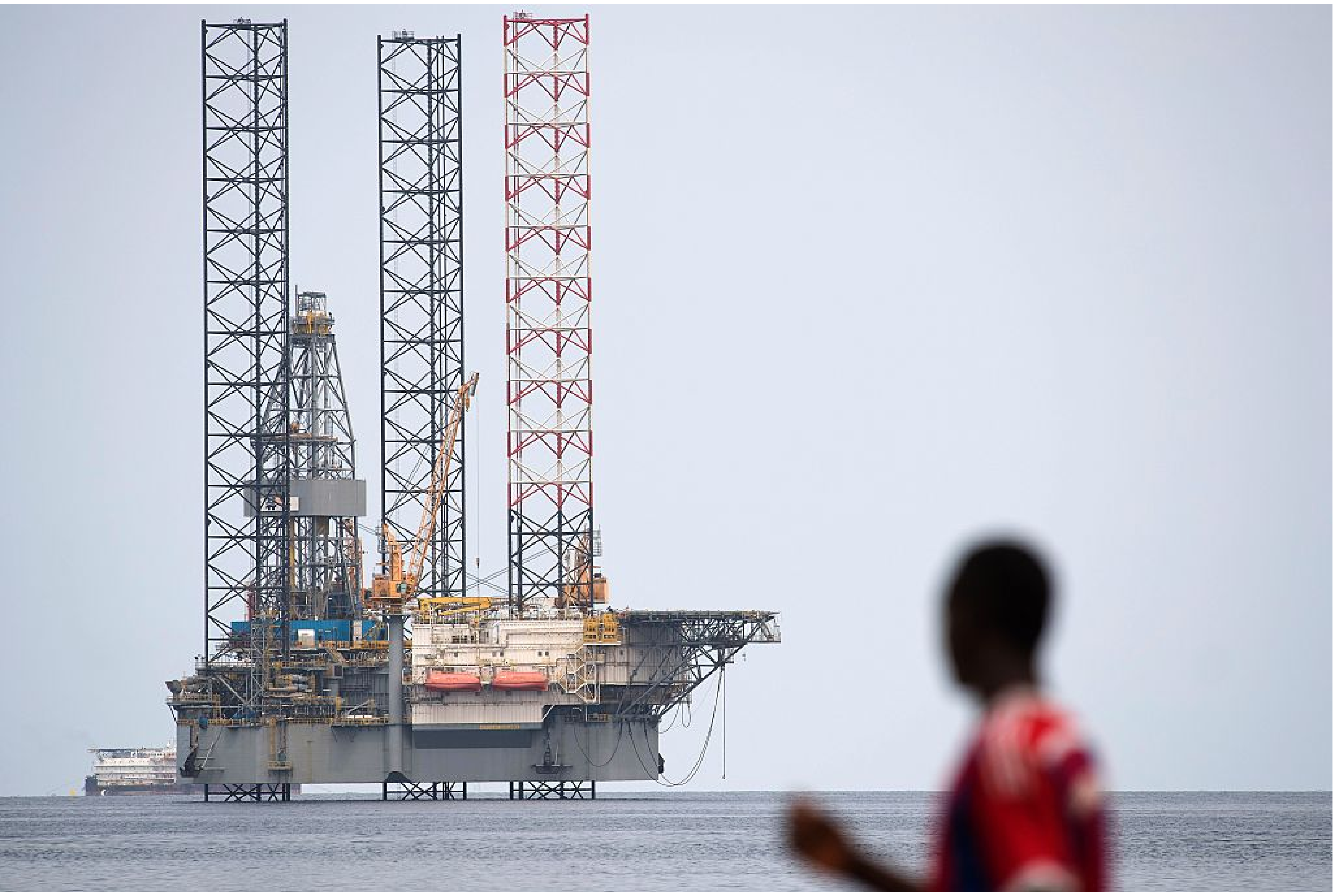
global witness

RIGGED

WHERE HAS REPUBLIC OF CONGO'S OIL MONEY GONE?

