



global witness

A blueprint for reform

Lessons from past mismanagement and murky practice in Libya's oil sector

Overcoming the legacy of the 42-year authoritarian dictatorship of Gaddafi and the effects of the civil war are huge challenges for Libya's interim and future Governments. As Libya embarks on this path, the importance of oil revenues cannot be overstated.

Oil represents two-thirds of Libya's GDP and 90 percent of government revenues. The proper management of oil revenues is therefore crucial for the country to establish and maintain a legitimate government that can provide security and create the necessary conditions for sustained growth and economic development for the country's six million citizens.

Revenues derived from oil and gas exploitation have the potential to significantly contribute to Libya's development. To achieve this, as we argue in this document, it is imperative that the interim and future Governments of Libya institute and implement reforms in the management and transparency of the sector.

But this is not only an issue for Libya - international oil companies must also play their fair part in ending mismanagement of the past. There is now an urgent need for new global standards of transparency around the vast payments made by oil companies to governments. This process has begun with the passage in the United States of Provision 1504 of the Dodd-Frank Wall Street Reform and Consumer Protection Act (Dodd-Frank Act), and through similar disclosure laws currently being formulated in the European Union. These will require companies to report the payments they make on a country-by-country and on a project-by-project basis.¹

Lessons from past mismanagement in Libya's oil sector

Global Witness has obtained Gaddafi-era documents that detail the mismanagement of millions of dollars of Libyan oil revenues and highlight murky practices by Libya's state-owned National Oil Company (NOC). These documents provide a blueprint for the current and future Libyan Government of how best to implement the reforms necessary to prevent mismanagement and shoddy dealings in Libya's oil sector in the future.

The complaints against the NOC are contained in a report titled "An Annual Report by the Control Board for 2010" (the "Report"), as well as a series of NOC letters from 2008 and 2009. They include:

1. The systematic under-pricing of oil that led to the loss of millions in oil revenues.²
2. Selling lower quality crude oil than advertised to ExxonMobil, resulting in a loss of nearly \$4m for ExxonMobil.
3. Providing large discounts to select foreign companies such as the Norwegian fertilizer company *Yara International ASA (Yara)*³.

The Report was produced under Gaddafi by the Ministry for Inspection and Popular Control and was intended to be presented to Libya's legislature in 2011.

When asked to comment, long-time Libyan anti-corruption activist Abdelhamid El Jadi said that these documents reinforced his own findings into Gaddafi's extensive history of mismanagement of the oil sector and his knowledge of shoddy practices within the NOC. El Jadi also praised one of the Report's contributors, Najwa El Beshti, a former head of oil contracts at the NOC, who faced an assassination attempt and numerous threats as a result of her work to report mismanagement in the sector.

The Complaints:

1. Under-pricing of oil:

Incompetence? Or questionable motivations behind the pricing of Libya's oil?

According to the Report, the NOC pricing committee and its marketing department lacked the requisite expertise and proficiency to set Libyan oil prices.⁴ Additionally, the NOC's technical studies prepared in connection with the pricing and quality determinations of Libyan oil were "poor."⁵

The Report states that as a result, Libyan oil was priced at below competitive market prices during 2010.⁶ This would have caused a loss of revenues into NOC's accounts and implies therefore a loss of revenues to the Libyan people.

The Report adds that marketing managers responsible for selling crude oil had committed unspecified infringements and violations but they were still being given support within the NOC.⁷

Internal NOC letters from 2008 and 2009 reveal the under-pricing of crude oil is known to have caused losses in the tens of millions of US dollars for the NOC that should have been deposited within their accounts and used for the benefit of the Libyan people.

The letters also demonstrate that the contracting department at the NOC repeatedly informed the pricing committee and the marketing department that the NOC was selling oil below the market price.⁸

A subsequent letter from a member of the pricing committee to the pricing committee's head confirms the contention from the NOC's contracting department that the NOC was under-pricing its crude oil and caused losses in the millions of dollars.⁹ One of the letters also contains a recommendation to re-price a certain crude oil.¹⁰

This raises questions as to the motivation behind the NOC's continued under-pricing of its oil in 2010.

Mispricing linked to the misrepresentation of the quality of crude?

