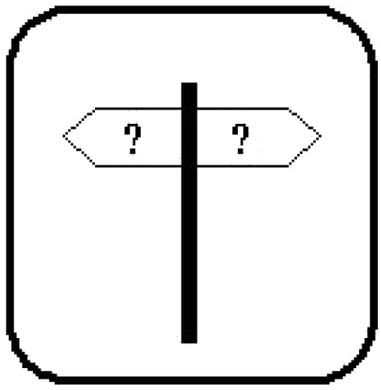
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POST-REFERENDUM ARRANGEMENTS

FOR SUDAN'S OIL INDUSTRY



HOW TO SEPARATE SIAMESE TWINS

ECOS
European Coalition on Oil in Sudan

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COLOPHON

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Contact:
European Coalition on Oil in Sudan
P.O. Box 19316
3501 DH Utrecht
The Netherlands
info@ecosonline.org
www.ecosonline.org

The European Coalition on Oil in Sudan (ECOS) is a large group of European organizations working for peace and justice in Sudan. ECOS calls for action by Governments and the business sector to ensure that Sudan's oil wealth contributes to peace and equitable development.

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INTRODUCTION

Negotiations for Sudan's future after the Comprehensive Peace Agreement started in earnest on 23 June 2010 with the signing of an MOU by the NCP and SPLM that lays down the modalities for resolving post-referendum issues and arrangements. The Southern Sudan Referendum Act stipulates that: *"[…] the parties of the CPA shall enter into negotiations aiming to achieve an agreement on post-referendum substantive issues to be witnessed by the organizations and countries signatories to the CPA […]".* It lists two key points regarding the petroleum sector: 1) oil fields, production, transport and export of oil; and 2) contracts and environment in oil fields. The Working Group on Financial and Economic Issues & Natural Resources has been tasked with negotiating an agreement about these and related issues.

This document identifies key issues affecting the petroleum industry that will emerge during the post-referendum negotiations. It points out the crucial factors and makes recommendations with a view to unleashing Sudan's oil industry potential to contribute to peace and equitable development. It is meant to inform the wider public and discussions in the Working Group on Financial and Economic Issues & Natural Resources.

The decision on unity or secession will be taken by the South Sudanese people. Whatever the outcome, a new agreement for managing the oil industry is needed. This document pays special attention to the complex issues that will arise should the South gain full independence, not to advocate secession, but because Southern independence will be the most challenging outcome for the industry. The worst case scenario is a disputed secession. The second worst case scenario is a poorly negotiated secession that fails to settle key issues, giving rise to destructive disputes. The only acceptable road ahead is an agreement that is truly comprehensive, satisfies the interests of both parties, and offers a commercially attractive framework for the future management of the industry.

The petroleum industry is complex and secession means unravelling an intricate web of legal, financial, contractual, economic and managerial factors. Like separating Siamese twins, it will be a risky and painful operation. It has been publicly noted that a new revenue sharing agreement may create the post-referendum body of common interest between NCP and SPLM that could guarantee peace. Less attention has been given to the need to maintain oil revenues and foster a social support basis for the industry. Without political stability and commercially attractive conditions for the industry, investment levels may fall and Sudan's oil potential may never be fully exploited.

North and South Sudan share a heavy dependency on oil, and a healthy petroleum sector is crucial to all. The future arrangements for the oil industry will be watched closely by international financial markets as the potential for sustained economic growth in Sudan is tremendous. The South's potential for agricultural development and natural resource exploitation is phenomenal, and the impressive oil-driven economic growth in the North has built a significant human and institutional capacity that enables it to attract and absorb high levels of foreign direct investment. A comprehensive, straightforward and legally sound deal that ensures continued and responsible exploitation of Sudan's oil wealth is essential for building confidence in Sudan's economic future among the international business community.

For the sake of convenience, we use the improvised acronyms GONS (Government of Northern Sudan) and GOSS (Government of Southern Sudan) to indicate the two post-referendum governments.

How to read this report

Each of the following sections includes five categories, marked by the symbols below:



1) Issue identification



2) Stakes and considerations



3) Options for the negotiators



4) Road ahead: recommendations



5) Recommended action

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CHALLENGES FOR A POST - 2011 PETROLEUM DEAL

The end of the CPA's Wealth Sharing Agreement in July 2011 poses a number of major challenges:

1. The present revenue sharing deal will come to an end. Without oil revenues, the GONS[1] will lose approx. 30% of its budget, crippling its ability to sustain political patronage and destroying the main driving force behind the country's economic growth. The 30% oil revenues are the GONS' main source of hard currency. Any reduction in oil revenues would seriously jeopardise the new government's ability to service its international hard currency debts, leading ultimately to default, which would result in economic and in all likelihood political mayhem.