27 JANUARY 2020



Justin Tallis/AFP via Getty Images

RIGGED: WHERE HAS CONGO'S OIL MONEY GONE?

Republic of Congo, Sub-Saharan Africa's third largest oil producer and one of the world's longest lasting kleptocracies, is facing bankruptcy. In July 2019, it received its fourth multi-million dollar bailout from the IMF. At the heart of its ailing oil-dependent economy is SNPC, its national oil company, a notorious black box that has been plagued by corruption scandals since its incorporation in 1998. Over the past year under IMF pressure, previously hidden accounts and oil contracts have finally seen the light of day. Our exclusive analysis of these documents sheds light on why Congo is getting so little in return for its oil. We reveal apparent abusive commercial practices by foreign oil companies and millions of dollars in missing funds.

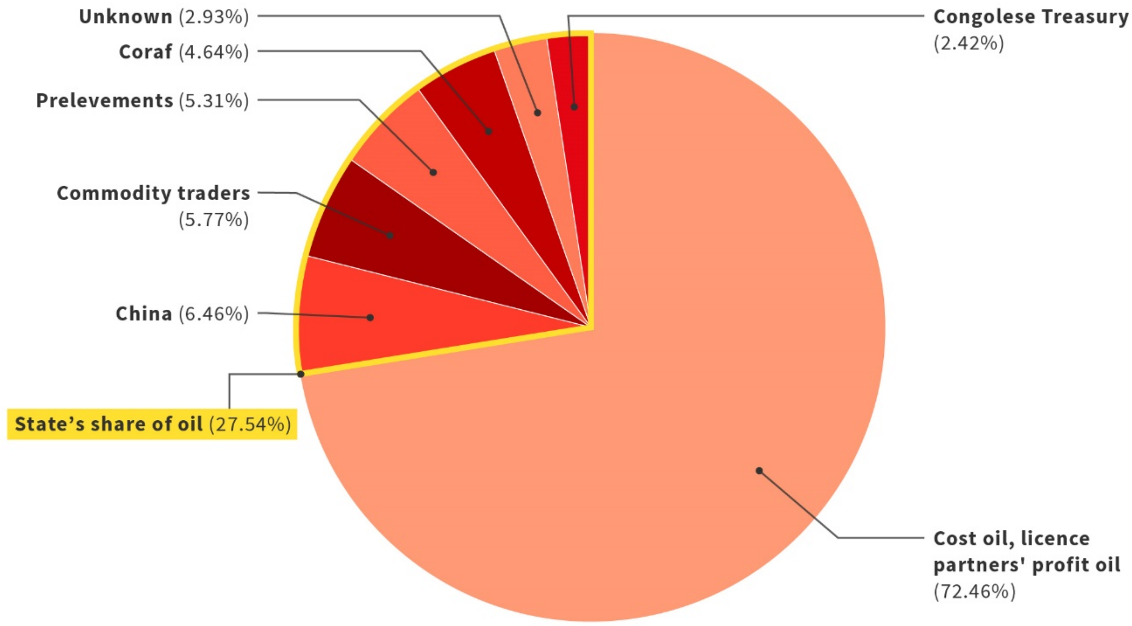
The Société Nationale des Pétroles du Congo (SNPC) is Congo's largest state-owned enterprise and a key pillar of the small central African country's economy. With a balance sheet equivalent to almost fifty per cent of Congo's GDP, its solvency is of national interest. Yet, it is in poor financial health.

The company's poor performance means that Congo is getting little in return for the sale of its oil. Dividends paid to the state, SNPC's sole shareholder, are consistently low or nothing at all, according to SNPC's accounts and Extractive Industries Transparency Initiative (EITI) reports. Twenty-one per cent of Congo's share of oil production went towards repaying expensive loans that SNPC contracted with commodity traders, according to EITI.[1] Overall, Congo's treasury received the dollar equivalent of just over two per cent of the country's total oil and gas production in 2017 (see chart 1).