In the 2008 and 2009 NOC letters, the contracting department states that the under-pricing of the NOC's crude oil was also a result of the NOC's misrepresentation of the quality of crude oil for sale. Two different types of crude oil were mixed together but when sold they were classified as only one of the types of crude oil. This affected the specifications of crude and had a "negative effect on [NOC's crude oil] price in the market".¹¹

2. Selling Lower Quality Crude Oil Than Advertised:

How ExxonMobil incurred a loss of approximately \$4m

In 2008, ExxonMobil informed the NOC via letter that the quality of two cargoes of crude oil they purchased from the NOC in 2008 was of a quality consistently lower than advertised by the NOC.¹² According to ExxonMobil's evaluations, the differences in the quality of crude oil advertised compared with the actual quality provided by the NOC caused ExxonMobil a direct loss of USD \$3,987,900.¹³

The letter adds that "[ExxonMobil] are keen to engage in dialogue with [the NOC] as regards compensation for [ExxonMobil's] losses."

Global Witness wrote to ExxonMobil regarding the contents of this letter and whether they received compensation from NOC with respect to this claim. ExxonMobil did not respond.

3. Providing large discounts in the price of natural gas to Yara International:

Were these discounts reasonable? Is there any relationship between these discounts and the ongoing investigation against Yara?

The Report alleges that Yara received large discounts in the price of natural gas on the pretext of encouraging investment, while the NOC was selling natural gas into the local market at world prices.¹⁴

Global Witness has asked Yara if and why they received these large discounts in the price of natural

gas and how/why these amounts, if received, are justified. Yara stated that the gas prices had a profit sharing link with product prices (ammonia and urea) in their joint venture agreement in Libya,¹⁵ but they could not disclose further details because the gas agreements are subject to confidentiality clauses. It remains unclear how much of a discount in gas prices Yara received as a result of the profit sharing agreement and whether the differences in gas prices compared to those provided to the local market were justified.

On April 11, 2011 Yara initiated an external investigation headed by Jan Fougner, a partner at the Norwegian law firm Wiersholm, Mellbye and Beck, related to the interest of its joint venture in Libya with the NOC and it notified the Norwegian National Authority for Investigation and Prosecution of Economic and Environmental Crime (Økokrim) of its investigation.¹⁶ Subsequently, Yara announced that Økokrim charged them with violation of anti-corruption provisions in the Norwegian penal code in connection with the negotiations preceding Yara's investment in Libya.¹⁷ On March 23, 2012, Yara announced that it uncovered unacceptable payments from its joint venture in Switzerland and notified Økokrim of these findings.¹⁸ The investigations are taking place to clarify how such payments have been carried out and authorized.¹⁹ According to Yara, they can neither confirm nor dismiss any connection between these payments from its joint venture in Switzerland and their activities in Libya.²⁰

Global Witness has asked Yara to confirm whether its investigation in Libya is connected to it receiving large discounts in the price of natural gas. Yara has failed to confirm or deny whether the two are connected: they said that they must await the result of the investigation before making any comment on what was paid, for what and to whom.²¹

Recommendations: The reforms needed to improve the management of Libya's oil sector

The complaints detailed above raise questions about how Libya's oil sector has been managed in the past and whether the full benefits were shared with the Libyan people. In the absence of explanations for the complaints, as well as proactive steps taken going forward to improve transparency in the management of Libya's oil, the Libyan people will not know whether their oil is being managed in their interests.

Global Witness welcomes recent moves by the NOC to publish production, pricing and sales figures on its website, including all the income received from its oil sales since the liberation of the country on October 23, 2011 up to February 17, 2012 – approximately USD \$8.4 billion.²² However, we believe further reforms are necessary; a failure to make these will fuel mistrust and suspicion that the interim and any future Government is not committed to reversing the past legacy of mismanagement.

Action must be taken by both the interim Government and the future elected Government of Libya to ensure good management of its oil sector.