2. The GOSS is even more heavily dependent on oil revenues. Without the pipelines, refineries, export terminal, sub-contractors, human resources and the consortium's offices in the North, there will be no oil revenues at all and the GOSS may simply collapse.

3. The existing oil contracts establish rights for oil companies to exploit certain concession areas and the right of the Government to share in profits without investing any money itself. In the case of secession, the GOSS will instantly inherit contracts and all the rights and duties they entail, without having at its disposal the necessary human resources, institutions, experience and legal capacity to manage petroleum reservoirs, monitor operations, enforce the law and protect its own rights and interests and that of its population.

4. Sudan holds some $36 billion in external debt. Should separation become a reality, the North and the South will have to reconcile numerous different interests and viewpoints. The SPLM may argue that it has never benefited from these loans, and lacks the resources to carry any of it, while the NCP may argue that it cannot afford to sustain the full debt on its own. Both positions are legitimate and drastic debt reduction is paramount for economic development and political stability.

5. The Government of Sudan has perhaps taken out external loans that are secured against future oil production, over which it may lose all rights with separation. Southern independence would require these loans to be restructured, adding stress to the GONS[1] already unsustainable burden of debt. International creditors would object if GONS was to privilege commercial creditors, leaving the GONS with few other options than to accept the conditions of its creditors or to take draconic austerity measures.

6. The failure to find commercially-viable quantities of oil in Block 5B, north of the Sobat river and in Ethiopia's Gambella region, have lowered overall expectations for Southern Sudan. Total has downgraded its exploration programme and no other large international oil companies have shown an interest in Sudan. To carry on, the industry will have to raise its technical, social and environmental performance which would involve making significant new investment. This requires attractive commercial conditions, political stability, competent governance, and an end to US sanctions. Otherwise, Southern Sudan risks not maximising its potential and merely attracting marginal companies such as Fenno Caledonian, Star Petroleum, Jarch, and White Nile, adventurous hopefuls with no proven history of business performance.

7. The petroleum industry lacks a satisfactory social support basis, and consequently suffers from sabotage and stoppages, adding to its already high-risk profile and discouraging investment.

Government of North Sudan, a provisional name for the government in the North should the country split in two. The 30% is after the 50-50 split in revenues from South Sudan produced oil that is transferred to the GOSS.

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ISSUES TO BE ADDRESSED

Issue 1 Money and the Complexity of the Negotiation Package

The financial, legal, managerial, political, and economic dimensions of the oil industry are complex and interconnected. A post-2011 deal on the oil industry must be an integral a **broad negotiation package**. The alternative, many separate agreements, will be time-consuming, incoherent, and eventually disappointing for at least one of the parties.

Peace and long-term economic perspectives are best served by a deal that avoids acute financial stress either for GONS or GOSS. The oilfields in the south can only generate revenues for two countries on the basis of a stable relationship between GONS and GOSS. The right of a newly independent southern Sudan to take full command of its dominant industry will have to be balanced against the importance of developing mutual interests with northern Sudan. The petroleum sector is in many ways “bi-national” and to ensure ongoing investments in exploration and production it must be organised accordingly – at least for an interim period following July 2011. A far-reaching cooperation agreement on economic matters, based on a long-term development agenda, would create the necessary enabling environment for this.

The complexity of the issues require to table the main managerial and financial questions first. If the hard choices are left to the final stages of negotiations, the technicalities and complexity of the issues at stake risk being neglected resulting in an inconclusive hotchpotch that holds the seeds of sustained disputes which will only frustrate the industry’s future development.

In essence, a new revenue management agreement could consist of either a form of continued revenue sharing, payments for the use of the infrastructure in the North - i.e. transport and management fees - or a combination of the two. Questions as to infrastructure ownership must be taken into account as should the distribution of the many layers of debt, financial obligations that are connected with the oil industry. The time-schedule for the transfer of managerial responsibilities must take each party’s capacity into account. Simply continuing revenue sharing is no option; apart from being a political non-starter in the South, it would overlook the complexities of the industry’s financial and managerial structures.

