Conflict Prevention and Revenue-Sharing Regimes

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Violent conflict – both within and among countries – is a disturbing but nonetheless inescapable fact in many regions of the world. Its effects are pernicious – causing untold human suffering and wreaking havoc in economic, social and other terms. Another inescapable fact is that the vast majority of conflicts, in whatever form, are the result of failed governance. It has been demonstrated repeatedly, in conflict after conflict, that such violence is caused by failed and ineffectual political regimes. Thus, the primary focus of conflict resolution and prevention needs to be on establishing good governance and its related ideals, including the rule of law and the respect for the principles of human dignity and social equity.

While the responsibility for conflict prevention lies primarily with governments, it is important to understand that other societal actors have a role to play, including – importantly – the private sector. Economic failure, which is closely linked to political failure, is often a root cause of conflict and civil unrest. While companies have little influence over a given country's macro-economic policies and infrastructure, they nonetheless have great influence over the allocation of economic and financial resources as a result of their business operations. Indeed, in many countries around the world, poverty and inequality are not necessarily due to the lack of resources, but rather to lack of *access* to resources generated by the private sector.

One important instrument that companies can use in maximizing their positive effects on societies is "revenue sharing," a term which encompasses a variety of social, economic and political objectives, including: the equitable distribution of resources at the national, regional and local levels; compensation for resettlement or loss of land; and strategic economic and social investment to meet the needs of future generations.

The following discussion analyses the essential factors for creating functional revenue-sharing regimes to contain socio-economic tensions that promote conflict. The paper concludes with appendices elaborating on the legal framework surrounding revenue sharing regimes, along with examples of current revenue sharing regimes linking the interests of the private and public sectors and civil society.

Revenue Sharing Regimes: Goals and Categories

The function of a revenue sharing mechanism is to define a system for the allocation of social investments by companies and disbursement of project-related taxes, royalties, and other transfers paid by corporations to host governments. Revenue sharing regimes fall under three general categories. Stabilization funds apply revenues to immediate needs of economic stabilization and development. Future-generation funds collect current revenues for future use. Sustainable economic development revenue regimes allocate proceeds for current social, environmental, and developmental purposes such as the construction of hospitals, schools, roads, and infrastructure.

Despite differences in function and approach, revenue sharing regimes share common attributes in respect to conflict prevention. For a revenue sharing regime to contribute to the amelioration of conflict situations, four factors are decisive. The regime must engage the right stakeholders; it must have legitimate mechanisms for the management of revenues; it must enforce provisions to ensure transparency; and, finally, the regime must include effective procedures for dispute settlement.

Factor One: Engage the Right Range of Stakeholders

For a revenue-sharing regime to prove effective, its provisions must engage the full range of relevant stakeholders at risk of becoming embroiled in conflict. If all of the interested parties are not encompassed in the web of consultation and representation, even the most promising proposed solutions will eventually invite resistance from excluded constituencies.

The challenge of engaging the right range of stakeholders is particularly pronounced in the extractive industries. In most extractive projects an extensive list of stakeholders are involved, including companies, host governments, home governments, local government representatives, civil society groups, local and indigenous community leaders, and in some instance, multilateral organizations, as well. [1]

One useful template for stakeholder engagement is the World Bank's Emerging Best Practices on Consultation. It describes a process for identifying and engaging local authorities and key representatives of different local groups, NGOs and indigenous people; gathering relevant social and cultural information; and designing community relations programs and developing local capacity to "effectively communicate complex issues across cultural barriers." The template also offers guidelines on how to craft long-term solutions to the plight of those affected by company operations. [2] Private sector actors have also developed tools for stakeholder consultation. Shell has created matrixes for identifying stakeholders[3], and Business for Social Responsibility has refined an effective stakeholder mapping technique.

Community relations are central to the task of stakeholder engagement. As a World Bank study on mining and sustainable development observes:

> "In the relationship between the mining operation and the surrounding communities there are always at least three major players: the local (and regional) community, the central government, and the mining company. However…the more usual case in the Latin American context is that the company negotiates with the central government and the local community (or government) separately, while there is very little communication between government and the local community….A pernicious weak communication between

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[1] Jay Hair in Mining, Minerals and Sustainable Development Project, 2001 provides a good discussion of responsibilities of relevant stakeholder parties.

[2] www.worldbank.org

[3] Shell's stakeholder engagement program in Camisea, Peru, has received several awards as "best practice". For a university of California Berkeley case study on this program see http://socrates.berkeley.edu/erg/documents/camisee.pdf

> government and local community (the incomplete triangle) is that almost all fiscal revenues go to the central level, and that very few communities benefit from these resources."[4]

Three factors are critical to community engagement. First, proposed revenue-sharing regimes should be informed by community appraisals that include focus groups, polls, and one to one conversations with community members and leaders. Second, community representatives should be empowered to play an active role in negotiations. Best practice in consulting communities is increasingly seen to require significant efforts to build community capacity to engage in such negotiations on a level playing field.[5] Third, a broad spectrum of views should be focused on the role of the local community. NGOs and journalists have brought new ideas to local communities about what type of revenue sharing they should be seeking—even to populations in remote areas.

As a result of these practices, local communities are slowly becoming more sophisticated in addressing the economic, social and environmental issues that may affect them. Governments and companies share a responsibility to educate community stakeholders about private sector operations. Those consultations, in turn, have the potential to tap local insight to foresee problems on the horizon, and can thus be instrumental in reducing the risk of conflict between community and company.

Factor Two: Create Legitimate Mechanisms for the Management of Revenues

At the core of any revenue-sharing regime is the mechanism to manage project funds and revenues. There must be clear agreement among stakeholders about precisely what measures should be implemented for reporting, auditing, and monitoring of proceeds; effective safeguards must also be established to protect against corrupt practices. These provisions have an even greater centrality in countries where legal, financial and

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[4] "Socio-Economic and Environmental Effects of Large Mines on the Community: Case Studies from Latin America, Canada and Spain" Gary McMahon-Global Development Network, Felix Remy Mining Department, World Bank Sept. 18, 2000.