1. All contracts and subcontracts that award companies the right to explore for and exploit petroleum and mineral resources should be published and made available online

- a. In October 2011 the interim Government disclosed the oil transactions made by the National Transitional Council during the civil war.²³ The interim Government should now go a step further and disclose all existing agreements prior to the revolution.
- b. The NOC, the Ministry of Oil and/or the Ministry of Finance must be mandated to make petroleum agreements and sub-agreements available for download online.
- c. The newly elected Government should build on the above and implement full contract transparency by:
 1. Mandating the publication of all oil and gas contracts in the new constitution of Libya to be drafted in 2012; and/or
 2. Passing a new petroleum act that requires publication of all oil contracts and subcontracts.

2. The Libyan authorities should work with international audit organisations and the World Bank to build capacity and enhance accounting and auditing of NOC data

Sources within the NOC, foreign oil companies and the Office of the Auditor General of Libya report that accounting procedures may not be in line with best practice methods and result in significant inaccuracies in revenue figures. Even though the NOC publishes information on production, pricing and sales, this process is not sufficiently precise to rule out abuse.

Because of inadequate accounting standards within the NOC, the Government needs to work with international audit organisations and the World Bank to build capacity to enhance accounting and auditing of NOC data, ensure scrutiny of public expenditure and prevent corruption and waste.

In addition to the above, the elected Government of Libya should:

3. Establish an independent, comprehensive review process to assess and scrutinise oil contracts

- a. The review process should operate under Parliamentary oversight.
- b. The review process should have the power to revise contracts if there are grounds for the contract to be treated as either void or voidable under Libyan law.²⁴

4. Enshrine constitutional safeguards²⁵ that reflect the principles of transparency and accountability. These should include, but not be limited to:

- a. A provision that requires public disclosure of how the government manages its oil revenues.
- b. The publication of all oil and gas contracts and related subcontracts in the new constitution to be drafted in 2012.

Recommendations relating to new global transparency standards:

This briefing also starkly illustrates the need for global transparency standards that will shed light on the payments made by extractive companies to governments right down to a country-by-country and project-by-project level.²⁶ Unfortunately, efforts currently under way to do just this – through Provision 1504 of the Dodd-Frank Act in the United States, and current efforts to promulgate legislation across the European Union are being undermined by the lobbying tactics of the international oil industry. These legislative efforts have been developed over the past nine years, during which time the various aspects of an effective law have been extensively debated, including the arguments presented by the oil industry to remove project-by-project disclosure. It is difficult, given the quantity of bogus arguments put forward by the oil industry during this period, not to conclude that the two main reasons for objecting to project level disclosure are that:

Project Level Disclosure would:

- Expose the extent of tax avoidance by international extractive companies seeking to minimize their tax burden through transfer pricing strategies involving subsidiaries in tax havens.
- Expose illicit payments made by international extractive companies that are legitimized through being wrapped in a veneer of legality provided by contract provisions.

Given that the full extent of Gaddafi's mismanagement is only now starting to become apparent, the oil companies' efforts to gut these transparency laws are shameful. It is now critical that the Commissioners in the US Securities and Exchange Commission (SEC) and officials in the European Union²⁷ resist illegitimate calls by the extractive industries and produce strong transparency standards.

These should include:

- The requirement for companies to disclose all payments on a country-by-country and on a project-by-project level.
- These laws must not provide exemptions from disclosure for any country. The creation of exemptions would completely gut the purpose of such laws and would be in effect a dictator's charter – where far from providing the necessary transparency over these payments, it would aid and abet dictators' efforts to loot their countries.

¹ A project should be considered as equivalent to activities governed by a licence, concession or similar legal agreement. Where any payment liabilities are incurred on a different basis, reporting shall be on that basis.

² Translation of "The Annual Report by the Control Board for 2010", page 3, bullet point 2.

³ Translation of "The Annual Report by the Control Board for 2010", page 3, bullet point 8.

⁴ Translation of "The Annual Report by the Control Board for 2010", page 3, bullet point 2.

⁵ Translation of "The Annual Report by the Control Board for 2010", page 3, bullet point 3.

⁶ Translation of "The Annual Report by the Control Board for 2010", page 3, bullet point 2.

⁷ Translation of "The Annual Report by the Control Board for 2010", pages 2-3, bullet point 1.

⁸ Translation of Internal Memo reviewed by Global Witness containing internal NOC letters from August 19, 2008; February 11, 2009; March 31, 2009; April 5, 2009; and June 15, 2009.