The agreement will have to ensure a stable economic, legal, and managerial environment for the mid-term. That requires a certain coherence in regulations and policies between North and South. In the longer term, Juba and Khartoum are likely to develop in different directions, with South Sudan probably integrating itself into the economic orbit of the East African Community and an independent North, and possibly developing its own petroleum infrastructure and an export route through Kenya. Unless it manages to control its foreign debt, North Sudan is likely to continue its successful policy of attracting Asian and Arab investments. A considerable level of shared economic concern will however remain, because of the interdependence between the border states and because investments in the South are likely to be dominated by the same kind of Asian and Arab investors that are active in the North.

Adequate technical preparation is paramount. The international community[2] could offer to facilitate the preparation of the necessary technical working papers by ensuring adequate funding and assisting in contracting external experts.
The parties may establish a working group to analyse the industry’s need for regulatory and policy coherence.

2. Norway would be best placed to take the lead in this, considering its proven commitment, and the even-handedness with which it has to date advised GONU and GOSS on petroleum and related issues.

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Issue 1.a Pipeline Fees and Ownership

Two **pipeline** networks link the oil fields with the refinery in Khartoum and the export terminal in Port Sudan. Since 2005, the North has been deducting pipeline fees from the national revenue before splitting the remainder between North and South. It is unclear how this figure is determined, but it generally accounted for 3-8% of the governments' share in late 2008 (see: Global Witness, 2009). Nor is it known what services are covered by the fees, for instance whether they include security provision.

It is unclear whether the fees are paid to the oil companies, to Sudan's Government, or to both. Detailed ownership arrangements are not disclosed; however the ownership of the Heglig - Port Sudan and Adar Yale - Port Sudan pipelines is expected to go to the Government in 2014 and 2021 respectively. Some would argue that Southern Sudan has already de facto acquired partial ownership by having paid 50% of the fees to the oil companies during the CPA period, but this is unlikely to have a sound legal basis. However, separation would require a division of national debts and assets, creating a justification for a Southern claim for ownership of a part of the petroleum infrastructure.

A straightforward fee arrangement would be the most practical outcome. Once a transport and management fee, joint oversight, and export guarantees can be agreed upon, formal ownership becomes irrelevant.

GOSS could agree to pay service charges to operating companies in line with a clearly defined formula, for example between $US 4-6 per barrel. Management charges, to the extent they apply, could be paid to Sudapet.
Pipeline fees only partially benefit Khartoum, and therefore do not necessarily present the NCP with an attractive option. A fee-based agreement however could be part of a broader financial scheme. It could also be made to include costs that are usually paid from the national budget like security and regulatory administration and enforcement. For instance, the GONS could present a budgetary plan on policing the pipeline. The actual fees for the Government's services will be open for negotiations that cannot ignore the broader economic implications of separation.

Only a fee-for-service model would be simple and effective. All payment should be made in foreign currency.

Issue 1.b Ownership and Other Downstream Fees

During the CPA, **downstream activities** were coordinated by Khartoum's MEM. In turn, South Sudanese agencies had virtually no operational tasks regarding central processing facilities, refineries and export terminals. The Government of Sudan is believed to annually receive almost half a billion US Dollars to perform this task.

With most downstream facilities located in the North, the question is to what extent the South would be involved in the management thereof. The same applies to the management of upstream operations, which will in any case be required for a transitional period.

Either SPLM and NCP agree to keep downstream operations under Northern management under a fee-for-service model and leave upstream management to the GOSS, or the parties agree on a financial sharing formula and establish joint management structures.

Even though a joint management structure and financial sharing would encourage economic cooperation between North and South post-2011, the more realistic options lies in a fee-for-service deal, which would give GONS the main responsibility for downstream management. Joint management structures are complex and require precise task divisions between North and South, with each having full control of their respective areas of responsibility as well as unrestricted information sharing. Such a system is likely to malfunction. A transitional period of gradual transfer of responsibilities would be needed, in parallel with the building of a Southern Sudan Petroleum Authority.

A deal could include standards for calculating a fixed percentage of the achieved price per barrel (calculated on a monthly basis) for each of the management tasks as well as for the downstream operations such as processing, refining and export handling in Port Sudan. Payment clearance to be done on a monthly basis, in foreign currency.

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Issue 1.c Nilepet, the Southern National Oil Company



Sudapet is the a fully-fledged National Oil Company, while Nilepet has very limited capacity and experience in oil exploration or production.



Nilepet's takeover of Sudapet shares would require the organisation to plan a massive scale-up, including beefing up its current team of 30.



