

Validation of the UK
Draft Validation Report
CowaterSogema Independent Validator
16th May 2019

1. EXECUTIVE SUMMARY

The United Kingdom (UK) became an EITI implementing country in October 2014 after submitting a candidature application in August 2014. A multi-stakeholder group (MSG) was formed and has overseen the publication of four EITI reports covering the years 2014 - 2017. On 25 October 2016, the Board agreed that the UK's Validation under the 2016 EITI Standard would commence on 1 July 2018¹.

This report presents the findings and initial assessment of the International Secretariat's data gathering and stakeholder consultations. The International Secretariat has followed the Validation Procedures and applied the Validation Guide in assessing the UK's progress with the 2016 EITI Standard. While the assessment has not yet been reviewed by the MSG, the Validator's assessment is – in line with the International Secretariat - that much progress has been achieved in the process. However, the Validator finds that seven requirements are assessed as unmet with meaningful progress, and two requirements are assessed as unmet with inadequate progress. The corrective actions identified through this assessment relate to civil society engagement and MSG oversight (*see Requirements 1.3 and 1.4*), license allocation and registers (*see Requirements 2.2 and 2.3*), production and export data (*see Requirements 3.2 and 3.3*), the reporting of social expenditures by companies (*see Requirement 6.1*) and reviewing the outcomes and impact of implementation (*Requirement 7.4*).

2. BACKGROUND

Oil and Gas

While oil and gas production from the UK sector of the North Sea peaked in 1999, the UK remains a substantial producer. Over the last four decades, 39 billion barrel of oil equivalent (boe) have been extracted on the UK Continental Shelf (UKCS)². The industry employs 283 000 people³, and the services industry (centred in Aberdeen) is a leader in developing technology for hydrocarbon extraction offshore. Historically most gas came from Morecambe Bay and the Southern North Sea off East Anglia. Oil production comes mainly from the North Sea close to the median line with Norway in two main clusters – around the Forties oilfield east of Aberdeen and the Brent oilfield east of Shetland. There have been recent discoveries west of Shetland⁴.

¹ <https://eiti.org/document/validation-schedule-decisions>

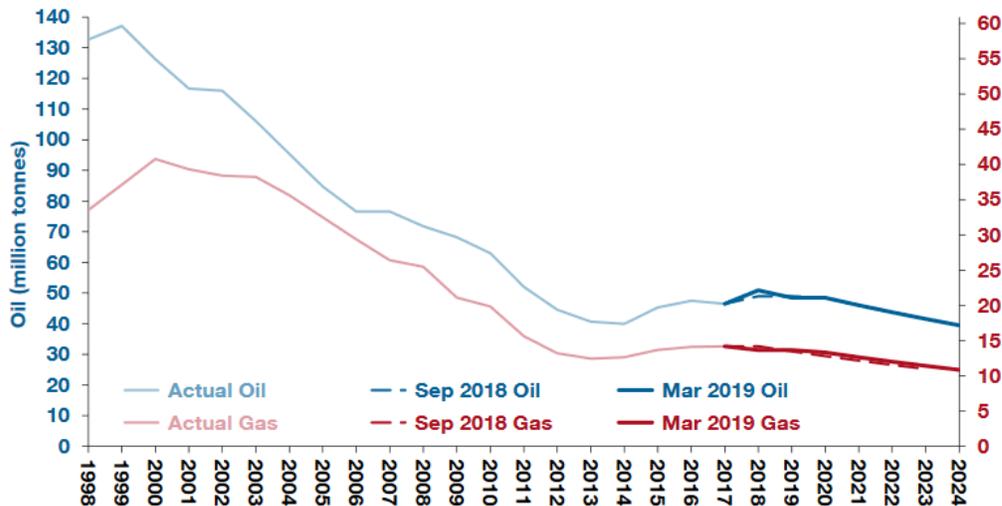
² <https://www.gov.uk/guidance/oil-and-gas-infrastructure#pipelines-and-platforms>