⁹ Letter from a member of the pricing committee to the pricing committee's head, April 5, 2009.

¹⁰ Letter from the head of the contracting department to the marketing department, June 15, 2009.

¹¹ Letter from head of contracting department to deputy head of international marketing from August 19, 2008.

¹² Letter from ExxonMobil to National Oil Corporation Crude Oil and Gas Department Manager from November 7, 2008.

¹³ Letter from ExxonMobil to National Oil Corporation Crude Oil and Gas Department Manager from November 7, 2008.

¹⁴ Translation of "The Annual Report by the Control Board for 2010", page 3, bullet point 8.

¹⁵ In Libya, Yara holds a 50 percent interest in the Libyan Norwegian Fertiliser Company (Lifeco), with the NOC and the Libyan Investment Authority each holding a 25 percent stake, available at http://www.yara.com/about/where_we_operate/libya_production_lifeco.aspx; Email received from Yara to Global Witness on April 10, 2012.

¹⁶ Yara: Yara initiates external investigation regarding Libyan JV, April 13, 2011 available at http://cws.huginonline.com/Y/134793/PR/201104/1505950_5.html

¹⁷ Yara: Yara initiates external investigation regarding Libyan JV, April 13, 2011 available at

http://cws.huginonline.com/Y/134793/PR/201104/1505950_5.html; Yara: Økokrim Charges Yara, May 12, 2011, available at http://cws.huginonline.com/Y/134793/PR/201105/1514866_5.html (Økokrim charged Yara with violations of Sections 276a and 276b of the Norwegian General Civil Penal Code, available at <http://www.ub.uio.no/ujur/ulovdata/lov-19020522-010-eng.pdf>.)

¹⁸ Yara: Yara has uncovered further unacceptable payments, March 23, 2012, available at http://cws.huginonline.com/Y/134793/PR/201203/1596684_5.html. Email received from Yara to Global Witness on April 10, 2012.

¹⁹ Yara: Yara has uncovered further unacceptable payments, March 23, 2012, available at http://cws.huginonline.com/Y/134793/PR/201203/1596684_5.html.

²⁰ Email received from Yara to Global Witness on April 10, 2012.

²¹ *Ibid.*

²² *Libya's National Oil Company*: The oil sector during the February 17th revolution, available at http://www.noclibya.com.ly/index.php?option=com_docman&task=cat_view&Itemid=34&gid=74&orderby=dmdate_published&ascdesc=DESC (translation)

²³ *Dow Jones*: Libya's National Oil Co Takes Rare Step of Disclosing Oil Deals, available at <http://www.africanewswire.net/story.php?title=libyas-national-oil-co-takes-rare-step-of-disclosing-oil-deals-foxbusiness>

²⁴ The transitional government has set up a special committee to investigate allegations of widespread corruption in the oil industry. This committee will be in charge of assessing, scrutinising and potentially revising any contracts in the oil industry. However, the huge task of checking oil contracts for corruption has no deadline and the process has not yet started as of March 30, 2012., according to Reuters who reported on this committee at Reuters: Libya's oil contracts to be unsure for months more, March 28, 2012 available at

<http://www.reuters.com/article/2012/03/28/us-libyaexploration-idUSBRE82R0EC20120328>.

While this committee is welcome, Global Witness suggests that best practice requires a review process after an elected government is in place.

²⁵ Congressional Research Service, *Libya: Transition and U.S. policy*, Christopher M. Blanchard, March 28, 2012, available at <http://www.fas.org/sgp/crs/row/RL33142.pdf> (After elections in June 2012, the elected assembly will choose a committee to draft a new constitution. Within three months of the establishment of this committee, a national referendum will be held on the proposed constitution, requiring a 2/3 vote for approval.)

²⁶ A project should be considered as equivalent to activities governed by a licence, concession or similar legal agreement. Where any payment liabilities are incurred on a different basis, reporting shall be on that basis.

²⁷ It should be noted that Dodd-Frank provision 1504 requires project full disclosure. So because project level disclosure cannot be removed by the SEC, current efforts (as of mid-April 2012) by the oil industry to remove project level disclosure in Europe make no sense as they will create an unlevel playing field – something they claim they wish to avoid.