With oil shares comes operational responsibility for Nilepet. As is the case with legal revisions or employment quotas, any attempt to smoothen the transition would require patience and a well-phased restructuring effort. The question is when Nilepet could take over from Sudapet.



Joint management of GNPOC would give Nilepet breathing space. It is recommended that the parties agree that Nilepet focuses on scaling up and integrating staff into PDOC and WNPOC operations. Additional training might be done in close cooperation with GNPOC and the three large parent companies CNPC, Petronas and ONGC.
NCP and SPLM could agree that the GONS takes over the full debts still owed for oil infrastructure in the north, in exchange for full ownership shares. This would include the outstanding payments to India's OVL for the Khartoum-Port Sudan pipeline. Outstanding payments for GNPOC investments, if applicable, may be shared between GONS and GOSS. Oil production from GNPOC would serve as collateral for Khartoum, with, if required, international donors providing additional guarantees.



NCP and SPLM could agree on a major capacity building effort in all projects and decide on a gradual integration of Nilepet staff into PDOC and WNPOC operations over a 5-year period. In addition, it would be a shared interest if the capacity building costs of the GOSS would be incorporated into the overall financial agreement.

Issue 1.d Sudan's Oil-related Debt



Sudan's national debt amounts to some US$ 36 billion, which is simply unmanageable given the size of the economy. The distribution is roughly as follows: 1/3 Paris Club; 1/3 non-Paris Club; 1/6 Multilateral; and 1/6 commercial. Most commercial loans are from China and the Gulf States. Many Chinese loans have paid for petroleum infrastructure and they are possibly secured against future oil production.



Without drastic debt rescheduling, Sudan's economic growth will be frustrated.



It may help to reach an agreement on oil-related debt by linking it with the costs of management fees.



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The international community could prepare a debt servicing plan that is connected to compliance with post-referendum arrangements, good governance, and a sustainable economic growth policy.

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Issue 1.e Full Data Disclosure



Post-2011 arrangements must be based on **full and reliable information about all the financial, legal and economic aspects of the oil industry,** available to both negotiating parties well in advance.



Sudan's oil industry is not transparent. Social and Environmental Impact Assessments are confidential; tendering processes are murky; companies are reportedly coerced behind closed doors to award contracts to designated companies such as Petroneeds; financial structures and money flows are difficult to understand; the GONU does not fully and credibly account for its finances and business deals with parliament; neither does the GOSS; the SPLM leadership has a history of engaging in secretive and legally invalid deals with shady companies.
Unless both parties to the negotiations have identical, comprehensive and reliable information at their disposal, the outcome will be inequitable and warrant sustained disputes. The oil industry itself will most definitely suffer heavily from dubious arrangements.



The relevant information is generally available from the GONU and the companies' home countries. Levels of distrust being what they are in Sudan, it would be judicious if an impartial party were to step in to collect and verify all the necessary data in a comprehensive audit of the entire sector.
The oil companies themselves have a wealth of information and it would be in their interests to share this information with parties.



To inform the negotiations and provide a level-playing field to the parties, a complete database is needed with all legal, contractual, financial, commercial, technical, geological, environmental and managerial aspects of the industry, including all international loan contracts, to be made available, under strict confidentiality, to parties.
A concise overview of the main elements could be prepared for publication to inform the public, to allow for public scrutiny and build a social support basis for the industry.



The international community could facilitate drawing up an inventory of the required information, identify where it can be found, offer adequate funding, ensure timely availability, and provide technical assistance in building a dataroom with all relevant information.

Issue 2 Future of GNPOC



GNPOC operations in Blocks 1, 2 and 4 straddle the yet to be demarcated border between North and South. Its oil fields are in decline. Southern secession would make North and South each sovereign over another part of the present concession area. But **carving up the GNPOC Consortium along the border may have dire consequences for all parties involved.**



A split would certainly be unattractive and possibly commercially unacceptable to the international parent companies. The South is contesting the Technical Border Commission's decision to locate the Heglig fields (Block 2) in the North. A new expert committee might look at the remaining disputed areas which would have an impact on the right to oil revenues. By contrast, the Abyei referendum will not change much in terms of oil production. Only one of the GNPOC oil fields (Diffra) is located in Abyei territory.