SNPC barely broke even over the seven-year period from 2012 to 2018, the years for which its accounts are available (see chart 2). Despite 5.7 billion dollars' worth of sales during this time, it made only $123 million in profits and acquired at least $741 million in liabilities to foreign oil companies alone, including Total, Eni and Chevron.[2] In 2018, the company was highly leveraged (meaning it had more debt than equity – an indicator of financial risk), more so than other national oil companies (NOCs), such as Angola's Sonangol, Malaysia's Petronas and Azerbaijan's SOCAR (see chart 3).[3]

In the long-term, SNPC's debt could end up on the state's books. The impact of this would be catastrophic. Congo is already in 'debt distress,' meaning that it cannot repay its creditors on the agreed terms and timeframe. From 2015 to 2018, amid its ongoing debt crisis, public spending dropped by well over 50 per cent, recent research shows. People are going years without their pension payments and hospitals are chronically under-resourced. The country has one of the most unequal societies in the world. With a president who likes to spend hundreds of thousands of stolen public money on crocodile shoes and millions more on fancy clothes and luxury property, it is the

CHART 1: WHERE DID CONGO'S OIL GO IN 2017?



"Prelevements" refers to the state's share of oil used to reimburse a) Eni Congo for the operating costs and investment relating to the Centrale Electrique du Congo (CEC) (87% of prelevements), and b) Total E&P Congo relating to the Nkossa and Nsoko licences RMP royalty, and the Yanga and Sendji carry (13% of prelevements). "Coraf" is Congo's oil refinery. "China" refers to the state's share of oil transferred to an escrow account to guarantee China's infrastructure project investments. "Commodity traders" refers to the state's share of oil used to repay loans from commodity traders Glencore, Trafigura and Orion Oil. Outstanding stock of the state's share of oil may account for at least part of the "Unknown" category.

Source: EITI Republic of Congo, 2017

poor who shoulder the country's economic woes.

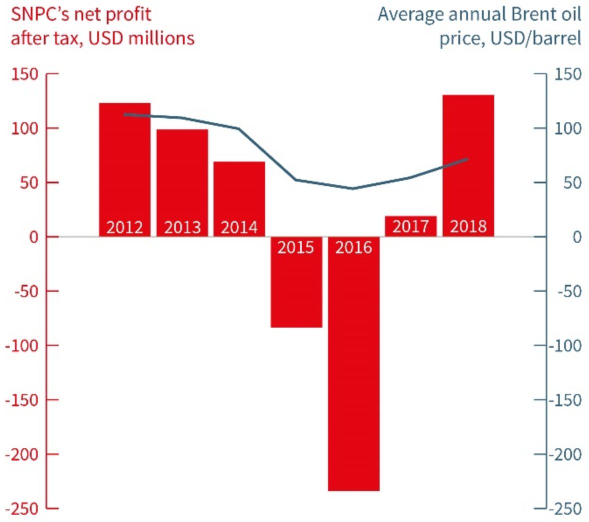
SNPC has been plagued by mismanagement and corruption scandals since its incorporation in 1998. From 2009 to 2018, Denis-Christel Sassou Nguesso, a son of the Congolese president, was a company director. A 2005 UK court revealed his involvement alongside Denis Gokana, then head of SNPC, in a series of sham transactions designed to undersell Congo's oil cargoes for private profit and to avoid claims of the country's creditors. More recently, Denis-Christel Sassou Nguesso and his sister Claudia appear to have laundered up to $70 million in stolen state funds, Global Witness revealed.

In this context, our analysis raises serious questions about where Congo's oil money has gone. It paints a picture of mismanagement; namely, an oil sector that is skewed in favour of foreign oil majors – Total, Chevron and Eni, in particular. It also reveals a number of major corruption red flags in the form of discrepancies and missing millions (see box 1).

More broadly, our analysis provides unique insights into the inner workings of an NOC, typically secretive companies that control a whopping ninety per cent of known global reserves. It touches on IMF oversight in a country to which it has provided multiple bailouts despite repeated broken promises.

