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Best practice in structuring agreements with foreign service providers to promote local participation

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BEST PRACTICE IN STRUCTURING AGREEMENTS WITH FOREIGN SERVICE PROVIDERS TO PROMOTE LOCAL PARTICIPATION

UNCTAD - OIL GAS MINES EVENT

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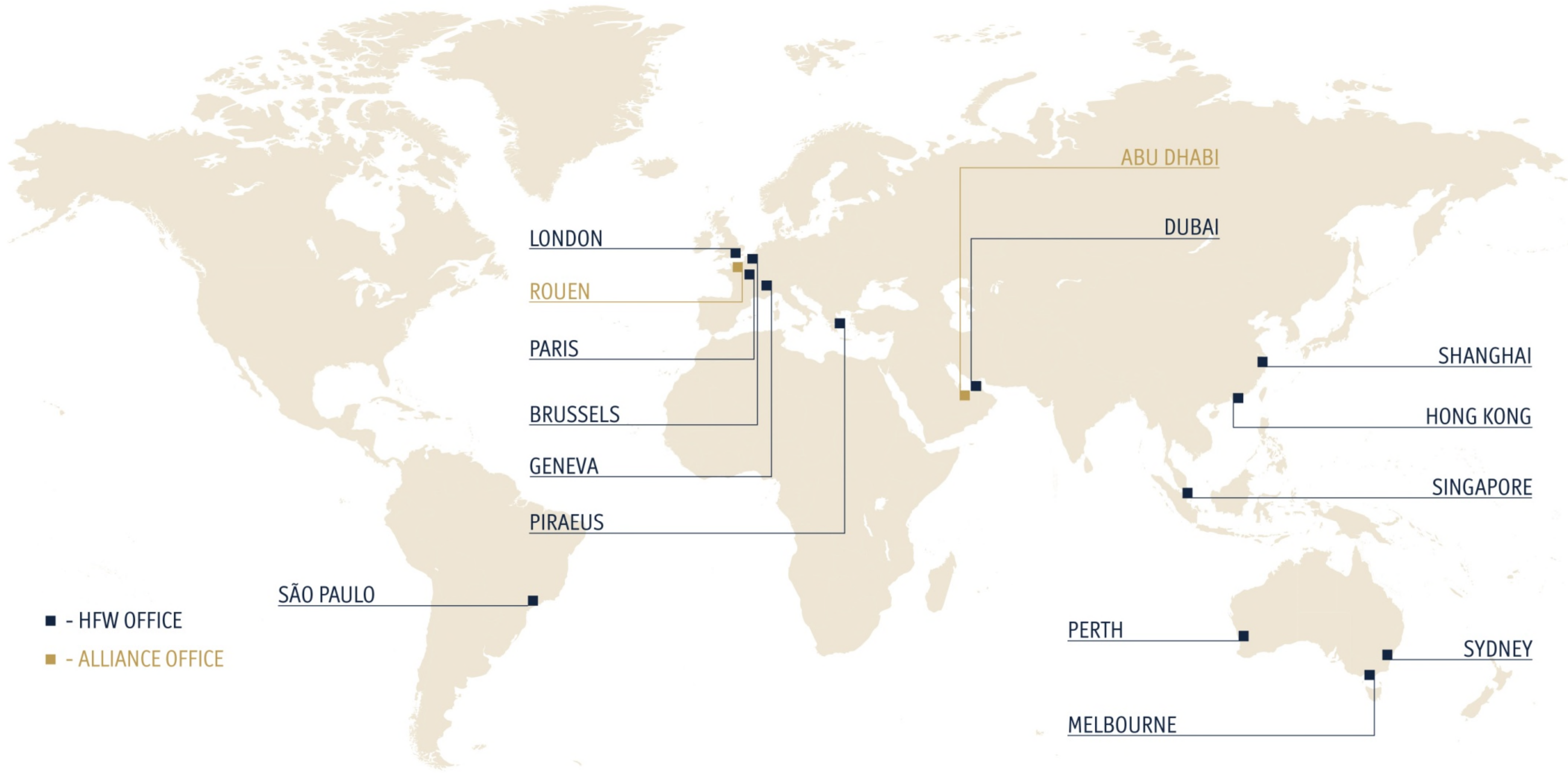
Holman Fenwick Willan world office map