³ Oil and Gas UK (2018): "Workforce Report 2018" <https://oilandgasuk.co.uk/wp-content/uploads/2019/03/OGUK-Workforce-Report-2018.pdf>

⁴ *Ib id*

In 2017, capital investment in the UK offshore oil and gas industry was £5.6 billion⁵. Oil and gas production in the UK increased by more than 4% in 2018, averaging 1.7 million boe per day (see Figure 1). The UK Oil and Gas Authority predicts that oil and gas production over the period 2016–2050 of 3.9 billion boe. In 2017, UK production accounted for 60% of total UK oil and gas demand⁶.

Figure 2– Actual & projected UK continental shelf oil and gas production ⁷



The tax regime which applies to exploration for, and production of, oil and gas in the UK and on the United Kingdom Continental Shelf (UKCS) currently comprises three elements:

1. ‘Ring Fence’ Corporation Tax (RFCT). This is calculated in the same way as the standard corporation tax applicable to all companies but with the addition of a ‘ring fence’ and the availability of 100% first year allowance for virtually all capital expenditure. The ring fence prevents taxable profits from oil and gas extraction in the UK and UKCS being reduced by losses from other activities or by excessive interest payments. The current rate of tax on ring fence profits, which is set separately from the rate of mainstream corporation tax, is 30%.
2. Supplementary Charge. This is an additional charge, currently at a rate of 32% (increased from 20% from 24th March 2011), on a company’s ring fence profits (but with no deduction for finance costs).
3. Petroleum Revenue Tax (PRT). This is a field-based tax charged on profits arising from oil and gas production from individual oil and gas fields which were given development consent before 16

⁵ Oil and Gas UK (2018): “Economic Report” <https://oilandgasuk.co.uk/wp-content/uploads/2019/03/OGUK-Economic-Report-2018.pdf>

⁶ Oil and Gas UK (2018): “Economic Report” <https://oilandgasuk.co.uk/wp-content/uploads/2019/03/OGUK-Economic-Report-2018.pdf>

⁷ Source: UK Oil and Gas Authority (2019) “Projections of UK Oil and Gas Production and Expenditure” https://www.ogauthority.co.uk/media/5391/oga_projections_of_uk_oil_and_gas_production_and_expenditure.pdf

March 1993. The current rate of PRT is 50%. PRT is deductible as an expense in computing profits chargeable to ring fence corporation tax and supplementary charge.

Mining

The United Kingdom has a long history of mining dating back to Bronze Age. Later, lead and copper attracted the Romans to Britain. The widespread availability of coal and iron was a significant factor in Europe's Industrial Revolution of the late 18th and early 19th centuries. Although coal and iron ore are no longer mined in significant quantities in the United Kingdom, they were once mined in large quantities throughout the United Kingdom and used for steel and energy production.

Nowadays, mining in the United Kingdom produces a wide variety of fossil fuels, metals, and industrial minerals. In 2006, there were over 2,200 active mines, quarries, and offshore drilling sites on the continental land mass of the United Kingdom⁸. Total proved coal reserves in the United Kingdom are estimated at 220mn tonnes⁹. About 17mn tonnes was produced in 2012. though about 63mn tonnes was consumed (including imports)¹⁰. There is also significant production of potash, gypsum, salt, tin, gold, china clay, and tungsten. In addition, almost 200mn tonnes of aggregates are used for construction – crushed rock, sand and gravel, and recycled.

In line with the Validation Guide, the International Secretariat carried out the first phase of validation—initial data collection, stakeholder consultations, and preparation of their initial evaluation of progress against the EITI requirements (the “Initial Assessment”). CowaterSogema was appointed as the independent Validator to evaluate whether the Secretariat's work was carried out in accordance with the Validation Guide. CowaterSogema's principal responsibilities as Validator are to review and amend the Initial Assessment, as needed, and to summarize its independent review in this Validation Report for submission to the Board through the Validation Committee.

