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Tangible Transparency

Ensuring a Transparent and Verifiable Oil Deal in Sudan

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Purpose of this Paper

The purpose of this paper is to provide suggestions for ways in which a new, post-referendum oil deal between north and south Sudan could be made as transparent as possible in order to ensure that the deal is stable and that any tension and mistrust between the two sides is minimised. This document outlines the suggested transparency provisions, and the attached annex contains specific suggestions for the wording of these transparency provisions. Global Witness presents this document to the Parties in the hope that the experience we have gained from researching oil and transparency issues in Sudan and other countries, and from the pivotal role we have played in shaping the Extractive Industries Transparency Initiative (EITI),¹ can be of some use in fostering a new oil deal in Sudan that promotes peace and the economic viability of north and south.

Transparency will be needed regardless of the exact type of oil arrangement to which the Parties agree. As such, we have presented the transparency requirements that will be needed under any type of arrangement, and, separately, have also presented the transparency requirements particular to the most commonly-suggested types of possible arrangement. We have, of course, avoided commenting on issues such as the amount of money that one Party may choose to pay the other or the percentage of oil revenues that may be shared with the other; such figures are for the Parties to decide. We have also restricted our comments to the transparency provisions that will be needed to ensure the long-term stability of any new oil agreement, and to possible transitional arrangements that could be agreed.

There are several other oil-related decisions that the Parties will need to agree in order for any new oil deal to be successfully implemented, such as the position of the north-south border, and the ownership and management of the oil concessions, both in the north and south, as well as those that currently straddle the border. We have not commented on these issues in this document. We have outlined the reasons why transparency is in the interests of all Parties in previous documents, available from our website.²

Background

The 2005 Comprehensive Peace Agreement states that a referendum on southern independence shall be held by January 9, 2011 in which southern Sudanese shall vote on whether they wish to stay part of a united Sudan or secede to form an independent country. The current oil wealth sharing agreement, which is based on a percentage split arrangement, has seen more than \$8 billion transferred from north to south Sudan and has played a significant role in helping to keep the peace between north and south. This agreement comes to an end in January 2011.

More than three-quarters of Sudan's known oil reserves are located in the south while the majority of the oil pipelines, Port Sudan that provides the sole point of export for the country's oil, and all of the country's refineries are located in the north. Both governments rely heavily on oil: oil revenues accounted for 50% of domestic revenue and

93% of exports in 2009 [in all Sudan]³ and 98% of the Government of Southern Sudan's non-aid income,⁴ more than any country in the world. Any significant disruption in supply would be extremely financially detrimental for both parties. In addition, because both main blends of Sudanese oil, Nile blend and Dar blend, require heating to keep them liquid to transport along pipelines,⁵ any supply disruption, even if temporary, could cause the pipelines to block, requiring extensive renovations to get them back into service and substantial delays in receiving oil revenues for both governments.

An independent Southern Sudan would be landlocked. At current, and for the foreseeable future, the only possible route for exporting oil from the south is via oil pipelines which run through north Sudan to the Red Sea coast. As a result, if southern oil is to be exported, north and south will have to cooperate. As a consequence of all of these factors, a new, fair, transparent, and verifiable oil arrangement will be critical to ensuring peace and stability in Sudan. Negotiations between the National Congress Party (NCP) and the Sudan People's Liberation Movement (SPLM) over such a deal are currently underway.

Transparency, Independent Verification, and Public Dissemination Requirements

The following provisions describe the key transparency, verification and public dissemination requirements that will be needed to ensure the stability of any new oil deal.

Transparency Requirements:

1. **Full public disclosure of the agreement itself.**
2. **Regular and timely publication of disaggregated oil production figures.** The figures need to be disaggregated – in other words, available for each individual oil field – so that they can be verified.
3. **Regular and timely publication of disaggregated oil sales and revenue figures.** The figures need to be disaggregated so that they can be verified. The oil sales figures should be disaggregated by blend of oil.
4. **Regular and timely publication of disaggregated fees paid and received.** This includes pipeline and management fees as well as royalty payments made by the companies and investment costs claimed back by the companies. The figures need to be disaggregated – that is, available for each oil consortium.
5. **Full public disclosure of all the oil sector contracts.** This includes the Exploration and Production Sharing Agreements, Crude Oil Pipeline Agreements, and any other oil-related contracts.