Introduction

- 90% of new hydrocarbon production in the next 20 years will come from developing countries (Baker III Institute, 2007).
- Local participation allows local communities and host economies to gain benefits from oil, gas and mining that are unrelated to tax or royalties.
- This talk will discuss a number of strategies countries have introduced to ensure local participation within the oil, gas and mining industries as well as the key considerations when structuring agreements with foreign service providers.

Benefits of Local Participation

- Local Content/ Participation introduces value through:
  - Workforce development
    - Employing a local workforce
    - Training a local workforce
  - Supplier development
    - Developing supplies and services locally
    - Procuring supplies and services locally
- Also advantages are available to foreign service providers:
  - Reductions in operating costs (expatriate staff are kept to a minimum);
  - Smoother flowing supplies of goods and services;
  - Renewals of licences to operate; and
  - Enhanced engagement with local stakeholders.

Local Participation – Challenges and Risks

Challenges

- Lack of human capacity and educational skills
- Poor infrastructure
- Weak industrial base
- Poor governance
- An inadequate business environment.

Risks

- If not effectively staffed or supervised, state-owned companies can slow project development, decrease the revenue accruing to the state, or exacerbate corruption.
- Creation of corruption by increasing opportunities for public officials to steer valuable contracts toward their own interests.
- National participation can also cause the economy to become more dependent on non-renewable natural resources

Defining local participation

Local could be held to mean:

- Local registration: legal entity is registered under local law.
- Local ownership: a certain percentage (for example, 50 percent or more) of the company is owned by citizens of the country or by existing locally owned and registered entities.
- Local workforce: majority of the company's workforce, whether directly employed or on contract, are citizens of the country.
- Local value-added: a specified percentage of goods/services is produced within the country.
- Joint venture between a foreign and a local company: the local company owns a specified minimum percentage of a partnership with a foreign company.

Any structure must clearly define local.

Consideration - WTO Regulations

- The WTO Agreement on Trade-Related Investment Measures (TRIMs) seeks to ensure that goods purchased within a country do not discriminate against international competitors.
- The rules however make some allowances for domestic regulation to require or incentivise local procurement by an enterprise and for domestic regulations to restrict the volume or value of imports that an enterprise can purchase in order to further incentivise demand for local goods.
- Developing countries who are members of WTO are granted these allowances for a “transitional” period of five years (seven years for the category of Least Developed Countries).
- Currently, 31 countries that are WTO members and are also considered least developed countries (LDCs) can introduce measures that deviate from the NTO clause for a defined period of time.

Local Content Policies Adopted By Governments (1)

Legislation Specifying Minimum Local Content Targets

- Advantages:
  - Can be, in theory, more powerful in terms of enforcement.
- Disadvantages
  - May prove to be too rigid in the face of changing competitive circumstances.
  - Legislation that does not reflect local realities can be counterproductive, as it may lead to economic inefficiency and increased corruption.

Limited implementation from least economically developed countries:

- prominent mismatch between international companies' requirements and local suppliers' capabilities
- limited capacity that LDCs have in introducing, implementing and regulating legislation.
- LDCs have very limited bargaining power and more limited access to good practices to make informed policy decisions and negotiate with companies.

Local Content Policies Adopted By Governments (2)

- Case Study: Nigeria
- The Nigerian Oil and Gas Industry Content Development Act 2010
- Specifies minimum amounts of local materials and personnel used by oil and gas operators in the country.
  - For example, the law stipulates that 65 percent of divers in energy projects must be Nigerian, and 60 percent of steel ropes must be made locally.
- Nigerian subsidiaries of international companies must own at least 50% of equipment (including offshore drilling rigs) deployed for work in Nigeria
- Nigerians to be considered first for all employment and training. Only Nigerians to be employed in junior and intermediate roles.
- Where contract bids are within 1% of each other on a commercial level, the bid with the highest Nigerian content should be selected.