[5] The experience of BHP-Billiton and the Inuit Communities Near the Ekati Mine in Northern Canada

governmental institutions may not have deeply embedded procedures ensuring regulatory oversight and transparency.

Fiduciary responsibility may be structured according to different models. When revenues are entrusted to local governments or community organizations, provisions must be made to assure accountability in the management of the funds. If central governments or community organizations cannot ensure accountability and transparency, a third-party trustee may be necessary--particularly when private sector engagement has an impact on local communities or indigenous stakeholders.

Models of third-party trusteeship include independent community development agencies, trust funds, and foundations, each of which can "offer the institutional flexibility to react to community needs of external influence."[6] In the "shared workplans" model, partners share the tasks of planning and implementing the partnership activities. Parties share control of the outcome of the revenues and their delivery, while local government authorities or the corporation retain overall ownership. This arrangement "engenders ownership by community groups" and shares responsibility. [7]

Local NGOs, companies, and special government agencies may also be integrated into mechanisms for trusteeship. The Chad-Cameroon agreement, for example, engages a range of private, public, and civil society actors in an innovative mechanism to control revenues. In this case, an independent, third-party institution—an offshore audited escrow account—holds the revenues and disburses them to agreed-upon special accounts, which fall into three categories: poverty reduction (80%); government expenses (15%); and local regional needs (5%).[8] The offshore accounts are subject to audit controls that have been codified into law. The agreement is monitored by a control group that includes representatives of a Chadian NGO, a trade union, members of Parliament and the Supreme Court, as well as civil servants from relevant government departments.

Factor Three: Enforce Effective Transparency Provisions

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[6] Tri-Sector Partnership for Social Development: Ownership and Control of Outcomes. Working Paper No. 5 June 2000 Aidan Davy www.bdp-naturalresources.org

[7] IBID

[8] www.essochad.com

Transparency is an ascendant international norm of the twenty-first century, increasingly shaping expectations of what constitutes correct conduct in both the private sector and public realm. According to the NGO Transparency International:

> "The belief that increased transparency can achieve not only more meaningful levels of accountability, but can do so in a highly cost-effective fashion, is now expressed universally. There is also a widespread recognition that fundamental and enduring changes in attitudes and practices can only be brought about by harnessing the energies of all of the points of a society's triangle of forces—the state, the private sector and civil society—and not only within countries, but also transnationally."

The functional transparency of revenue sharing regimes is a prerequisite for their perceived legitimacy. Only through the enforcement of transparency provisions can the multiple stakeholders in a revenue-sharing regime verify that agreements are honoured and implemented in a fair, equitable, and consistent fashion.

Various standard measures can contribute to the transparency of financial information. The IMF Code of Good Practices on Transparency recommends that public funds be subject to publicly reported audits of financial operations; independent third party monitoring of central government financial operations; and an "independent assurance of integrity provision made under law for verification of the transparency and thoroughness of government accounts by means of an independent central audit office".[9] The adoption of the *General Agreement on Trade in Services* is placing greater attention on the conduct of financial services while the United States and the OECD have adopted laws promoting transparency in the international business arena, such as the U.S. Foreign Corrupt Practices Act and the OECD Convention Against Bribery of Foreign Public Officials.[10]

In some countries the government imposes transparency requirements on its agencies, including central banks and financial institutions. In such cases central banks and financial agencies follow the same practices as other

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[9] http://www.imf.org/external/np/rosc/cze/trans.htm
[10] http://www.wto.org/english/tratop_e/serve_e/gatsintr_e.htm

units of government—they reconfirm or supplement the government-wide transparency practices in their publicly available bylaws.[11] In government contracts where these measures are not present, it falls to other parties--including companies and international financial institutions--to help ensure transparency and accountability.

Actors from civil society have actively promoted proposals to enhance transparency. The "Integrity Pact for business and public officials" developed by Transparency International calls for practical strategies to control extortion, bribery and corruption by adopting a so-called Integrity Pact framework.[12] Its provisions call for a prohibition on any form of payment, financial or otherwise, except for those legally provided for while offering or taking services or procuring goods, services or materials. The framework also calls on the full disclosure of all third party payments; the engagement of civil society organizations in a monitoring role; and for international business to operate only in those countries that have agreed to criminalize bribery.

In *The Business of Peace*, a comprehensive study of the private sector and conflict prevention, the Prince of Wales Business Leaders Forum describes several recommendations made by Global Witness encouraging companies to adopt policies of full transparency in respect to funding arrangements and government contracts. These include the disclosure of all payments, ranging from signature bonus payments to resources spent on social investment. Global Witness also recommends that companies consult with the World Bank, IMF, UN agencies, international NGOs, representatives of civil society and government—i.e. all relevant stakeholders—to form a broad alliance for transparency as well as to participate in independent audits of the impacts of company social programs.[13]

Despite enhanced international attention, transparency has been inconsistently applied among different industry sectors. Historically, there has been little transparency regarding agreements between governments and companies exploiting natural resources. Contracts seldom provide for public reporting on how revenue is generated or how governments dispose of it.

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[11] Jane Nelson, The Business of Peace (London: Prince of Wales Business Leaders Forum, International Alert, Council on Economic Priorities) 2000.
[12] http://www.tinepal.org/pact.htm
[13] The Business of Peace, p. 81.

According to Gordon Barrows, a leading expert on international extraction contracts: [14]

> Prohibitions against revealing terms of the contract or concession are enforced in some countries, i.e. Gabon, Algeria, and Indonesia. In others (USA, United Kingdom, France) there is no government secrecy provision. While there may be some rationale to government secrecy early on when contracts are being negotiated, a continuing obligation not to reveal the contractual terms is counter-productive. It slows new exploration and makes a mystery of what should be public knowledge.