1. Work Performed by the Independent Validator

The Secretariat's Initial Assessment was transmitted to CowaterSogema on 1st May, 2019. Our Validation Team undertook this phase of the Validation process through: (1) In-depth review and marking up of the EITI Assessment by each team member; (2) Detailed review and comments by the Multi-Stakeholder Specialist of Requirements 1 and the Civil Society Protocol; (3) Detailed review and comments by the Financial Specialist of Requirements 4, 5 and 6; (4) Consolidation of reviews and the production of this draft Validation Report, sent to the International Secretariat on the 15th May, 2019.

2. Comments on the Limitations of the Validation

The Validator carefully reviewed the Secretariat's Initial Assessment and at this stage has no comments on the limitation of the validation process.

⁸ UK Mining Yearbook <http://www.bgs.ac.uk/mineralsuk/statistics/UKStatistics.html>

⁹ World Coal Institute <http://www.worldcoal.org/pages/content/index.asp?PageID=404>

¹⁰ UK Government Department of Environment and Climate Change.

3. Comments on the International Secretariat’s Initial Assessment

The initial data collection, stakeholder consultations, and drafting of the Initial Assessment were generally undertaken by the International Secretariat in accordance with the 2016 Validation Guide. The data collection took place across three phases. Firstly, a desk review of the available documentation relating to the country’s compliance with the EITI Standard, including but not limited to:

- The EITI work plan and other planning documents such as budgets and communication plans;
- The multi-stakeholder group’s Terms of Reference, and minutes from multi-stakeholder group meetings;
- EITI Reports, and supplementary information such as summary reports and scoping studies;
- Communication materials;
- Annual progress reports; and
- Any other information of relevance to Validation.

Secondly, a country visit took place on 19-26 September 2018. All meetings took place in London and Leicester, United Kingdom. The secretariat met with the multi-stakeholder group and its members, the Independent Administrator and other key stakeholders, including stakeholder groups that are represented on, but not directly participating in, the multi-stakeholder group. In addition to meeting with the MSG as a group, the Secretariat met with its constituent parts (government, companies and civil society) either individually or in constituency groups, with appropriate protocols to ensure that stakeholders are able to freely express their views and that requests for confidentiality are respected.

Finally, the International Secretariat prepared a report making an initial assessment of progress against requirements in accordance with the Validation Guide. The initial assessment did not include an overall assessment of compliance.

2. GENERAL COMMENTS

• Progress in EITI Implementation

EITI implementation in the UK has two mutually reinforcing objectives. Domestically, the UK EITI aims to increase public understanding of the social and economic impacts of the UK's extractive industries and enrich public debate on the governance and stewardship of the UK's oil, gas and mineral resources. This is achieved by working to ensure that essential information to inform public debate is accessible and presented to the public in a clear manner. Internationally, EITI implementation supports the UK government’s championing of extractives transparency and open government. UK industry and civil society have strongly supported these efforts. UK EITI stakeholders agree that, having helped establish the EITI globally, the UK should “practice what we preach” and set an example for other resource rich countries.

These objectives have been met. While the UK EITI has been hampered by internal challenges related to the representation of civil society organisations on the multi-stakeholder group, the UK has produced four high-quality EITI reports that address both the domestic and international objectives. There is limited demand for EITI data, not least since considerable amount of information is already publicly available. Oil, gas and

mining companies incorporated in the United Kingdom or listed on the London Stock Exchange (LSE) publish reports on payments to governments each year under UK law. Payment reporting covers payment types as published under the EITI. While these are not disaggregated to the levels required by the EITI Standard, they are more up to date and cover every country where each company operates. The UK EITI Reports collate a wide range of information relating to the UK. In accordance with the 2016 EITI Standard, they reconcile company and government disclosures. The resulting information is of interest to relatively small and specialised audiences. That said, the high quality of EITI Reports underscores the government's commitment to transparency and accountability, and stakeholders continue to see value in using domestic implementation as a means to encourage other resource-rich countries to implement the EITI and high social and environmental standards.