Independent Verification Requirements:

6. **A retrospective audit of the implementation of the wealth sharing agreement under the Comprehensive Peace Agreement, 2005-2011.** Terms of Reference for such an audit have been signed off by the Ministers of Petroleum/Energy of the Government of National Unity and Government of Southern Sudan and are currently awaiting approval by the President of Sudan and President of Southern Sudan.
7. **Full, annual independent audits.** The audits should be completed to international standards by a reputable, independent auditing company, mutually agreed by both Parties. They should cover engineering, technical, and financial flows, and should be made publicly available in a timely manner.
8. **An independent monitoring process to verify all oil sector data and management processes, and oversee the disclosure of information.** This process should involve international experts and reputable, independent local civil society, and should have sufficient authority, resources, access, and expertise. The monitors should produce regular and timely public reports that include recommendations based on systemic weaknesses and oversight challenges identified. This process is also in line with the standards and principles of the Extractive Industries Transparency Initiative.
9. **A system of double-disclosure wherein oil companies – in addition to the Sudanese government(s) – are legally required to publish relevant oil sector data.** This data should include Exploration and Production Sharing Agreements, pipeline contracts, all payments made to the government, gross oil volume figures from wellheads and field processing facilities, net oil volume figures from both the central processing facility and point of export, and disaggregated costs claimed back by the oil companies. This program of double disclosure is in line with the standards and principles of the Extractive Industries Transparency

Initiative and significantly increases the ability of local civil society to watchdog the sector and ensure best management of the country's natural resources.

Public Dissemination:

10. **All the oil sector data and reports described above to be made easily accessible online on the relevant ministry websites.** This information should be presented in a clear and easy to understand format, in both Arabic and English, and should be published a maximum of one month after it is generated.
11. **A monthly advertisement in major Sudanese Arabic-language and English-language newspapers.** The information should include, at a minimum, details of the points numbered 2, 3 and 4 above. In other words, figures on the gross and net volumes of oil produced by each oil field, the percentage of oil belonging to the governments, oil companies and the state oil companies for each oil block, the costs claimed back by each oil consortium, and the prices for which the governments' and state oil companies' oil have been sold. Figures should be given for the amount of revenue accruing to each government on a field-by-field basis. If the oil agreement reached requires payments to be made by one government to another, figures should be given of the amount of money owed and the dates and amounts of any payments that have been made. This should include state-level governments as well as sub-regional and national government(s). Details should be provided of the accounts in which the oil monies are held, including the names and addresses of the banks, the means by which money can be withdrawn and the balances of the accounts.
12. **Additional dissemination of key oil data by radio on a monthly basis in Arabic and English.** This should include the most up to date oil sector information and should be presented in a way that is easy to understand. This is likely to be the most effective means of reaching the wider population, given the low levels of access to the internet and low literacy rates. Existing donor initiatives such as those involving civic engagement radio programs and the distribution of solar-powered radios in rural areas could be of help in this area.
13. **Public Information Offices in Khartoum and Juba** at which any citizen or resident of Sudan/Southern Sudan can request the production of any information that is required to be made public. The Offices should have a legal obligation to appear before the Legislative Assembly of Sudan/Legislative Assembly of Southern Sudan on an annual basis to testify about the compliance of the authorities of Sudan/Southern Sudan with these information disclosure provisions.

Additional Transparency Provisions Required by Specific Types of Oil Deal

There are a number of different arrangement structure options available to the negotiating parties. Global Witness does not aim to use this paper to argue for the benefits of one particular structure over another, beyond pointing out that the simpler the arrangement, the easier it will be to ensure that it is seen to be being implemented fairly.

This section seeks to highlight the specific transparency and trust-building provisions that would be required under the most commonly suggested future oil arrangements.

A) A service/fee arrangement

Of all the possible future oil arrangements, a service/fee arrangement is the easiest to make transparent and verifiable. According to recent public opinion survey conducted by the National Democratic Institute, it is an arrangement that is viewed as more acceptable to the citizens in the south than the current percentage split system.⁶ It would also give both parties a fresh start and a chance to reduce the high-levels of mistrust that have flourished under the current agreement.

A service/fee arrangement would involve the south paying the north for the use of the oil pipelines and processing and export facilities. Such fees would most likely be on a per barrel basis, meaning that the only variable that would require verification would be the volume of oil being transported at different points along the pipeline. The volumes should be measured at the wellheads and field processing facilities in order to obtain gross oil volumes, and at the central processing facility to obtain the net oil volume. Additionally, the volumes should be measured at any

branch points in the pipeline and at the final point of export at Port Sudan, in order to determine the volume sent to local refineries and the volume exported.

An independent, third-party company with expertise in oil monitoring should be employed to verify these oil volumes and report their findings to both parties and, critically, to the citizens of the north and south. Such verification is not difficult, nor is it uncommon. Indeed, such companies are often employed at ports where oil is exported in order to verify the quantity of oil loaded onto oil tankers; a condition that is important for buyer and seller to agree upon. It is possible to largely monitor the volumes of oil passing through oil pipelines remotely, so it would not be necessary for the monitoring company to have full-time staff based at each of these points along the oil pipelines. Sudan's donors should provide the funds for such third party monitoring.