A number of leading oil companies have taken the initiative to revise their policies on transparency. In its 1997 social report, BP acknowledged that the company's involvement in Angola could become problematic "if the government fails to live up to the commitments made to increase democracy, accountability, and transparency and if oil revenues continue to be the main source of income to the government."[15] Chairman Peter Sutherland announced that BP would "insist as far as we can that such payments are transparent."[16]

The company decided to reform its policy following an extensive dialogue with Angolan civil society leaders and international NGOs, as well as BP employees and the Angolan government. As a policy paper published by the company explains: "BP can become the catalyst or excuse for conflict --not because we are doing our job badly, but because we and others are perhaps doing it too well. Increased prosperity often represents a threat to minority or vested interests - some want to capture a larger share for themselves; others see it as undermining their own internal position. This is particularly the case in societies which are undemocratic, where democratic institutions are less developed, or where societies are deeply divided." To ensure that the company's operations help generate benefits for the host country's civil society-- BP's policies include publicizing payments to the

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[14] www.barrowscompany.com

[15] BP Amoco (now BP), "BP Social Report 1997".

[16] Undated letter from BP Amoco (now BP) Chairman Peter Sutherland to House of Lords Member Lord Averbury.

government so “that the societies can rightfully inquire into the uses which government make of the revenue streams which global companies generate.”

Statoil, the Norwegian energy company, has also reformed its policies on transparency. Tax and signature bonus payments made by Statoil’s subsidiary companies to host states where Statoil operates appear in each company's annual report and accounts. In accordance with Norwegian law, copies of these transactions are filed at the Brønnøysund Register of Annual Company Accounts and are a matter of public record. Statoil thus applies the same standards of accounting, reporting and transparency to its operations in Angola as to its operations in Norway.

Factor Four: Develop Effective Dispute Settlement Mechanisms

In *Greed and Grievance: Economic Agendas in Civil Wars,* Indra de Soysa observes that “The strong association between mineral wealth and conflict suggests that the high stakes associated with controlling mineral wealth are likely to be a cause of conflict." To maintain stability in developing countries rich in mineral wealth, de Soya concludes effective democratic institutions--coupled with continued economic growth--are essential. Among the most critical institutional mechanisms are dispute settlement provisions for revenue-sharing regimes.

Mechanisms for dispute settlement are particularly essential in revenue sharing agreements with national governments lacking a mature legal system and strong rule of law. Dispute settlement mechanisms are also crucial when the rights of vulnerable stakeholders, such as indigenous peoples or local communities, are at stake. Because oil and mining investments are based upon long-term projected interests--spanning from 10 to 30 years or more--companies, local communities, and governments share an interest in crafting alternative dispute resolution agreements in their contracts.

Parties to a contract may rely on a variety of measures to facilitate dispute resolution. Arbitration is a common mechanism applied by companies, governments, and local communities.[17] Similarly, there may be

[17]An illustrative arbitration provision states: “The government and the contractor shall consult with each other in good faith and shall exhaust all available administrative and other

local charters, bills of rights, and declarations regarding land ownership that outline how disputes shall be resolved. Clauses outlining good faith proceedings are often included in contracts to help build trust among the parties and resolve disputes out of court. Dispute resolution techniques such as multi-stakeholder dialogue and stakeholder monitoring committees are becoming more common in project planning and have proven effective in preventing disputes from escalating into more direct conflict. In addition, these mechanisms can help identify local and community concerns regarding private sector operations and thus contribute to the prevention of future conflict.

Other measures to ameliorate conflict between companies, communities, and governments include special education programs on the costs and benefits of private sector operations; continued research and fact-finding efforts to assess the social and economic impact of private sector operations; dialogue forums; the use of third-party mediation and facilitation; management training; and coalition building through the creation of representative committees composed of community, government, and company stakeholders.

Conclusion

When business operates in zones of conflict, companies often become reluctant players in the broader debate over the distribution of state wealth and resources. As the World Bank observed, business is perceived to comprise one leg of a triangle composed along with the national government of a host country and the local communities that absorb the greatest impact of company operations. Revenue-sharing agreements may be one effective measure to promote stability among these and other influential stakeholders. Yet such revenue allocation regimes must be carefully crafted. They must be methodically inclusive, to address the interests of all relevant stakeholders.

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similar remedies to settle any and all disputes or disagreements arising out of or relating to the validity, interpretations, enforceability, of performance of this Agreement before resorting to arbitration; If any dispute or disagreement cannot be resolved by mutual accord, the dispute or disagreement shall be submitted to arbitration in accordance with the then current Rules of Conciliation and Arbitration of the International Chamber of Commerce by three Arbitrators appointed in accordance with the said Rules."

They must apply rigorous business practices and create legitimate mechanisms for the management and allocation of revenues. The transparency of financial structures and all transactions must be constantly maintained and enforced. And finally, in the event that disputes do arise, revenue sharing regimes must have clearly defined dispute settlement procedures. Revenue sharing agreements that incorporate these provisions for transparency, rule of law, multi-stakeholder engagement, and legitimate financial management may help fill gaps or weaknesses in governance, and thus alleviate conflict.

Appendix One: Revenue Sharing Regimes and Legal Norms

A broad range of legal norms have been used to apply revenue sharing contracts and regulate the social and environmental consequences of business activities. They include provisions in respect to the following principles.

a. Indigenous People

Because indigenous people often lack capacity and resources, they have had difficulties in protecting their interests in negotiations with companies eager to exploit natural resources in remote rainforests or mountainous regions. In the recent past, host governments have been accused of discouraging companies from any type of consultation or agreement directly with people living in the mining or oil project areas. These attitudes have changed with a growing awareness of the rights and interests of indigenous peoples, as articulated by a variety of international normative documents and agencies.[18]

- The United Nations Working Group on Indigenous Populations encourages UN member states to "actually increase the involvement of indigenous peoples in national decision-making" as part of the International Decade of the World's Indigenous People (1995-2004).