One option could see the GNPOC consortium divided into two, each exploiting their own side of the new border between North and South. This would be an extremely costly and complex operation and is likely to result in two poorly-performing companies. As it would drive up the costs of exploitation, it would result in a decrease in investment, lower production and plummeting revenues.
Alternatively, NCP and SPLM could continue the GNPOC project under a 'business as usual' deal that would transform the border problem into a joint cross-border development project. The challenge of this option is to ensure adequate Southern ownership and oversight, as well as a reform in GNPOC's operational practices in order to guarantee conformity with the SPLM's professed goal of achieving a sharply improved social, environmental and developmental impact.
Joint management of Petrodar and WNPOC could also be considered, if only for a transitional period. This could build trust and create a substantial body of shared interest, reflecting actual interdependence.

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If carved up along an as yet to be decided border, the GNPOC project has few prospects of profitable exploitation. Production has been declining and analysts say that at 25%, the average recovery rate [percentage of oil in place that is actually produced vs. what remains in the ground] is already critically low. Only with high investment levels and the implementation of new, top-notch technology for enhanced recovery can GNPOC continue to generate revenues in the mid-term. Otherwise, GNPOC's production may come to a halt within 5 years (see graph below). It is therefore recommended that SPLM and NCP agree on a joint post-2011 management structure for GNPOC, and possibly also Petrodar and WNPOC. The Southern national oil company Nilepet could take over some of the Sudapet shares and vice versa. Exploration and Production Sharing Agreement (EPSA) would not need to be fully renegotiated, but qualification of several articles is obviously required, for example under Article 32.1 of the GNPOC contract[3]. Modifications would also be required to deal with the financial consequences of GOSS concerns such as Southern Sudanese employment targets; social, environmental and development standards and targets; rules and objectives for community development; rules and financial arrangements for abandonment and rehabilitation; a Southern capacity building programme; transfer of offices to the South; financial and managerial transparency; and monitoring and enforcement.

GNPOC could prepare for its post-CPA survival by setting options for a joint management structure that would that satisfy the interests and aspirations of both GONS and GOSS, and present them to the Working Group on Financial and Economic & National Resources.
NCP and SPLM identify a team of capable individuals who will together oversee joint management structures and joint development zones.

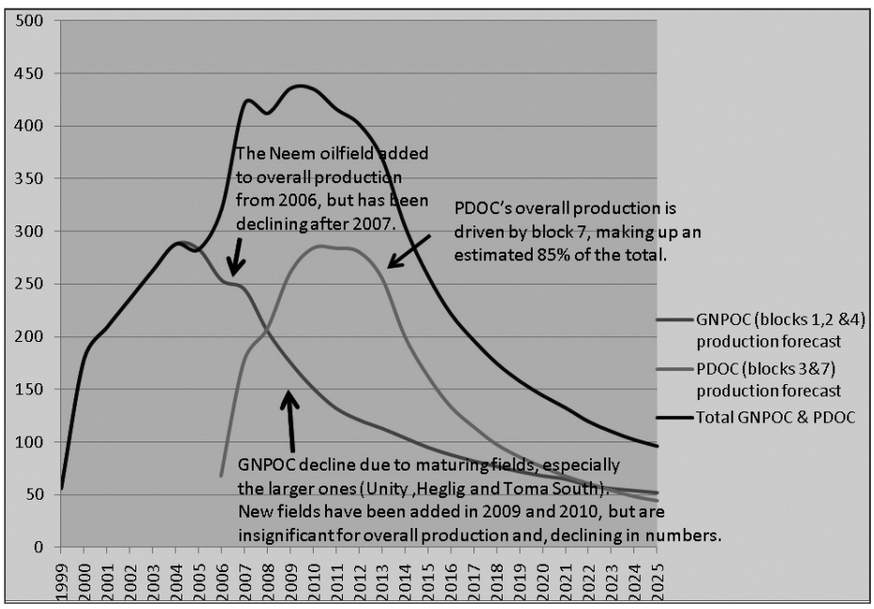


Figure: projected decline in production in Blocks 1, 2 & 4, and 3 & 7. Data source: GNPOC and PDOC data. GNPOC 2020-2025 are ECOS' estimations. New wells and modern technologies may add 5% to the current recovery rate , shifting the curves towards the right and adding several years to the projected production. To make the required investments commercially attractive, it may be necessary to renegotiate the percentage of future production that goes to the government and the consortium in favour of the latter.

Issue 3 The Three Areas

The Three Areas along the North-South border (Abyei, South Kordofan and Blue Nile) play a key role in future North-South relations. With all major pipelines running through these areas, the oil industry's future also depends on a stable outcome for these areas. Similar considerations also apply to the other border states including the oil producing Southern states of Unity and Upper Nile.