Our findings take us a step closer to understanding the flow of money and oil in

CHART 2: SNPC'S PROFITS AND THE GLOBAL OIL PRICE CRASH



Sources: SNPC's annual accounts, 2012-2018; www.statista.com

one of the world's longest lasting kleptocracies, where President Sassou Nguesso has been in power for most of the past 40 years. They paint a picture of a government that is mismanaging the primary source of sovereign wealth today, while mortgaging off what will remain of that finite resource for the generations of tomorrow. This warrants close scrutiny – particularly from the IMF, which is gearing up to issue another tranche of a bailout worth nearly half a billion dollars.

SNPC'S LIABILITIES

Are international oil companies ripping Congo off?

SNPC owed its oil licence partners, including Total Exploration & Production Congo, Chevron and Eni Congo, a total of $2.41 billion in December 2018, according to its audited accounts (see table 1). This is equivalent to a mammoth 21 per cent of Congo's GDP, is more than double SNPC's turnover for that year and is up from $1.81 billion in 2010. It is accounted for as 'current liabilities', financial obligations that are supposed to be repaid within twelve months.

These liabilities are for investments that the licence partners are making on SNPC's behalf in jointly held oil licences, according to the data disclosed. Under Congolese law, licence partners split oil development and exploitation costs pro rata but may be required to cover the state's share, held via SNPC, to be repaid later, typically in oil (a 'carry' or *portage*). In this scenario, the operator clocks-up costs in line with an agreed budget and then invoices its partners for these on a regular basis.

The partners, including the state, usually have the right to audit these costs. This is triply important. Not only do they become liabilities on the NOC's accounts and cost it millions of dollars in interest – for SNPC $103 million in 2018, almost eighty per cent of its net profit for that year. They also impact how much revenue the state collects from oil production in the form of taxes and oil sales. Under Congo's model, costs are first deducted up to a ceiling ('cost stop') and the leftover oil ('profit oil') is split between partners – the higher the costs, the longer it takes for them to be repaid via oil that could otherwise be a source of state revenue. Companies may also try to minimise taxes by deducting ineligible or exaggerated costs, often paid to related parties.

Nonetheless, we understand that the state does not always exercise its audit rights and that, when it does, the companies do not always fully cooperate. The last publicly reported cost audit mandated by the Congolese government dates to 2004-5. It found that oil companies, including Total and Eni, overstated their costs by $127 million.

CHART 3: DEBT-TO-EQUITY LEVERAGE RATIOS OF SELECT NATIONAL OIL COMPANIES IN 2018

Source: SNPC, SOCAR, Sonangol and Petronas' audited annual accounts, 2018

Our analysis of Congo's production sharing contracts reveals that companies can recover an extensive range of "operating costs," including salaries and pension contributions for employees, their medical, transport, telephone and accommodation fees, and their children's school fees. In effect, Congo's representatives have agreed to subsidise the business overheads of some of the largest oil companies in the world.

Total's predecessor Elf even managed to get its $50 million 'signature bonus' for its Haute Mer licence treated as one of these operating costs, according to a side agreement to the 1994 production sharing contract. This means that it could be reimbursed for what is supposed to be a one-off signing fee and key source of oil revenue for the state – and it charged Congo five per cent interest on this so-called "loan."

These practices raise serious questions about the interests at play in Congo's oil sector. Are international oil companies (IOCs) ripping Congo off? Why did Congo and SNPC's representatives agree to these contracts?

SNPC and a representative of Ernst & Young Congo, which has signed SNPC's audits alongside Congo's national audit office since at least 2012, did not respond to Global Witness' questions.

Eni and Chevron replied, but did not answer our questions. Eni said that it does not comment on its commercial relations with NOCs. Chevron said that it complies with all applicable laws and regulations in Congo, that it conducts its business responsibly and with integrity, and that it will continue to work with the government to develop the oil and gas industry.

Only Total provided a detailed response, in which it explained SNPC's carry in the Nkossa and Moho Bilondo (formerly Haute Mer) licences. It is normal business practice to include all categories of costs related to a good or service in the associated invoice, the company said. It added that the state and licence partners conduct audits for each financial year, and that Total Exploration & Production Congo's accounts are audited too.

