Corruption Risk in the Oil and Gas Industry

Identifying—and Avoiding—the Potential Pitfalls

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Over the past year, global oil and gas companies have been repeatedly reminded of their exposure to risks associated with corruption. In February 2012, the Securities and Exchange Commission (SEC) charged three oil services executives with allegedly bribing customs officials in Nigeria to obtain illicit permits for oil rigs in order to retain business under lucrative drilling contracts.\(^1\) More recently, several companies faced investigations involving alleged improper payments to customs officials in Kazakhstan.\(^2\)

And these are not the first times the oil and gas industry has been under the scrutiny of regulators. Some of the largest enforcement actions under the United States Foreign Corrupt Practices Act (FCPA) have involved energy companies, including one against Italian oil and gas company Eni S.p.A. and its Dutch subsidiary Snamprogetti Netherlands B.V. that resulted in a $365 million penalty in 2010.\(^3\) Regulators have also pursued cases against oil service companies and industry providers.

In short, now is the time for companies in the oil and gas industry to examine carefully the landscape of risks they face—and take the appropriate steps to mitigate them.

Regulators Cast a Wide Net

Both the U.S. Department of Justice and the SEC have used industry-wide sweeps to expand investigations and obtain information on oil and gas companies. Regulators have begun to zero in on service providers such as drilling services, equipment and freight-forwarding companies. This is because, in many cases, resources in oil-rich countries are controlled by the government, which leads to a high level of interaction between service companies and other third parties with individuals considered “foreign officials,” under the FCPA.

In June, 2012, for example, executives at a manufacturer of products for the oil and gas and other industries were charged with violations of the FCPA after they were found to have made illegal payments to government officials in several countries.\(^4\) In 2010, Swiss freight-forwarding company Panalpina and its U.S.-based subsidiary were fined for paying bribes to foreign officials in Brazil, Kazakhstan, Nigeria, Russia, and elsewhere.\(^5\)

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\(^1\) Press release, Securities and Exchange Commission, February 24, 2012


\(^3\) The FCPA Blog, December 29, 2011

\(^4\) The FCPA Blog, December 29, 2011

\(^5\) Press release, United States Department of Justice, June 15, 2012

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So, what’s driving these risks? To begin with, some of the countries within the geographic regions where most of the world’s oil reserves reside—Central and West Africa, the former Soviet Union, South America, and the Middle East—are among the most corrupt places to do business. Often, these countries lack the infrastructure and controls necessary to combat corruption, or they may possess a cultural dynamic that heightens the risks associated with bribery.

The oil and gas industry is inherently subject to risk, particularly when measured against other industries. Often, companies and their agents must interact with foreign governments that may directly own rights to oil and gas exploration, or with foreign officials who are charged with authorizing these activities. Offering anything of value to a “foreign official,” inclusive of an employee or representative of a government-owned entity, may be a violation of bribery laws, such as the FCPA. It may also violate the U.K. Bribery Act, which, by virtue of its extra-territorial reach, has implications for companies with virtually any ties to the U.K. For example, a European oil company with a U.K. subsidiary that is found to have offered a bribe to a foreign official in Africa could expose the parent company to liability, even if the parent or subsidiary were not aware of the intermediary’s actions.

Globally marketed products and services frequently pass through customs, and officials may seek kickback payments or other fees to expedite the processing of licenses and permits required for clearance. Energy companies frequently employ third parties such as distributors, consultants, and agents, which may expose them to entities that lack the controls necessary to address corruption risks. As a result, payments made through third parties, in cash, or in advance of the receipt of goods may raise red flags. Finally, oil and gas companies are commonly involved in joint ventures with either state-owned entities or foreign companies. In such instances, a company, as well as its officers, may be liable for corrupt payments to foreign officials made by a business partner.

Unique Challenges in Oil-Producing Regions

Much of the world’s oil and gas exploration is located in challenging operating environments. Regions such as Africa, the Middle East, Russia, and South America each present unique sets of risks, ranging from political instability to cultures in which gift giving is a standard business practice.