While Abyei might or might not join the South in case of secession. Southern Kordofan and Blue Nile will certainly remain part of the North. Political deals to accommodate minority rights in both states will be negotiated through "popular consultation", but are also subject to political deal-making. There is a risk that without meaningful development prospects for their homelands, many communities in these three areas could over time feel marginalized and turn against the oil industry.

3. The full GNPOC contract is available on www.ecosonline.org.

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The CPA provisions for the three border areas are clear and – if well implemented – provide a framework for political accommodation. Genuine commitment to implementing the CPA could therefore suffice to arrive at a settlement on political inclusion in a new Northern state. This would unlink post-referendum negotiations from the political intricacies of the three areas. On the other hand, time for adequate consultation might be running out, leaving the parties with a need to accommodate the three area issue within a broader post-2011 deal.

To prevent the oil sector from becoming a target for violence, post-referendum arrangements could take the political dynamics in the three areas into account. Negotiations would include a programme for pro-poor and politically inclusive sustainable development of these regions as well as the other border areas. Modelled on the idea of the Unity Fund, a joint trust fund could be geared towards state-level development, including support for migration solutions, transport/infrastructure projects and the management of cross-border trade routes. A fixed percentage of oil revenues could be allocated for this purpose. To forestall unnecessary disputes, exposing the fund to independent scrutiny might be considered. A certain percentage of the funds could be reserved for cross-border projects which would benefit the states on both sides of the border.

A comprehensive development programme for the three areas and border regions to be developed jointly by parties.

Issue 4 Security

Current security arrangements for the oil industry are not sustainable. Petroleum consortiums in Sudan are reportedly required by the Government to employ specific security staff, who have background or experience in the army or the security services. They allegedly report to security agencies based in Khartoum rather than to their employers.
In preparation for the post-referendum era, both SAF and SPLA may reinforce their military capacity in the border areas and the oil fields. In any scenario, the industry will need peace in the border areas and guarantees that its assets and staff will be safe. A post-2011 oil deal will have to include these guarantees.

The replacement of ANY former SAF and NISS staff employed by the consortiums should not disrupt operations and it will therefore have to be a gradual process. They should not be replaced by Southern security officers as this would violate best industry practices and international standards like the Voluntary Principles. It would ensure that the industry will remain highly politicised and frustrated by non-economic considerations. This would inevitably deter technologically advanced parties who would be able to raise the recovery levels and overall performance of the industry. It would also complicate reforms that would make the industry more efficient, profitable, and accountable.

An inclusive security concept, based on the principle that security is a shared concern for government, companies and the population, and that support from the population is a priority security concern, should replace the industry's current dependency on a combination of fear, patronage, and the buying of goodwill with service delivery. The continued prevalence of people with a military and security background, albeit originating from the SPLM, may provide a certain kind of security, but risks sustained alienation and dissatisfaction among the population and perpetuating a climate in which targeting companies remains socially acceptable. It runs the additional risk of the political exploitation of popular discontent.
An inclusive security concept would not be restricted to strict rules for public security providers, but also see oil companies adopt conflict-sensitive business practices and support and facilitate conflict prevention and peace-building programmes, directly engage with stakeholders and promote the rights and interests of the people affected by the operations.

International Best Practices for corporate security policies include the assurance that both private and public security providers respect international principles and international law, including respect for human rights. By introducing these standards, international trust in the sector will improve and a major obstacle to attracting mainstream investors that have hitherto been reluctant to look for opportunities in Sudan will be removed.
The international best practice on security guidelines for the oil and mining industry is the Voluntary Principles on Security and Human Rights [VPSHR, see: www.voluntaryprinciples.org]. Several guarantors of the CPA participate in the VPSHR, including the US, UK, Norway and the Netherlands. The VPSHR provide guidance on key issues such as risk analysis; vetting and training for security providers; reporting;

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community consultation; engagement with private security providers; consultation with communities; and grievance mechanisms. The latter is particularly important for achieving maximum operational security at minimum cost.



NCP and SPLM could agree to gradually weed out ANY staff members with military and security affiliations from oil consortiums and contracting companies' payrolls.
All consortiums would restructure their community development operations, fully unlinking them from their own and outside security providers. This would require full disclosure of all (former) SAF and NISS staff working with the oil companies and their contractors.
NCP and SPLM seek technical advice from participants to the Voluntary Principles on Security and Human Rights on integration of international best practices on security and human rights in post-referendum arrangements.
The industry is required to comply with VPSHR standards.