- The UN Convention on the Elimination of Racial Discrimination (CERD) recognizes "the importance that the land holds for indigenous peoples and their spiritual and cultural identity, including the fact that they have a different concept of land and ownership," and explicitly protects "[t]he right to own property alone as well as in association with others" without discrimination.

- The World Bank in its Operational Directive 4.20 requires disclosure to and consultation with indigenous communities.

[18] Norms as summarized by Russel Laurence Barsh in his papers, "Socially Responsible Investing and the Worlds Indigenous Peoples" and 'Is the Expropriation of Indigenous People's Land-Gatt-Able?" NYU School of Law

- The ILO Convention on Indigenous and Tribal Peoples, 1989 (No.169) acknowledges the “aspirations” of indigenous peoples “to exercise control over their own institutions, ways of life and economic development.”

- The 1992 UN Convention on Biological Diversity (CBD—*Agenda 21*) calls for governments to adopt measures in “full partnership with indigenous people” including the “[r]ecognition that the lands of indigenous people and their communities should be protected from activities that are environmentally unsound or that the indigenous people concerned consider to be socially and culturally inappropriate,” the protection of “sustainable harvesting” practices, and the devolution of “greater control over their lands.”

An example of how these international norms have been incorporated into national legislation is the Indigenous Peoples' Rights Act (IPRA) adopted in 1997 by The Philippines, which largely adopts the principles in ILO Convention 169. In principle, the IPRA gives indigenous peoples in The Philippines the right to veto or impose conditions on any development activities within their ancestral territories. [19]

Criticisms of Impact Benefit Agreements are that the monetary portions of such agreements are often kept private. As a result, the architects of the community agreement between the Dogrib people and Diavik Mine (Rio Tinto), near Yellowknife, Canada, opted instead for a "Participation Agreement."

In a joint statement the community and company say the agreement outlines: [20]

- Diavik's commitments to provide employment and business opportunities to members of the Dogrib First Nation. To facilitate the achievement of these objectives, the Dogribs have agreed to maintain and make available to DDMI on an ongoing basis, an up to date human resource inventory and a business registry for their membership.

[19] Further, the Supreme Court noted that the right to negotiate terms and conditions granted under section 7b pertains only to the exploration of natural resources . . . and cannot be equated with the entire process . . . which under the Constitution belong to the State – *again Cruz V Secretary*
[20] http://www.diavik.ca/html/body_committee_created_to_oversee_a.html),

- The creation of a joint implementation committee to outline responsibilities, tasks and timelines for reaching project-related employment and business development targets for the Dogribs. The Dogribs agree to employ a representative to liase with DDMI on these and other social development issues.

The affirmation by the Dogribs for their support of the development, construction and operations of the Diavik Diamonds Mine as approved by the Federal Minister of the Environment in November 1999. In so providing, the Dogribs have ratified the Diavik Environmental Agreement and the Socio-Economic Monitoring Agreement. The agreement is legally binding.

b. *Anti-Corruption Regimes*

International laws governing corruption include the Organization for Economic Cooperation and Development's (OECD) Convention on Combating Bribery of Foreign Public Officials in International Business Transactions, commonly known as the OECD Bribery Convention. The convention obligates its thirty-four member states to 'criminalize' the bribery of foreign public officials in the conduct of international business.

Other important anti-corruption agreements include:

- The OAS Inter-American Convention Against Corruption, which outlaws corrupt practices on both the national and international level. It commits signatory nations to reform their criminal codes and bring domestic law into compliance with the convention. The OAS is also exploring ways to develop a viable monitoring and review mechanism relating to the Inter-American Convention.

- In February, 1999, eleven African countries in the Global Coalition for Africa (GCA), adopted 25 anti-corruption principles that encourage implementation of common standards at the national level, as well as joint action between and among them.

- The Asia Pacific Economic Cooperation (APEC) forum is promoting economic reforms that enhance governance and transparency and create better investment and business climates to attract foreign direct investment. Its work builds on existing commitments of APEC Leaders (Presidents and Prime Ministers) and a broad range of programs in

APEC, including in the areas of investment, customs procedures, competition policy, government procurement, corporate governance, and regional financial markets. Many programs involve the private sector as integral participants in developing, carrying out, and assessing activities aimed at increasing transparency and promoting good corporate governance.

- The Council of Europe (COE) is active in a number of anticorruption initiatives and has adopted several conventions, including Criminal and Civil Law Conventions on Corruption. The Criminal Law Convention on Corruption is broad in scope, requiring parties to criminalize bribery (both giving and receiving) of public officials and private persons, domestic and foreign. The implementation of the Convention will be monitored by, the Group of States Against Corruption (GRECO), which will also monitor compliance with the "20 Guiding Principles" adopted in 1997 by the COE's Council of Ministers.

- The UN member countries are negotiating a new legally binding international convention against corruption to address the problems posed by corruption "which may endanger the stability and security of societies, undermine the values of democracy and morality and jeopardize social, economic, and political development."[21]

c. Host and Home Country

Although international treaties that are signed and ratified obligate a state to abide by its terms, a host country's domestic laws are the most accessible way to enforce contractual agreements. Examining the country's judicial and legal systems is key to determining whether its domestic laws are adequate to enforce revenue sharing provisions governing indigenous rights, property rights, natural resources, civil society organizations, etc. It is promising that some legal experts see "an increasing number of countries are changing their regulatory frameworks to require revenues be distributed to regional and local communities and even sometimes at the community levels."[22]

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[21] UN newswire, Aug.2, 2001

[22] IMF paper. New initiatives in Venezuela, Bolivia, Colombia, PNG, Indonesia, Philippines, and Canada have incorporated community level initiatives.

Most developing countries with an abundance of natural resources have laws governing extraction operations that address a variety of issues including environmental standards. However, in major regions of extraction activity, such as Latin America, often little or no attention is paid "to local economic benefits or social and cultural issues, a situation which pretty much left it to the initiative of the companies to define the quality of relationship they wanted with their neighbouring communities."[23]

As many experts have observed, there is a compelling need for host country legislation that ensures local communities and cultures share in revenues produced from natural resource extraction.