Concurrent with preparing for this Validation, the MSG was exploring opportunities to streamline EITI implementation through systematic disclosure ("mainstreaming"), which would speed up the publication of data and reduce the cost associated with EITI Reporting. Accelerating this work presents a further opportunity for the UK to set an example to other EITI implementing countries.

- **Impact of EITI Implementation**

As noted above, the UK EITI has been hampered by internal challenges related to the nomination and representation of civil society organisations on the multi-stakeholder group. The civil society organisations that had been active in the EITI's work globally since its inception played a strong and supportive role in establishing the EITI in the UK. Through the UK EITI Civil Society Network (CSN) these groups represented civil society when the MSG was first established. However, concurrent with similar challenges with the EITI's global governance^{11,12}, conflict arose regarding how civil society representatives to the MSG should be selected. The EITI Standard requires that "each stakeholder group must have the right to appoint its own representatives, bearing in mind the desirability of pluralistic and diverse representation" and that "the nomination process must be independent and free from any suggestion of coercion" (*Requirement 1.4*). An organisation called the Extractive Industries Civil Society (EICS) challenged the existing nomination process¹³. When efforts to agree a compromise stalled, the UK government took a decision to split the nomination role between the two groups. This led the CSN to withdraw from the UK EITI process¹⁴, a situation that persisted until the commencement of Validation.

The International Secretariat is not mandated or resourced to carry out a detailed examination of this controversy, or to comment on the behaviour and motivations of the parties involved. The views of the CSN and the EICS are a matter of public record and are summarised in this assessment. The International

¹¹ The Economist (2016) "Flare-up: Tensions run high at an international transparency initiative" <https://www.economist.com/business/2016/02/25/flare-up>

¹² Clare Short (2016) "The former EITI chair Rt Hon Clare Short reflects" . <https://eiti.org/blog/former-eiti-chair-rt-hon-clare-short-reflects>

¹³ Martin Brown (2017) "PWYP walks out of UK EITI (again)" <http://goxi.org/profiles/blogs/pwyp-walks-out-of-ukeiti-again>

¹⁴ UK EITI Civil Society Network (2017) "Civil Society Organisations withdraw from UK EITI" <https://www.publishwhatyoupay.org/pwyp-news/civil-society-organisations-withdraw-from-uk-eiti/>

Secretariat team met with representatives from each group. Validation focuses on whether the EITI Requirements have been met and whether the broader objective of the requirements have been fulfilled. The International Secretariat has applied the Validation Guide and determined that Requirements 1.3 regarding civil society engagement and 1.4 regarding the multi-stakeholder group oversight are not met. As of 1 July 2018, the civil society constituency was not “fully, actively and effectively engaged in the EITI process” (Requirement 1.3) and not adequately engaged in MSG oversight of EITI implementation (Requirement 1.4). As a consequence, the broader objectives of the EITI have not been fulfilled.

The International Secretariat does not consider these incidents to constitute a breach of the civil society protocol. There is no evidence of any legal, regulatory or practical barriers to civil society’s ability to engage in EITI, nor to their ability to freely operate, communicate and cooperate with the broader constituency. In the International Secretariat’s view, the government’s efforts to address the challenges regarding the representation of civil society organisations on the multi-stakeholder group were made in good faith. There is no evidence to suggest that the government has sought to influence or orchestrate civil society representation. Similarly, there is no evidence to suggest any coercion or threat of reprisal.

All stakeholders consulted by the International Secretariat agree that it is for the civil society constituency to resolve the matter of their representation on the MSG. At the time of writing, there had been some constructive discussions about resolving the situation. The procedure adopted at the international level in seeking civil society representatives for the EITI International Board through an open and transparent selection process managed by an independent civil society advisory group (CSAG) with the support of an independent organization (IO)¹⁵ could be replicated at the national level. The civil society constituency could consider seeking government support in this regard.