Issue 5 Contract Review



The Review of Exploration and Production Sharing Agreements is explicitly mentioned in the Southern Sudan Referendum Act. The prevailing contracts are outdated and do not meet the terms of the country splitting up. They are partly responsible for problems in the petroleum industry. Issues such as environmental protection, workmanship standards, compensation, labour rights, security provision, abandonment and rehabilitation, and social impact are either poorly addressed or not at all. These issues are also disregarded in the arrangements for cost recovery. As a result, in day-to-day negotiations between a consortium and the government, both share an immediate financial interest in keeping costs low, which victimises both the environment and people. In addition, the authorities' enforcement capacity is poorly developed.
The companies are unlikely to renegotiate contracts and the stabilisation clauses in the contract give them the legal right to reject this option. The overriding importance of not interrupting production and maintaining confidence in international markets argues against unilateral action. Nevertheless, all parties would have an interest in adjusting to the political realities. A series of ad hoc agreements could offer an acceptable middle ground.



Senior SPLM figures have emphasised that, in the case of Southern independence, they are keen to apply a policy of minimal change in order to maintain good relations with the leading oil companies. At the same time, several of them have made it clear that revision is needed to improve operational standards and practices, to make way for newcomers and to introduce stricter controls on environmental practices.



Secession necessitates a review of the contracts' consequences. There is also a need to create space for international best practices. A series of ad hoc agreements may be a quicker road to the upgrading of industry standards and performance than legal reform. Oil companies have a keen interest in reasonable profit levels and a predictable legal and political environment. Delays will lead to uncertainty and a reluctance to invest.



Addressing the many pressing social and environmental issues has financial consequences that need to be agreed upon. This may require adjusting cost recovery criteria.



Independent comprehensive social, environmental and development impact assessments could be carried out immediately to identify particularly pressing issues.
The international community could make legal and technical expertise available to parties.
Increasingly, countries and oil companies agree to make their contracts public. Transparency builds trust and it is strongly recommended that NCP and SPLM make all reviewed contracts publicly available.
In the case of separation, it is vital that oil legislation in North and South are streamlined and brought up to date.

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Issue 5.a Quota for Sudanese nationals in the workforce



The GNPOC contract includes a clause that obliges 90% **employment of Sudanese nationals** by 2010. Other contracts are believed to include similar clauses. To the extent that employment targets have been reached, they mainly involve people from North Sudan.



Should secession become reality, the consortiums may be contractually obliged to replace all non-South Sudanese staff members overnight. Either a separate agreement overruling the contract or contract modification is therefore required.



Recruitment, training and integration of new staff are long-term processes. Both the exact levels of South Sudanese employment and the time allowed to reach these levels is up for consultation.



A transition period would be needed during which the South Sudanese workforce is gradually increased in accordance with agreed targets.



As part of a North-South deal, the NCP could request firm guarantees from the SPLM to provide adequate funding for recruitment and training in order to ensure that the South's key institutions with responsibilities to run the Southern aspects of the oil sector perform well, so that Khartoum revenues from a fees-for-services model are guaranteed.

Oil consortia could open recruitment offices in the South as a matter of priority. Negotiations between SPLM and oil companies could also focus on well-defined responsibilities for recruitment policies, and for relevant training programmes on technical expertise in order to improve staff prospects for junior and senior careers in the sector.

Issue 5.b Office relocation



Related to the employment aspect, oil companies may be expected **to relocate some or all office accommodation to the South.** Operational headquarters are located close to the oil fields, along the to-be-demarcated border (GNPOC) and in the South (WNPOC and PDOC) while all main offices are located in Khartoum. With separation, this no longer makes sense.



With secession, it would be impractical and politically problematic to keep the company headquarters in Khartoum.



In order to be closer to Southern policymakers (and the oil fields), WNPOC and PDOC headquarters would benefit from relocating to Juba. The three parent companies CNPC, Petronas and OVL can opt to open new, fully-fledged offices in Juba, or keep most of their staff in Khartoum and risk alienation and hostility from their regulators and business partners.



In line with the Southern control of Southern oil fields, the management of upstream aspects of the active consortia are recommended to re-locate to the South, whether jointly managed or not. Depending on its projected remaining lifespan, special arrangements could be agreed upon for GNPOC.



In the case of PDOC and WNPOC, NCP, SPLM and the oil companies could agree to move the two headquarters to Juba. This with a transition period of 5 years. The parent companies Petronas and OVL may decide to open an office in Juba as CNPC is already planning to do in 2010. It is important that these offices house the executive management and are not mere liaison offices.