Ideally, this type of arrangement could be used to create a system where it would be in the interests of both parties to check the figures of the other; creating a mutual interest in transparency and in adopting best practice accounting standards. For example, if the South knew and was responsible for reporting the volumes of oil entering the pipelines in the oil fields, and the North knew and was responsible for reporting the volumes of oil reaching the refineries and the point of export, then both parties would need to rely on figures provided by other party in order to determine the amount of fees paid. The North would have an interest in ensuring that all of the oil had been exported via the pipeline (without any being exported via truck via a different point of export), and the South would have an interest in ensuring that all of the oil entering the pipeline was recorded as having reached a refinery or the point of export.

A service/fee arrangement could involve a) both parties being responsible for selling their own portion of oil once it reached the point of export; b) the North being responsible for selling oil from both north and south; or c) a mechanism whereby North and South were jointly responsible for selling oil. We do not seek here to address the advantages and disadvantages of each of these options in detail beyond commenting that option a) would require a significant and rapid increase in the capacity of the South to market oil, that option b) makes it particularly difficult for the South to verify that the best price has been obtained for its oil and the true price of sale has been disclosed by the North, and that option c) requires considerably more cooperation between north and south than has been seen under the current wealth sharing agreement. Accusations of such problems have plagued the current oil wealth sharing agreement.

B) A continuation of the current percentage split arrangement, with modification

The current wealth sharing arrangement, under the Comprehensive Peace Agreement, requires 2% of all oil revenues from each state to be given to the government of that state, and half of the remaining revenues from southern oil wells to be returned to the Government of Southern Sudan. Such a system sounds simple but requires the verification of numerous factors in order to be sure that the revenues have been shared fairly. In addition to verifying gross and net oil volumes, it is also necessary to verify the price for which the oil is sold, the percentage split of the oil between company and government specified in the Exploration and Production Sharing Agreements, the pipeline fees paid, the management fees paid, any royalties paid and the costs claimed back by the oil consortia.

There is a wide variety of information that would need to be made public and be independently verified in order to monitor a percentage split arrangement. The gross and net oil volumes would need to be measured and be independently monitored, as described above. In addition the price for which the oil is sold would need to be monitored. This could be achieved by setting up a system of regular oil sales audits, conducted by an independent, credible auditing company with the results of the audits being made public for all to see. The auditor would need to be given free access to the oil sales contracts and the bank account(s) into which the oil revenues were deposited. A regular audit would also have to be set up to verify the costs claimed back by the oil companies – such costs have a large effect on the amount of revenues left over for the government(s). These audits should also be carried out by an independent, credible auditing company with the results being made public for all to see. The governments would also need to publish information on: the oil pipeline contracts, which determine the level of fees payable to the oil pipeline companies and the ownership of the oil pipelines over time, disaggregated data on the payment of signature bonuses and royalties by each of the oil consortia, all verification processes, and the processes in place to manage the allocation and development of new oil blocks and contracts.

This kind of an arrangement is time consuming and expensive because it requires the publication and verification of a large amount of information to ensure that the agreement is being carried out fairly, let alone to

ensure that the revenues are being managed responsibly. It is challenging for industry experts, let alone an average citizen, to understand this information and therefore to be able to trust that the arrangement is being carried out fairly.

C) Shared stakes in concessions and state-owned oil companies

It has been suggested that one way in which both North and South could hold each other to account in terms of future oil industry management would be if the northern state-owned oil company, Sudapet, were to continue to hold equity stakes in all of the oil blocks in the south, and the southern state-owned oil company, Nilepet, were to be awarded equity stakes in all of the oil blocks in the north. Such an arrangement would, on paper, give both parties an economic interest in the stability of the oil industry north and south, as well as providing a corporate mechanism by which information could be obtained about oil production throughout the north and south. Such an option could be implemented in addition to the fees arrangement or the percentage split arrangements described above.

In practice, however, this option is unlikely to provide any additional transparency. Sudapet does not have a reputation for openness – for example the IMF has repeatedly requested, to no avail, that audits of Sudapet that were carried out in 2004 and 2005 be published.⁷ In addition, the World Bank has complained that the government's oil-related 'regulatory functions are not independent of its commercial activities':⁸ in other words, that Sudapet is responsible both for selling oil and regulating the sale of oil. Nilepet, on the other hand, has virtually no experience as an oil company and is therefore not likely to be in a position to monitor the behaviour of fellow equity members. A separate regulatory institution would need to be established in order to separate the selling of oil from the regulation of the sale of oil.

This option alone is unlikely to ensure good management of oil revenues. If it is implemented, the other safeguards described in this document should also be implemented in order to ensure sufficient transparency and therefore stability of the oil deal, and an oversight body should be set up with the powers to compel disclosure.