However even without such laws, revenue sharing provisions can be used to improve institutions such as judicial systems in ways that benefit the entire community. In countries that do not have a strong rule of law, revenue sharing agreements can be used to build the capacities of domestic legal institutions in order to strengthen and promote international legal norms as well as domestic legislation, as the Chad-Camaroon project seeks to do. In addition, the involvement of NGOs and other civil society groups in these arrangements can also contribute to opening the debate over how government revenues should be spent.

The laws of a company's home country can also affect revenue sharing arrangements. For example, in 1977, the United States adopted the Foreign Corrupt Practices Act (FCPA), which prohibits offers, promises, or payments to foreign officials, political parties, political officials, and candidates to secure business. Significantly, this domestic U.S. law has had a significant extraterritorial effect in exposing corrupt practices by foreign companies and government officials, and exposed them to a variety of civil and criminal liabilities, the loss of financing and insurance, as well as damage to their reputation.

d. International law in domestic courts

Poorly conceived revenue sharing arrangements could encourage human rights abuses that could lead to disputes that can be brought to the courts.

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[23] Socio-Economic and Environmental Effects of Large Mines on the Community: Case Studies from Latin America, Canada and Spain"-Gary McMahon-Global Development Network Felix Remy Mining Department World Bank Sept 18, 2000.

In instances where gross violations of human rights or possibly massive environmental damage has taken place, multinational oil and mining companies may be subject to the jurisdiction of US courts under provisions such as the Alien Tort Claims Act (ACTA), a US law that allows aliens to sue in US Courts for damages inflicted outside US borders. The ACTA is currently being tested in several cases in federal courts in New York and California to redress human rights abuses allegedly committed on the part of companies operating abroad. Europe is also showing development in its laws subjecting a company to liability in domestic courts for international operations.

Appendix Two: Examples of Revenue Sharing Regimes

1) Company to carry out ad hoc infrastructure or community development projects

The simplest form of a revenue-sharing regime are agreements between companies and governments or communities to carry out ad hoc development projects. These include such projects as the construction of hospitals, roads, schools etc. However these tended to be ad hoc in nature and did not result from a planned process of consultation nor a strategic plan for integrated development. These ad hoc projects initially were conducted in a manner that could be considered a top down approach that did not often involve input from the community. As the number of such projects multiplied, it became increasingly clear that they could benefit from a greater level of planning, consultation and/or coordination with other planned projects. Companies who realized some of the short comings of this approach have shifted to strategies that have greater community and government involvement.

2) Bilateral agreements between company and indigenous peoples

The specific needs and status of indigenous peoples have led many companies to develop specific agreements to deal with these issues.

Western Mining Company & Normandy Mining

WMC and Normandy Mining, Australian-based companies, have adopted a formal Indigenous Peoples Policy. WMC used this as the basis for its relations with the indigenous Bla'an tribe living near the copper exploration project in the southern Philippines. WMC engaged in a series of consultations and written agreements that created "an opportunity for both the Bla'an community and WMC to understand more about each other and provide a basis on which a mutual understanding and a positive working relationship could grow." As a consequence, the company says, "both WMC and the Bla'an indigenous cultural communities have come to understand and learn more about each other's culture and intentions in the area."

The WMC agreement with the Bl'an communities included a fund created with mining royalties, and the funding of the Community

Development Program. The agreement states: "The parties have consulted with each other...in relation to compensation, mining royalties and the implementation of the Community Development to promote the general welfare and long-term cultural and financial independence of the community" and provides that the fund is to be used "for the purpose of the development program for the socio-economic well-being of the community." Unfortunately, WMC later cancelled the project.

Rio Tinto's Hamersley Iron

In March 1997, Hamersley Iron a wholly owned subsidiary of the mining company Rio Tinto and the Gumala Aboriginal Corporation signed a Land Use Agreement for the development of the Yandicoogina mine. Hamersley Iron is one of the world's leading suppliers of iron ore and in 1999, the company exported almost 60 million tonnes of ore from its operations in the Pilbara region, in the remote northwest of Western Australia. A 1997 agreement provided a comprehensive framework for protecting the Aboriginal heritage and culture in this region as well as measures to promote local economic development. The company is providing $60 million over a 20-year period in assistance to the local Aboriginal communities in the form of community development, training, employment and business support.

BHP-Billiton Ekati Mine

Other means of dealing with such issues include Impact Benefit Agreements and Participation Agreements. Both methods have been instituted over the last decade in the North, and particularly at diamond mines in Northern Canada.

At the BHP-Billiton Ekati mine, for example, the company, regional government and communities negotiated an Impact Benefit Agreement that was designed to deal with environmental and social impacts. Under pressure from native communities in the mine area, the company agreed to an independent environmental monitoring process that has been considered an improvement over existing mechanisms under current Canadian regulations. "It is clear that the Environmental Agreement went well beyond what government and BHP had ever anticipated. It would be fair to say that all parties negotiated in good faith and that significant gains were made in the

public interest as a result of the direct participation of the Aboriginal organizations." [24]

3) Social Investment Projects

Increasingly, companies have attempted to develop a more integrated approach in their efforts to increase the positive social impact of their operations and the revenues they generate. These efforts have included greater consultation with stakeholders and their participation in the design and implementation of projects, more extensive efforts to work with governments at both the local and national levels, and an expansion in horizons of projects viewing investments from the pre-investment stages, through production years and closure.