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Issue 5.c Profitability and tax exemption



Sudan's oil industry is believed to have been extremely lucrative, particularly for GNPOC which has kept costs low while enjoying high prices. To equitably share arbitrary windfall profits generated by world oil prices, introducing a profit-sharing mechanism that allows the GONS and GOSS to enjoy some of the proceeds above a set price per barrel may be considered.



Based on the accounts that ONGC Nile Ganga has filed with the Amsterdam Chamber of Commerce, GNPOC's aggregate profits to date may exceed $10 billion, all taxed outside the country. This is far above world average for projects of this magnitude. Profit levels for Petrodar are believed to be lower, but still more than satisfactory, while profitability of the WNPOC operation in Block 5A has been much less satisfactory and WNPOC has lost tens of millions in Block 5B.
The contractually determined split of the profit oil between GNPOC and the Government -ranging from 40-60% to 20-80% depending on production levers per block- was based on an oil price of $20 compared with an average of around $80 in 2009.



Taxes are a national responsibility and will be handled differently by GONS and GOSS. However, it might lead to new problems if an independent South Sudan were to unilaterally introduce a windfall tax. Considering the disappointing exploration results of the past few years, taxation might discourage investment unless it is designed to only cream off excessive profits.
Alternatively, the split of the profit oil between companies and the Government could be modified by an ad hoc agreement that takes into account international oil prices as another variable in addition to production levels. This would be a quick and easy method.



It is recommended that windfall profits be dealt with, and the Government share in profit oil should be linked to market prices.



NCP and SPLM start discussions about windfall profit arrangements immediately.

Issue 6 Reconciliation and Compensation for Past Injustices



The CPA and hence the National Interim Constitution (NIC) establish a right to **compensation for damage incurred as a result of oil operations during the war.** This right cannot be expunged, but it does need to be properly framed post-referendum.



Partly due to the lack of adequate enforcement, the constitutional right has not resulted in adequate compensation for affected communities for claims from the past. This has led to grievances against the oil industry in various communities, particularly in the main producing blocks 1, 2, 3, 4, 5A and 7.



With secession, the SPLM may be tempted to avoid this sensitive topic. Addressing past wartime claims would start a difficult judicial process to determine who bears responsibility and who should pay how much in compensation. On the other hand, existing grievances about unresolved compensation claims are likely to fuel tension between oil companies and local communities and discourage investment. A political process would be preferable.



In line with the SPLM's ambition to 'cleanse' the sector and to pave the way for future investment, it is recommended that SPLM and NCP confirm the Sudanese people's entitlement to compensation. With the right level of political commitment, compensation claims could be framed in reconciliatory processes. The CPA suggests an individual approach to compensation. A community approach, however, would suit local culture better.



NCP and SPLM could agree to establish an independent claims commission with a mandate for compensating communities in accordance with the UN Basic Principles and Guidelines on the Right to a Remedy and Reparation for Victims of Gross Violations of International Human Rights Law and Serious Violations of International Humanitarian Law. This could deal with compensation claims per block, and be financed by signatories to the oil contracts, as defined by the CPA. The commission could also have the right to refer individual cases to an as yet to be established international court, should compensation affect companies that are no longer operational in Sudan.

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Issue 7 Environmental Protection



The CPA provisions on **environmental protection** are too general to effectively guide the industry. The 'best known practices' that the CPA requires have never been specified.



Inadequate standards and lack of enforcement are endangering the natural environment on which people depend for their livelihoods, as well as the industry's social support basis.



Divergent regulatory frameworks in North and South will complicate industry compliance, and acutely so for GNPOC. The GOSS is developing an up-to-date Act on the Environment as well as a Petroleum Act. Separate clauses that deal with the specific challenges of the oil industry are required. Consultation with GONU, whose legislation in these fields is also in need of an urgent update, is urgently required.
The legal framework that regulates environmental protection needs to be complemented by obligatory standards and procedures for the industry, including procedures for monitoring, reporting and enforcement. Time would be saved if they were to be agreed upfront, obviating a lengthy legal process.



The newly developed standards would include the principle of free, prior and informed consent.



NCP and SPLM could agree to create a joint multi-stakeholder environmental protection fund. Monitoring and enforcement mechanisms could be established in a decentralised manner and also paid for through that fund, giving key tasks to the state authorities in the Southern oil-producing regions.

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