant in a contractual joint venture is likely to be regarded as an "associated person" of that participant alone, absent any evidence that the agent was acting on behalf of the contractual joint venture as a whole.

Parent and Subsidiary

According to the Guidance it is very unlikely that bribes paid on behalf of a subsidiary by an employee or agent of the subsidiary will automatically result in liability for the parent company. For liability to arise for the parent, it would have to be proved that the employee or agent specifically intended to benefit the parent company as a result of the bribe. Payment of dividends by a subsidiary to its parent, without proof of this intention, would not give rise to liability for the Corporate Offence.

Other key points in the Guidance:

Facilitation Payments

Facilitation payments remain illegal and, contrary to the hopes of many in the extractive industries who face difficult commercial decisions caused by demands for facilitation payments, there is no exemption for such payments, unlike under the US Foreign Corrupt Practices Act.

The Government's position here is unhelpful as it states that, if a facilitation payment triggers the provisions of the Act

"prosecutors will consider very carefully what is in the public interest before deciding whether to prosecute. The operation of prosecutorial



The good news in the Guidance is that routine hospitality such as rugby, tennis or Grand Prix tickets, provided it is for the purposes of getting to know your clients or cementing a business relationship, is very unlikely to fall foul of the legislation.

discretion provides a degree of flexibility which is helpful to ensure the just and fair operation of the Acts".

This is fine in theory but few, if any, businesses will want to plan their commercial arrangements by reference to a prosecutorial discretion which gives the prosecuting authorities flexibility but those commercial organisations no certainty. What is clear from the SFO's prosecution guidelines is that they will consider as part of the decision to prosecute, whether the company in question has a genuine commitment to eliminating bribery and corruption and has put in place and properly implemented systems and procedures to achieve that goal. However, the prosecution guidelines make clear that large or repeated facilitation payments, or where facilitation payments are part of an organisation's standard way of conducting business, are factors indicating that a prosecution is in the public interest.

This is an area, where we expect to see litigation and self-referrals (potentially) to the Serious Fraud Office.

Corporate Social Responsibility

Building schools, roads, hospitals and related infrastructure as part of a bid for a mining or oil exploration licence is a common form of corporate social responsibility ("CSR") and local engagement for the extractive industries. The Guidance makes clear that, if such expenditure is required by local law or is a term of the tender, it would not be considered bribery under the Act, to offer it. However, the Guidance does indicate that this sort of CSR could still constitute bribery if not required by local law or the tender. For example, the offer to build a school or hospital (if not otherwise required by local law) in the Natural Resources Minister's village/town could be seen as bribery of a foreign public official ("FPO") if the Minister obtains an advantage from it (e.g. in terms of increased reputation/power within his village or town) and the intention of building the relevant infrastructure was to improperly influence the Minister in the performance of his function.

Corporate Hospitality

The good news in the Guidance is that routine hospitality such as rugby, tennis or Grand Prix tickets, provided it is for the purposes of getting to know your clients or cementing a business relationship, is very unlikely to fall foul of the legislation.

The Government has also recognised that whether hospitality is "reasonable", or whether it is "lavish" (and falls foul of the legislation) depends on the standards of the relevant sector in which the parties operate. In this respect, the Guidance is helpful, as entertaining FPOs is a matter of real commercial significance for the extractive industries as it is a significant and legitimate part of the process of doing business in the extractive industries.

The Guidance is clear that providing transport and accommodation for the purpose of site visits by an FPO falls outside the scope of the Act.

In summary the Guidance really only amounts to saying (a) do not pay bribes and (b) commit to and implement clear anti-bribery policies and you should be ok.

Interestingly, the Guidance suggests that foreign travel and accommodation for the partner of an FPO as his travel companion (including fine dining and related entertainment) is permissible, provided there was a genuine business reason for the foreign travel (e.g. meetings in foreign countries to accommodate busy schedules). The Guidance says that paying for the FPO's ordinary travel and lodging is permissible. We would infer from the Guidance, that business class travel and similar quality accommodation would be acceptable.

On the other hand, paying for an FPO and his partner to go on a Caribbean holiday with no business connection, is very likely to be viewed as a bribe.

The 6 Principles

The Guidance sets out 6 principles ("the Principles"), which, in practice, overlap quite significantly.

The Principles are:

1. Proportionate Procedures
2. Top-level Commitment
3. Risk Assessment
4. Due Diligence
5. Communication (including training)
6. Monitoring and Review

The upshot of the Principles is that (a) corporates must undertake a thorough risk assessment to identify their risk of exposure to bribery in order to develop anti-bribery procedures that are proportionate to the degree of risk identified ("the Procedures") (b) top-level management must make visible commitments, both internally and externally, to effective implementation of the Procedures and then train their employees in the Procedures (c) keep the Procedures under ongoing review to ensure they match the current risk position of the corporate and (d) undertake due diligence on their contractual partners, including, in particular, any local agents.

It is beyond the scope of this article to explain in detail what anti-bribery procedures will be necessary for a particular company as inevitably, the risk assessment for each company will identify discrete areas of concern meriting their own specific solution. However, in general terms, it is likely that all companies in the extractive industries need to have in place the following:

1. A written corporate ethics code for employees which specifically prohibits conduct that would amount to bribery.
2. A regular training programme on anti-bribery procedures for all employees.
3. All employees/agents must certify that they have read and complied with the ethics code on an annual basis. Records should be kept to ensure that annual certifications are returned by employees.





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4. Any contract with an agent should specifically state that bribes are prohibited and allow for termination in the event that bribes are offered/paid.
5. Due diligence should be done on any agent/ potential business partner/ JV partner before entering into a contract with them.
6. Effective accounting and record- keeping controls to prevent the use of “slush funds” and to ensure that all books and records accurately reflect the underlying transactions.
7. A procedure for reporting dubious conduct.
8. Your company’s worldwide risks and prioritise the areas where your company is most vulnerable. Check local laws in key jurisdictions regarding what is considered to be corruption/a bribe.
9. An anti-bribery Compliance Officer who monitors the company’s compliance with the Act.

Conclusion

Where does the Guidance really leave companies in the extractive industries? Ultimately, it is more helpful than not, to see the Government’s thinking on some of the more specific concerns (e.g. facilitation payments and corporate hospitality) that the extractive industries had about the Act.

However, in summary the Guidance really only amounts to saying (a) do not pay bribes and (b) commit to and implement clear anti-bribery policies and you should be ok.

It is the effective implementation of these policies that will give companies the greatest protection against liability under the Act.

About the Authors

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