It is becoming common that the social and environmental responsibilities of a multinational corporation are written into its contract of work with the host government. These are legally binding requirements for the contract. The 'social license to operate' is the unwritten one generated by the community on a daily basis as it agrees, minute by minute, to allow the project to operate. The possible range of outreach activities in this area are broad and can include the hiring of local employees and providing good training programs, sourcing locally and helping develop local businesses, having avoidance or "do no harm" mechanisms, which entails compensation for damages on the land or the costs of resettlement. This category also includes more pro-active community outreach projects like building schools, hospitals, roads etc. that result from a planned process of consultation or a strategic plan for integrated development.[25]

According to the World Bank:

> Typical business benefits from social investment include: improved operating climate, reduced risk of disruption to business; improved security; increased availability of local

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[24] Kevin O'Reilly, The BHP Independent Environmental Monitoring Agency As a Management Tool Prepared for the Labrador Inuit Association Submitted to Voisey's Bay Environmental Assessment Panel.

[25] The scale of the social investment is key to understanding whether the revenues will have a positive or negative impact. In the case of oil for example in oil A ver small percentage of a large field is lots of money and this shared revenue might create problems of its own if special measures are not taken.

> services or potential staff/contractors; improved relationships with community leaders and public authorities; positive publicity; and improved employee relations and morale.

Increasingly social investment, the development of people, is being used more specifically to refer to social capacity building, rather than infrastructure development.[26]

Foundations or trusts usually have a legal status of a charity and are community relations' instruments that are conducted by an entity sometimes independent of business but structured as to make them a partnership between company and community and run by a independent board. Rio Tinto has several foundations and trusts that operate alongside Coal & Allied in Australia, Rossing in Namibia, Rio Tinto Zimbabwe, Rio Tinto Indonesia and Palabora in South Africa. Similarly, Newmont Mining Corporation has project-sponsored foundations in Indonesia, Peru and Bolivia.

Freeport Fund for Irian Jaya Development

In Indonesia, like in many countries, the central government considers surface, and subsurface natural resources to belong to the people. Revenues are to be paid directly from the company to Jakarta as a condition of a long-term contract of work. While these contracts do make reference to Indonesian law, which stipulates that a portion of royalties paid by the company will be sent back to the province from which the minerals come - in practice there is little evidence that this actualy occurs. Because of this, Freeport McMoRan Copper and Gold Inc. and other Indonesian-based resource companies have created voluntary revenue sharing programs working directly or indirectly with local governments. Freeport has created the Freeport Fund for Irian Jaya Development, providing one percent (80 million dollars since its inception in 1996) to benefit the people living in the area. It also has social investments in infrastructure and development to compensate landowners for loss of land.

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[26] "Social Investment" assumes these revenues are for education, roads, health, etc. But justice, law enforcement, rule of law and military protection of the life, rights, and property of citizens can be social too, according to the context of the country or region."

Placer Dome-Papua New Guinea

Two community-oriented projects of the Placer Dome mines in Papua New Guinea serve as examples of direct cooperation between the company and local populations most affected by the company's operations. Although the PNG government is a shareholder in each mine (25% at Porgera and 20% at Misima), local communities complained that the benefits promised by the government to be paid for out of taxes received from the mines were not materializing. Placer Dome and the government agreed that a percentage of taxes owed by the mines could be retained and invested directly by the mines in local infrastructure improvements under the direction of local communities and authorities.

The resulting Tax Credit Scheme (TCS) and Infrastructure Development Program (IDP) has directly contributed millions of dollars of revenue to local communities in the mine impact areas, and funded initiatives that focus on education, community/government infrastructure and health. Placer Dome, in partnership with the government via the Porgera District Sustainability Plan, is also working to help the communities after the mine closure by promoting partnerships with key stakeholders such as the district government, local level government councils, landowner associations, women and youth associations, and local NGO's.

Newmont's Minihasa Raya Mine and Rio Tinto's Kelian Equatorial Mining

Additional considerations arise when it is time to close a mine. Both the Minihasa Raya mine (Newmont) and the Kelian Equatorial Mining (Rio Tinto), for example, will close within the next five years. Both mines are in remote parts of Indonesia. Both companies are committed to socially and environmentally responsible strategies for mine closure, and are developing and implementing detailed closure plans that meet these objectives. Part of the plans involves working in partnership with the various community groups, government authorities, and a local university, with the aim of contributing to the long-term social and environmental sustainability of the region. Partnerships include providing training to farmers in new techniques and promoting small-scale businesses. In the case of Minihasa Raya, the company has also set up a regional sustainable development foundation, funded with a US$1.5-million endowment, to create sustainable initiatives in the region close to but not directly affected by the mine.

4) Natural Resource Funds

Examples of governments using natural resource revenue funds to ensure intergenerational equity, strengthen demand management, and maintain competitiveness exist in both developed and developing countries. In assessing the social effectiveness of government oil funds-whether they will be used for long-term social and economic development or for short-term political purposes -- critical issues are the management of the assets, governance, transparency, and accountability. According to Stern the oil funds will only be successful in political and legal environments that are fully transparent, "that is, where issues of governance, corruption, and human rights converge. If the government does not allow public scrutiny of its accounts and is not accountable for their use, these funds become huge pots of money ripe for corruption and mismanagement, while broader goals of development and democratic participation are undermined."

Centrally Controlled Funds

The centrally controlled funds do not involve stakeholders outside the central government. The management and distribution of the revenues is decided by the central government. These funds usually do not included requirements regarding a need for third party auditing and transparency.

The State Oil Fund of Azerbaijan (SOFAR) and The Kazakhstan National Oil Fund

Both Azerbaijan and Kazakhstan sought advice from the World Bank and the IMF in creating their oil funds. However both funds have been the subject of criticism for lacking sufficient safeguards to ensure transparency and accountability

The State Oil Fund of Azerbaijan (SOFAR) was created in 1999 and currently holds assets valued at US$537 million.[27] The fund reportedly consists of money obtained from oil exploration and extraction contracts between the State Oil Company and foreign investors, including exploitation of oil and gas reserves in the Azerbaijani sector of the Caspian Sea.[28] As it is currently structured, it is the president who has power to decide how much

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[27] www.oilfund.az
[28] The Statute of the State Oil Fund of the Azerbaijani Republic," Azadliq, January 4, 2001

money should be taken out of the fund and how the money should be spent. The fund managers have said that they wanted to let the fund accumulate to $1 billion so that they could start making returns but there have already been two disbursements. Another goal was to use the funds to develop non-oil sectors, yet the government recently announced that the Fund would be used to finance Azerbaijan's share of the BTC pipeline.