A reconstituted MSG, with the full, active and effective engagement of civil society would then be well placed to follow up the recommendations from this Validation. The corrective actions relating to disclosures are not onerous, and it should be possible to address these quickly. The work that commenced on EITI mainstreaming should be continued. More widely, the MSG should review the impact of the first five years of EITI implementation and explore the opportunities to further leverage the EITI platform to enrich public debate on the governance and stewardship of the UK’s oil, gas and mineral resources.

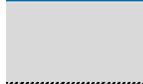
¹⁵ CBI (2018) Selection of Civil Society Representatives on the International EITI Board (2019-2022)
<https://www.cbi.org/project/eiti-board-cso/>

The Independent Validator's Assessment of Compliance

Figure 1 – Validator's assessment

EITI Requirements		LEVEL OF PROGRESS				
		No progress	Inadequate	Meaningful	Satisfactory	Beyond
Categories	Requirements					
MSG oversight	Government engagement (#1.1)				█	
	Industry engagement (#1.2)				█	
	Civil society engagement (#1.3)		←	█		
	MSG governance (#1.4)			█		
	Work plan (#1.5)				█	
Licenses and contracts	Legal framework (#2.1)					█
	License allocations (#2.2)			█		
	License register (#2.3)		←	█		
	Policy on contract disclosure (#2.4)				█	
	Beneficial ownership (#2.5)					█
	State participation (#2.6)	█	█	█	█	█
Monitoring production	Exploration data (#3.1)					█
	Production data (#3.2)			█		
	Export data (#3.3)			█		
Revenue collection	Comprehensiveness (#4.1)				█	
	In-kind revenues (#4.2)	█	█	█	█	█
	Barter agreements (#4.3)	█	█	█	█	█
	Transportation revenues (#4.4)	█	█	█	█	█
	SOE transactions (#4.5)	█	█	█	█	█
	Direct subnational payments (#4.6)	█	█	█	█	█
	Disaggregation (#4.7)				█	
	Data timeliness (#4.8)				█	
	Data quality (#4.9)				█	
Revenue allocation	Distribution of revenues (#5.1)				█	
	Subnational transfers (#5.2)				█	
	Revenue management and expenditures (#5.3)					
Socio-economic contribution	Mandatory social expenditures (#6.1)			█		
	SOE quasi-fiscal expenditures (#6.2)	█	█	█	█	█
	Economic contribution (#6.3)				█	
Outcomes and impact	Public debate (#7.1)		←	█		
	Data accessibility (#7.2)					
	Follow up on recommendations (#7.3)				█	
	Outcomes and impact of implementation (#7.4)			█		

Legend to the assessment card

	The country has made no progress in addressing the requirement. The broader objective of the requirement is in no way fulfilled.
	The country has made inadequate progress in meeting the requirement. Significant elements of the requirement are outstanding and the broader objective of the requirement is far from being fulfilled.
	The country has made progress in meeting the requirement. Significant elements of the requirement are being implemented and the broader objective of the requirement is being fulfilled.
	The country is compliant with the EITI requirement.
	The country has gone beyond the requirement.
	This requirement is only encouraged or recommended and should not be taken into account in assessing compliance.
	The MSG has demonstrated that this requirement is not applicable in the country.

3. DETAILED FINDINGS

The Validator disagrees with three of the findings of the Initial Assessment:

For Requirement 1.3, due to the internal conflicts over nomination and civil society leadership, civil society has not been effectively engaged in UKEITI. In line with the EITI Standard's definition of Inadequate Progress - "Significant aspects of the requirement have not been implemented and that the broader objective of the requirement is far from fulfilled" - the Validator suggests a downgrade to Inadequate Progress. Civil Society has not been substantively or meaningfully engaged in the EITI implementation in the UK so far.