Possible transitional arrangements

The Parties to any new oil arrangement must agree on the start and end dates of the deal. However, the start date need not be immediately after the results of the referendum are announced, nor immediately after the Comprehensive Peace Agreement ends, in July 2011. Instead, there is the option to continue implementing the current wealth sharing agreement, with the new inclusion of specific transparency provisions, until a specified, agreed date. Such a 'transitional period' would give both parties additional time to agree to the exact system and associated figures/fees, to train additional members of the Government of Southern Sudan and/or Nilepet, and to ensure that all the necessary transparency mechanisms, such as recruitment of auditors, are put in place. Depending on the details of the transitional arrangement, it could also provide for a gradual change in the oil revenues of North and South, and hence avoid a sudden change which could be difficult to deal with. The date on which such a transitional oil arrangement comes to an end would need to be agreed between the Parties.

In addition to agreeing an end date for any possible transitional arrangement, it may also be decided by the Parties to agree an end date for any new oil deal, with the ideal being that any new arrangement is phased out slowly over time, allowing the south to gradually build up its oil industry expertise.

Additional Requirements of Any New Deal

This section describes the other key processes necessary for the successful governance and oversight of any new arrangement, beyond the transparency measures described above..

1. **A dispute-resolution mechanism.** This should be a tiered process in which disputes are initially negotiated in mediation. If agreement cannot be reached in mediation, the dispute should be elevated to an adjudicative process such as international arbitration, where a binding decision will be made by a previously agreed-upon neutral third party. In addition, all credible allegations of corruption should automatically lead to independent investigation.
2. **Clearly established ownership of all oil blocks and contracts.** At the very least, any new agreement should set an explicit timeframe to establish this ownership.
3. **Distinct and clearly defined roles for the public institutions that regulate and oversee the oil sector.** International assistance to build management capacity in the relevant ministries will be necessary.

4. **An agreement on whether either party can export oil outside of the agreed arrangement.** Such outside arrangements could include either Party selling oil in return for supplies of military equipment, selling future supplies of oil in return for cash in advance or securing loans against future supplies of oil. Another outside arrangement could see the South exporting some oil overland via truck (or in the more distant future, via a possible new pipeline), and thus avoiding any fee paid for services rendered by the North. However, at least initially, it is likely in the South's interests to grant the North exclusive rights to transport southern oil, given the logistical difficulties in exporting southern oil via road, and the greater incentive that this provides the north to agreeing fees which are not prohibitively expensive.
5. **An agreement on the provision of domestic oil-resource consumption requirements.** At present, all of Sudan's refineries are located in the north of the country. Although the south has plans to build a refinery, it will take some time before it is functional and in the meantime the south will need to meet its gasoline and other oil-resource requirements. Agreeing a deal on the provision of such oil-resources could help build trust between north and south.
6. **Consensus on roughly how much oil will be extracted during the agreement's timeframe.** If one Party pays fees to the other that decrease over time, then it is possible that the Parties will have opposing interests in the amount of oil extracted.

Thank you.

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For more information please contact Dr. Rosie Sharpe in the UK on +44 (0) 20 7492 5893
rsharpe@globalwitness.org or Dana Wilkins in the US on +1 (202) 621-6687 or dwilkins@globalwitness.org.

References

¹ Extractive Industries Transparency Initiative, <http://eiti.org/>

² See Global Witness, Fuelling Mistrust: the need for transparency in Sudan's oil industry, September 2009, and Global Witness, Five principles for a post referendum oil deal in Sudan, July 2010. www.globalwitness.org

³ International Monetary Fund, Sudan program note, 21 April 2010, <http://www.imf.org/external/np/country/notes/sudan.htm>

⁴ Government of Southern Sudan, Approved budget 2010, Ministry of Finance and Economic Planning, http://www.goss-online.org/magnoliaPublic/en/ministries/Finance/mainColumnParagraphs/0/content_files/file20/Budget%202010%20-%20Final.pdf

⁵ Global Witness interview with an oil expert, June 2010

⁶ National Democratic Institute, Southern Sudan at the crossroads: citizen expectations, aspirations and concerns about the referendum and beyond, September 30, 2010

⁷ International Monetary Fund, Sudan: 2007 Article IV consultation and staff-monitored program, October 2007, <http://www.imf.org/external/pubs/cat/longres.cfm?sk=21397.0>; and Sudan: First review of performance under the 2007-08 staff-monitored program, June 2008, <http://www.imf.org/external/pubs/cat/longres.cfm?sk=22011.0>. Sudan usually meets the majority of the IMF's structural benchmarks under its Staff-Monitored Program; an exception is the request to publish audits of Sudapet which has been repeatedly not met

⁸ World Bank, Sudan public expenditure review: synthesis report, December 2007