In Kazakhstan, President Nursultan Nazarbayev reportedly plans to appoint a special council to run the government oil fund, with a governing body that will include himself, the prime minister, the heads of the two chambers of parliament, the National Bank chairman and the finance minister. The assets that will be kept in "a special government account" Managed by the central bank and invested in "highly liquid foreign financial instruments." National Bank Chairman Grigory Marchenko said in early January that the fund had received $660 million paid by Chevron-Texaco to Kazakhstan for its five percent stake in a joint venture at the giant Tengiz oil field. In December 2001 the Fund stood at $1.2 billion.

According to Kazakhstan's website for economic information the fund "[w]ill be replenished with extra budget revenues, taxes from oil companies and signing bonuses and royalties paid by partners in joint ventures and , "since the country's economy is so dependent on oil revenues, in January 2001 Kazakh President Nazarbayev issued a decree establishing the National Fund to make the country less vulnerable to changing prices for energy and commodities exports."[29]

Although the Kazakh fund produces daily, monthly, quarterly and annual reports for the government, these are not made public. In addition despite rules that require the annual report and the results of an annual audit to be published in the newspapers, this has still not happened.

Multi-Stakeholder Funds

Multi-stakeholder controlled natural resource funds are regimes that are designed to be transparent and accountable. This is reflected in the fact that they have professional staff and a broad group of diverse stakeholders who are responsible for ensuring that benefiting are shared in a socialy equitable

[29] www.eia.doe.gov/emeu/cabs/kazak.html

manner. In multi-stakeholder funds, a variety of stakeholders are involved in the management and distribution of the revenues. This can include the central or local government, private sector and civil society. The funds are professionally invested, audited by a third party and are transparent. Laws, regulations, detailed guidelines and professional accountants, money managers, and civil society govern the operations and capital management of these funds. The revenues are distributed for social, environmental and economic purposes depending on whether it is intended to ensure that present or future generation benefit from the proceeds.

The Norwegian Petroleum Fund

A model example is The Norwegian Petroleum Fund was established by the Parliamentary Act of June 22, 1990 No. 36 (effective of January 1, 1991) to establish mechanisms to preserve wealth generated by Norwegian petroleum revenues for future generations. The Fund operates to help diversify Norway's economy and reduce its dependence on oil revenues. The Fund generates annual income equal to the net cash flow from petroleum activities and the return on the Fund's capital. The Fund's annual expenses consist of transfers to the Norway's Fiscal Budget to cover the non-oil budget deficit. Norway's Ministry of Finance is responsible for managing the Fund, based on guidelines adapted by the Norwegian parliament. Any changes to the Fund's management (expenditure, investment strategy, etc.) must be approved by Parliament. Operational management is delegated to Norges Bank, the central bank of Norway, which manages the Fund in accordance with guidelines laid down by the Ministry of Finance. Current assets of the fund total 400 - 450 billion Norwegian kroner (NOK), which are projected to increase to 589 billion NOK in 2001. Although the Fund's management is highly transparent and uncontroversial, the intensity of the political discussion surrounding the fund's use rises proportionately with its growth. Some political figures advocate using the Fund to upgrade welfare services, while others evoke the risk of inflation and "Dutch disease" if more oil money is allowed to flow into the economy. The Fund's investment strategy has also been part of the political debate. As of January 31 2001, 1 billion NOK of the Fund is to be invested in a portfolio in accordance with environmentally responsible criteria. Some critics, however, would like to see that all the Fund's investment be invested according to both environmental and social/ethical criteria.

The State of Alaska's Permanent Fund

The State of Alaska's Permanent Fund (APFC) has a constitutional provision mandating that at least 25 percent of all mineral lease rentals, royalties, royalty sale proceeds, federal mineral revenue sharing payments, and bonuses received by the State of Alaska be placed into the APF. This constitutional mandate ensures that transfers to the APF are made independently of oil market and fiscal developments. The APF principal is invested permanently and cannot be spent without amending the State's constitution with a majority vote of the Alaskan population.

The Alaska Permanent Fund Corporation founded 25 years ago holds $24 million since its inception and has saved 54% and spent 46%. The Alaska legislature decides how the fund income is used. The legislature does two things with the annual income of the permanent fund: saves part for the future generations of Alaskans, and spends half on the current generation. The half paid out each year goes to the distribution of all qualified Alaskans. The fund's corporate charter states that its board of directors and others managing the fund must disclose if they are invested in any entity or project in which the board is invested and that the resources of the corporation must not be used to finance or influence political affairs.[30]

The Chad Cameroon Pipeline

The involvement of intergovernmental agencies in the development of revenue sharing regimes can provide an additional level of legitimacy, and a trusted mediator capable of working with all parties involved. It is also instrumental in situations involving several companies from different countries or in projects which themselves, or their impacts, that cross national borders.

An ambitious multi-stakeholder revenue sharing regime is the US$3.7 billion Chad Cameroon oil pipeline project created under the leadership of the World Bank. The project, one of the largest and most complex in African history, will develop oil fields in southern Chad, and includes the construction of a 1,070- mile pipeline through Chad and Cameroon to the Atlantic coast. It involves two sovereign states-Chad and Cameroon, their respective pipeline companies (COTCO and TOTCO), three oil companies

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[30] Section 11, Political Activities, Corp. Charter, found on www.apfc.org

(ExxonMobil, at- 40%; Malaysia's state-owned Petronas, at 35%; and Chevron, at25%), and $700 million in loans from the World Bank and the US and French governments. Prior to the project's inception, the participating oil companies had public consultations under World Bank guidelines that included nearly 900 village level public meetings, human environment surveys, public information campaigns, in-country and international NGO meetings, pygmy settlements, land valuations and verifications.