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6 Transparency International, Corruption Perceptions Index, 2011
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For example, transparency within the oil and gas sector in Nigeria and Angola, Africa’s largest producing countries, has historically been a problem. Government purchases of goods and services and the awarding of lucrative contracts have been vulnerable to alleged corruption. In some cases, companies seeking to win a government contract may not be required to participate in a competitive bid process. Stakes in oil fields have been awarded to companies that may be acting as fronts for government officials. Often, there is little transparency into how or why a company that possesses an opaque ownership structure may receive a lucrative contract.

Regions such as the former Soviet Union and South America also pose risks. The former Soviet state is perceived to be among the most corrupt in the world, ranking 143th out of 183 countries in 2011. The oil and gas industry remains a vital part of the country’s economy, representing approximately 40% of exports. Yet the link between private and state-owned companies is strong, a factor that has contributed to Russian oil companies ranking as among the most corrupt in the world.

Oil companies in countries such as Brazil, Mexico, Venezuela, Saudi Arabia, and Iran are wholly-owned by their respective governments. Conducting business with these entities requires access to government officials, which often necessitates the use of third-party agents. Saudi Arabia, which has cracked down on corruption in recent years, possesses a culture rooted in familial connections that may present concerns related to potential conflicts of interest. Meanwhile, doing business in Iran has grown increasingly risky in light of the recent accusations of money laundering levied on several leading banks and because of ongoing sanctions from the international community.

Brazil, meanwhile, possesses high taxes and an intricate tax system that place an additional burden—and cost—on foreign companies, potentially making them ripe for corruption. Such a framework may make companies susceptible to tax collectors who request bribes in exchange for relaxing tax assessments and inspections, or for refraining from pursuing alleged acts of tax fraud.

Under the FCPA, receiving unwarranted tax breaks or a discount on an assessed duty qualifies as a violation. Even if a payment is not made, a promise to do so may be considered a violation of the law.

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8 Transparency International, Corruption Perceptions Index, 2011.
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Addressing the Risks Proactively

It’s important for oil and gas companies to identify which corruption risks they are exposed to and where those risks exist. As past enforcement actions have shown, solely having a compliance program in place may not eliminate risk completely. For example, a parent company that has a compliance program may still be subject to enforcement action as a result of alleged misconduct, such as an improper payment made by a foreign subsidiary, even if the parent company was not aware of it.

To mitigate these risks, companies should implement compliance programs and policies that effectively address bribery laws. It’s important for companies to monitor their dealings with government officials, and provide comprehensive FCPA training and guidance regarding the applicable laws and regulations of those countries in which the company operates.

Oil and gas companies should also be keenly aware of risks associated with business partners particularly because of the high-risk jurisdictions in which they operate.

Companies should conduct due diligence on joint-venture and other business partners. As part of this process, it’s important to make sure that business partners are compliant with the company’s own policies and have controls in place to account for the FCPA and other anti-corruption laws.

As part of a rigorous risk assessment, it’s important for companies to perform detailed reviews of the consultants, distributors, and sub-contractors with whom they work. Companies should also establish ongoing third-party controls and monitoring. Companies should be mindful of the FCPA’s provisions regarding third-party payments and pay particular attention to payments made to agents, especially those that interact with government officials in areas such as importation and taxation. And it’s important for companies to document payments fully and accurately with invoices and receipts—and to record them accurately—as the FCPA’s books and records provision has been at the center of a number of settlements with regulators and remains an area of risk exposure.
Conclusion

By virtue of where they operate and those parties with whom they frequently interact, oil and gas companies will continue to face heightened exposure to bribery risk in the foreseeable future. Regions such as Africa, with its history of instability, and Latin America, where oil companies are state-owned, are worth watching closely. And, while the Middle East has not been the subject of bribery cases, recent turmoil in the region and sanctions in Iran could lead to additional risk. Given the rise in enforcement of anti-bribery laws globally, there may be no better time than now for oil and gas companies to assess these risks and take proactive steps to reduce them.
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