Local Content Policies Adopted By Governments (3)

Initiatives that give preference to locals without specifying targets

- Policies aim at directly increasing the participation of local workers and suppliers without establishing legally binding national local content legislation and regulations.
- Advantages:
  - Fall within the WTO regulations
  - Can be readily implemented (don't depend on enacting regulatory tools)
  - flexible to the needs of the local economy and the companies.
- Disadvantages
  - Effectiveness depends on the existence of a pool of competitive potential local suppliers
  - compliance cannot be enforced legally.
- Case Study: Chile
  - Industrial Association of Antofagasta have compiled a list of capable local suppliers (the supplier registry system).

Local Content Adopted by Governments (4)

Regulation requiring companies to produce local content plans

- Extractive companies required to produce local content plans that include enterprises and workforce participation.
- Disadvantage : Monitoring local content plans require a high degree of government capacity. Developing systems and capacities for verification needs to be weighed against the resources required to build the capacity of suppliers.
- Case Study: South Africa: Mineral and Petroleum Resources Development Regulation, Chapter 2, Part 2: Social and Labour Plan
- Social and labour plan must include strategy to achieve the requirement that 10 percent of the employees are women.
- 40 percent of management must be historically disadvantaged South Africans (HDSAs) within five years.
- Local economic development program must include a procurement progression plan for HDSA companies in terms of capital goods, services and consumables.

Local Content Policies Adopted By Governments (5)

- **Regulations to communicate opportunities to communities**
- Requirements, to encourage oil, gas and mining companies to increase visibility and access to opportunities in resource-affected communities
- Advantages: support enterprise development, skills development programs and other social and physical infrastructure that contribute to a healthy local economy.
- Case Study: Papua New Guinea: Section 3 of the 1992 Mining Act
- Requires the formation of development forums, a process of negotiation among national, provincial and local governments, affected landowners and project developers before a special mining lease can be issued.
- The outcomes of these negotiations typically are agreements among national government, provincial government and landowners, and mine development contracts between the national government and the mining firm.

Boosting Local Participation

- Potential Strategies:
- Impose lower royalties and taxes to encourage companies to increase levels of local participation in a way that demonstrably contributes to sustainable development
- Require the company or its major contractors to deviate from their usual procurement practices by;
  - setting aside some opportunities for procurement solely for local businesses;
  - offering local referencing in which local firms are favoured through a weighting in the procurement adjudication process;
  - "forward financing" in which the company or a major contractor may make a down payment for goods and services from a local company so that business can buy inputs required to deliver the goods and services under the contract;
  - rapid payment terms, when the local business is paid faster than the standard payment terms offered to outside businesses for its goods or services.

Conclusions

Recommendations:

1. Develop a thorough understanding of the local context in order to define which local content targets are realistic and achievable.
2. Focus next on capacity-building by requiring investors to develop the workforce and the supply base.
3. As a general rule, enlist foreign companies to develop local content.
4. Facilitate foreign companies' efforts to develop the local supply industry and workforce.

Dr. Matthew Parish specialises in international dispute resolution, including cross-border litigation, commercial arbitration and enforcement, international trade, foreign investment, including investment treaty arbitrations, emerging markets and public international law. He has represented clients across the full spectrum of international courts and tribunals. His practice involves a number of industry sectors, including insurance, financial services, energy and infrastructure and international trade and shipping. He has significant experience of international trade and investment issues affecting emerging markets, in particular the Middle East, Africa and Eastern Europe. He is the Co-Chair of the International Law Association's Committee on the Accountability of International Organizations and is a frequent speaker and writer on international law at a range of universities across Europe.

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