For Requirement 2.4, 2.4b of the Standard states, "It is a requirement of the 2016 Standard that the EITI Report documents the government's policy on disclosure of contracts and licences that govern the exploration and exploitation of oil, gas and minerals." The Initial Assessment points to the UK Government's adoption of Open Contracting and the Open Government Partnership's national action plans. However, these do not appear to be sufficient to meet 2.4b. This is buttressed by the Initial Assessment stating, "it is unclear from the report whether the government has a policy to publish the full text of all licenses in the mining and quarrying sector."

Finally, for Requirement 7.1, to all intents and purposes, it looks like the UK EITI Reports are clear and comprehensive, albeit with issues of timeliness raised by some stakeholders. 7.1a-d are met. However, contribution to public debate appears to be weak, at least partly because of the CSOs representation issue. The initial assessment states that "There have been limited efforts to promote this work beyond Report launch events, and there is limited evidence to suggest that the EITI has contributed to public debate." Meanwhile, 7.1e requires "Ensure that outreach events, whether organised by government, civil society or companies, are undertaken to spread awareness of and facilitate dialogue about the EITI Report across the country." Stakeholder views in the initial assessment state that "The majority of stakeholders noted that the EITI had not had a significant impact on the public's understanding of the extractives." The Validator therefore finds it difficult to accept that there has been satisfactory progress on this requirement given these statements.

4. RECOMMENDATIONS

While the following report includes recommendations for specific improvements the UK may wish to consider implementing, the following is also a list of strategic corrective actions that could help the UK make even greater use of the EITI as an instrument to support reforms.

1. In accordance with Requirement 1.3.a, the civil society constituency should demonstrate that they are fully, actively and effectively engaged in the EITI process. Specifically, civil society should ensure that they are able to fully contribute and provide input to the EITI process by ensuring that the constituency is adequately represented on the MSG, with agreed mechanisms for wider constituency engagement.
2. In accordance with Requirement 1.4.a.ii, the MSG should ensure that the civil society constituency is adequately represented, and that the civil society constituency appoints its own representatives,

bearing in mind the desirability of pluralistic and diverse representation.

3. In accordance with Requirement 2.2, the UK should disclose information related to the award or transfer of licenses pertaining to the companies covered in EITI reporting. This information should include the number of mining, oil and gas licenses awarded and transferred in the year covered by the EITI reporting cycle, a description of the award procedures, including specific technical and financial criteria assessed, and highlight any non-trivial deviations in practice. The UK is encouraged to consider innovative solutions for embedding a public accountability mechanism to ensure transparency on any non-trivial deviations from statutory procedures in its systematic disclosures of information per Requirement 2.2.
4. In accordance with Requirement 2.3, the UK should maintain a publicly available register or cadastre system(s), including comprehensive information on all active licenses held by all mining and quarrying companies included in the scope of EITI reporting. In the interim the UK should ensure that future EITI reporting provides the information set out under Requirement 2.3.b for all mining and quarrying companies. The UK is encouraged to consider the extent to which integration of EITI reporting with the work of organisations like the British Geological Survey could ensure systematic disclosure of information mandated under Requirement 2.3.b.
5. In accordance with Requirement 3.2, the UK should ensure that estimates of production values are publicly disclosed for all minerals produced in the year under review. The UK is encouraged to consider the extent to which estimates prepared based on average benchmarks could ensure that general estimates of the value of production is in the public domain.
6. In accordance with Requirement 3.3, the UK should ensure that export volumes and values are publicly disclosed for every mineral commodity exported annually.
7. In accordance with Requirement 6.1, the UK should assess the materiality of mandatory social expenditures ahead of future EITI reporting and ensure that reporting of mandatory social expenditures be disaggregated by type of payment, nature of in-kind contributions and beneficiary(ies), clarifying the name and function of any non-government (third-party) beneficiaries where applicable.
8. In accordance with requirement 7.4, the MSG, with the full, active and effective engagement of civil society, should review the impact of the first five years of EITI implementation and explore the opportunities to further leverage the EITI platform to enrich public debate on the governance and stewardship of the UK's oil, gas and mineral resources.
