

# Disclosure of Midstream Payments through the EITI

Background paper for the EITI Strategy Working Group

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## 1. The Importance and Use of Midstream Payment Disclosures

By focusing only on the revenues resulting from the upstream portion of the extraction process, the EITI does not cover the full spectrum of extractive sector revenues. Transparency regarding the delivery of natural resources to world markets is also of crucial importance, especially for transit countries.

Midstream payments related to the transportation of oil, gas and minerals are of considerable importance in terms of their economic effects, geopolitical significance and social impacts.

### *Economic Effects*

Revenues from the transportation of energy resources contribute significantly to the income of transit states. For example, transit revenues likely represent a substantial portion of the national budget in Georgia and Ukraine, but uncertainty around the exact figures is an important reason why greater transparency around these revenues is needed. The demand for natural resource transportation is cyclical, and declines in reserves can diminish the need for transportation, risking a reduction in related income. Thus, it is important to ensure adequate transparency regarding these transportation revenues in order to facilitate sustainable economic development through effective revenue management.

### *Geopolitical Significance*

International arrangements for oil, gas and mineral transportation and reliability of these networks are becoming increasingly important with the growth in energy trade and the greater integration of energy markets. Lack of transparency was a primary reason for the 2009 conflict between Ukraine and Russia, which resulted in gas flows via Ukraine being shut down, impacting 18 countries. Russia is now attempting to build a pipeline that will avoid Ukraine, but there is no guarantee that going through Bulgaria or Romania will eliminate the same problems. Former Ukraine Prime Minister Yulia Tymoshenko is being jailed for alleged wrongdoings in negotiating the transit of natural gas, an indication that a proper system of transparency and accountability could help in the reduction of future conflicts.

### *Social Impacts*

Transportation infrastructure, whether a pipeline, railway or roadway, is unique in its coverage of vast areas of land and large numbers of settlements. Transportation infrastructure can dominate the landscape in transporting countries. Such infrastructure can pose environmental risks, from the possibility of accidents during the transportation of supplies, to the destruction of biological diversity. The development of transportation infrastructure can also reduce opportunities for agricultural land use, negatively impacting rural populations that are often already poor. Greater transparency regarding

transportation volumes and revenues, and on the social projects of companies involved in the sector, would lessen the amount of public distrust regarding these transactions.

### ***Synergies with other Proposed Reforms***

In addition to increasing transparency in transporting countries, midstream payment disclosure will also enhance transparency regarding the transactions that surround physical receipts in producing countries. Synergies between midstream payment disclosure and the proposed changes regarding in-kind revenues are an example of how an expanded EITI would maximize the tangible impacts of the goals set out in the EITI Principles.

## **2. Existing Practice on Midstream Payment Disclosure**

Information on company payments and government revenues related to the transportation of natural resources is not currently required under in the EITI rules.

There are currently no global mechanisms that systematize the measurement of transit revenues.

Reports often do not offer information that is accessible, complete or meaningful for the general public and, where there is information available, it may be dispersed across several sources, making it difficult to analyze.<sup>1</sup> Some information related to transportation can be found regarding oil and gas pipeline enterprises. In comparison, access to information regarding railway transportation is less available. Even more challenging is access to information on maritime transportation, where information is usually second-tier, while data on volumes, tariffs and budgetary payments can be accessed only in an aggregated format.

Information on the state's share in company capital is often accessible, but specific information on company payments to the state budget and payments on dividends is often missing entirely. The same is true for

### **Coverage of Downstream Payments**

In Peru, the prospect of reporting on downstream payments has been discussed. In other countries, this could also make sense especially when state-owned companies or their subsidiaries process commodities themselves.

PETROPERU and REPSOL own and run the 2 oil refineries in Peru. The Consorcio Camisea runs the gas transformation plants in Ica and Lima. Doe Run owns the large smelter in the central highlands. They all generate income and pay taxes, and they could and should be included.

Petroperu has already manifested its interest in joining the Peru EITI process. It will present its own EITI report and make the formal announcement at the June Lima Seminar and Board meetings. If Petroperu joins EITI, there is no reason why Repsol will not.

<sup>1</sup> See: a) <http://mpe.kmu.gov.ua/fuel/control/uk/index> (contains information on oil and gas transit volumes), b) <http://www.naftogaz.com/www/2/nakweb.nsf?Open> (contains aggregated financial information and information on volumes, but lacks information on transit tariffs), c) <http://www.utg.ua> (contains information on gas transit volumes), d) <http://www.ukrtransnafta.com> (contains information on oil transit volumes for 2009), e) <http://www.blackseagas.com> (contains information on gas transportation tariffs), f) <http://www.nerc.gov.ua/> (contains information on oil/ gas transportation tariffs), g) <http://www.bank.gov.ua> –(contains aggregated information of state finances).

information regarding benefits or concessions accorded to the state in payment of its share in company investments. Lack of transparency is further aggravated by conflicting data on the tariffs that are applied on transit routes. The end result is that the inability to analyze or verify information allows budget evasion, abuses and corruption to persist.

### **3. Implementing Midstream Payment Disclosure in the EITI**

In order to begin the process of including midstream payment disclosure in the EITI, the Board could:

- Liaise with the European Energy Charter Treaty Secretariat, the International Energy Agency, the European Commission and any other relevant entities with expertise and involvement in this sector.
- Consider pilot projects including along traditional routes (e.g. Central Asia – Russian Federation – Ukraine – EC) and new routes (e.g. Central Asia – Caspian Sea - South Caucasus – Turkey – Mediterranean Sea or Central Asia – Caspian Sea - South Caucasus – Black Sea – Ukraine – EC).

#### **Proposed Changes to EITI Rules/Policy Notes**

In order to incorporate midstream payments in the EITI, the term “companies” would need to be defined to include companies involved in the transportation of oil, gas and minerals, including state-owned enterprises. This term would need to be used uniformly throughout the rules (e.g. references to “oil, gas and mining companies” and “extractive companies” would now refer to “companies”). Similar uniformity should also be applied to the terms “payments” and “revenues”.

Criterion 1 would need to be revised as follows: Regular publication of all material oil, gas and mining payments by companies to governments, including payments related to the transportation of oil, gas and minerals (“payments”) and all material revenues received by governments from oil, gas and mining companies, including revenues related to the transportation of oil, gas and minerals (“revenues”) to a wide audience in a publicly accessible, comprehensive and comprehensible manner.

The appropriate materiality threshold would be a crucial issue for further examination, possibly through the pilot studies.