The most significant feature of the project is the World Bank's lending framework, which incorporates social, economic and environmentally sustainable practices intended to benefit the civil societies of Chad and Cameroon. The Bank's funding requirements stipulated that 80 percent of each government's share of the revenue (expected to be as much as $1.7 billion for Chad and $500 million for Cameroon over a 25-30 year period) must be spent on improving public health services, education, agriculture, infrastructure and rural development. As stated in *Business Week:*

> "The bank also insisted on equitable distribution of the oil money. In a bid to ensure that the oil proceeds are equitably distributed, the bank made the Chad government cede a remarkable degree of control over its share of the revenue…The $3.7 billion project could bring Chad about $200 million per year for the next 25 years, roughly doubling the government's annual budget. If used wisely, it could help rescue Chadians from their crushing poverty"

According to the International Finance Corporation, an affiliate of the World Bank that approved the loan, "The project represents a pioneering effort by the World Bank group to create an unprecedented framework to transform oil wealth into direct benefits for the poor, the vulnerable and the environment." One of the intended purposes of the World Bank's lending requirements is to help reduce the companies' political risks in a region that has been plagued by sporadic outbreaks of civil war over most of the past 30 years, and to encourage investment by the companies in local economic development. The World Bank's loan conditions include adoption by Chad's National Assembly of a Revenue Management Plan mandating that eighty percent of the project's revenues be used for immediate development, and ten percent is be held in a trust for future generations. President Derby singed the Plan into law on January 11, 1999.

An ExxonMobil lawyer has articulated the project's revenue sharing rationale: "The law sets out a process for long-term management of the revenues from the oil development, ensuring that project benefits reach the citizens of Chad, including residents of the oilfield area. The revenues will be divided between a special treasury escrow account for 90 percent of the revenues and a savings account for 10 percent of the revenue. The funds must be allocated to the priority sectors, which include public health, social services, education, infrastructure, rural development (agriculture and livestock), environment and water. Five percent of the royalties are intended for communities of the producing region."

The project also includes the requirement of a Poverty Reduction Strategy Plan (PRSP), a Revenue Management Plan, Environmental Assessment and Environmental Management (action) Plan procedures. The PRSP's initial report serves as a road map to the capacity building needs of institutions as well as technical skills transfer, development of communication and data management infrastructure plan. It also includes plans to develop a research and analysis center in Chad's main university will eventually build institutional and human capacity and hopefully add partners to the independent monitoring and evaluation of the project over time. All of this intends to improve trading mechanisms to enhance Chad's marketability for entering into new and expanded trade arrangements.

The World Bank has also prepared an Indigenous People Plan specifically to protect the Bakola Pygmies of coastal Cameroon who live in the area of the proposed pipeline. The plan provides for a foundation to administer a dedicated fund to underwrite health, education and agriculture programs and a Community Health Program for a tuberculosis treatment. Compensation to tribe members will be determined by input received during public consultation process. For example, the Bakolas have indicated they may prefer to receive compensation in the form of in-kind goods, such as a sheet metal roof for a hut instead of cash payments.

In February the World Bank established the 'International Advisory Group' to monitor the use of the pipeline profits and to "identify potential problems as they arise, concerning issues such as the misallocation or misuse of public revenues"

Environmentalists and human rights groups have opposed the project amid concern about potential water pollution, the uprooting of villages, and whether revenue would reach ordinary people. Critics were further aroused in November 2000 when Chad's government used a cash advance from the project to purchase weapons. Despite these early problems, the project remains an important model for the use of the leverage that can be wielded by multilateral lending agencies to dictate transparency and accountability in resource development projects.

The Niger Delta Development Commission

After years of conflict between the Nigerian government and the Ogoni tribe, the Niger Delta Development Commission (NDDC) was created to redress the neglect and mismanagement of the oil-rich region's revenues. A revenue sharing plan requires nine oil-producing state governments, oil companies, and the federal government of Nigeria to pay revenues into the NDDC to support sustainable development in the region and remediate environmental damage. Dow Jones Newswires reports that the plan requires the oil companies who are members of the international joint venture to pay 3% of their annual operating budgets to the NDDC, state governments are required to pay 10%, while the federal government is required to pay 10 billion naira a year. The NDDC initiative has recently been marred by disputes over payments by the government, and complaints that it is not adequately reporting its activities or allowing local communities sufficient control over its funds.

The UNDP Human Development Fund Nigeria

According to the Amnesty International and the Prince of Wales Business Leaders Program joint publication *Human Rights-Is it Any of Your Business*, " In many developing countries, the centralised nature of government is such that remote communities often derive little or no benefit from state allocated resources. This can lead to disaffection within oil or mineral producing areas, expressed through protest about or disruption of companies' operations. This in turn can lead to cycles of civil protest and government repression, as has happened in Nigeria."[31]

[31] Human Rights, Is it Any of Your Business p. 39

The Human Development Fund (HDF) was initiated by UNDP in 1999 to mobilize private voluntary and targeted contributions in support of Nigeria's poverty alleviation efforts because of the "[g]rowing awareness and an unprecedented global consensus that poverty poses the greatest threat to peace and stability."[32] Although in the 1980's, Nigeria and Norway's GDP were relatively the same level of economic performance, by 1999 they were drastically different. This disparity is due to the fact that "the vast human and material resources deployed to poverty alleviation over the years have not produced the expected transformation in the fortunes of the poor."

The funds are to be used for "people-propelled development including ownership, participation, sustainability…" and to avoid poor targeting and randomness. The value of a UNDP administered fund is use its own networks and capacity to help ensure the proper targeting and use of the funds. The operational aspects will be carried out through micro-credit facilities, community social infrastructure and capacity building services.

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[32] HDF Concept Paper, for Community Development UNDP