Regarding the 1994 $50 million signature bonus reimbursement, Total said that this "was the sole case of such agreement on recoverability of a bonus" and that "as far as we are aware, Congo had no conditional lending arrangement in force with the IMF at that time." The accounting procedure applied to this bonus was amended in 1999 and subsequently "renders all bonuses non-recoverable unless agreed to be recoverable," the company added.

Eni's multi-million dollar write-off?

In addition to its current liabilities, SNPC is also carrying at least $905 million in long-term financial debt to be repaid in, or secured against, oil. This is up from $144 million in 2012 and is equivalent to around 8 per cent of Congo's GDP in 2018. This type of debt is to be repaid in a timeframe of more than one year.

Almost a third of SNPC's financial debt began as a current (i.e. short-term) liability to Eni. In 2014, SNPC converted this into financial debt as part of the renewal process for Eni's Djambala, Foukanda, Kitina and Mwafi (ex-Marine VI and VII) oil licences. During this process, SNPC took the titles off Eni and lost its right to a carry, according to its 2014 accounts. The resulting effect was that SNPC's $755 million current liability to Eni dropped by $581 million and it instead incurred $298 million long-term debt to be repaid in oil in 2018, 2023 and 2028 (the 2018 repayment was postponed, according to SNPC's 2018 accounts). It is not clear what happened to the remaining $283 million, which may have been written-off by Eni.

During these licence renewals, Eni's oil interests were diluted and it acquired a new, highly controversial business partner called AOGC. AOGC was founded and is seemingly controlled by Denis Gokana, a presidential appointee and former head of SNPC.

If Eni, a publicly-listed company, did write-off $283 million for SNPC, what did it receive in return? Was Eni's board consulted on this move, which does not appear to be in its shareholders' best interests?

TABLE 1: SNPC'S LIABILITIES TO LICENCE PARTNERS

USD millions

	2010	2011	2012	2013	2014	2015	2016	2017	2018
TEP Congo	623	625	640	761	928	1,140	1,284	1,309	1,231
Eni Congo	554	606	665	755	174	229	263	291	296
Chevron	530	534	549	484	613	707	784	799	753
Murphy (Azurite)	63	66	67	76	0	0	0	0	0
Sasol	11	0	0	0	0	0	0	0	0
PA Ressources	44	46	47	53	0	0	0	0	0
CMS	11	4	0	1,548	3	6	0	0	0
New Age	0	0	0	0	27	46	55	64	61
Wing Wah	0	0	0	0	0	0	0	40	70
TOTAL (SNPC accounts)	1,814	1,881	1,968	2,131	1,745	2,128	2,387	2,503	2,410
TOTAL (actual)	1,836	1,881	1,968	3,677	1,745	2,128	2,386	2,503	2,411

The data source is SNPC's annual audited accounts ('Comptes des partenaires') for all years except 2017, where SNPC's accounts do not include this information and the data source is therefore EITI ('Comptes avances').

Source: SNPC annual audited accounts; EITI

A lack of commercial justification for multi-million dollar deals is a major corruption red flag. Eni's 2014 permit renewals are the subject of a recent Global Witness investigation and Milan corruption probe into the Italian oil major's business and local partners in Congo. Our analysis of SNPC's accounts raises further serious questions around those deals.

SNPC'S RECEIVABLES

SNPC's financial health is thrown deeper into the doldrums upon analysis of its assets,

BOX 1. SNPC'S MISSING MILLIONS

- FEES: In 2018, SNPC "advanced" almost $3 million in fees to its lawyers on a loan arranged by Ecobank – "much more than one would expect to pay," in the words of a debt restructuring lawyer. Why is SNPC employing such expensive lawyers?
- LIABILITIES: In 2016 and 2018, $327 million and $423 million, respectively, in current liabilities went unexplained.* To which other entities does SNPC owe money (or oil) and why?
- DEBTORS: In 2018, SNPC was owed $1.18 billion by unidentified entities. Who owes SNPC money and why? What is the likelihood the company will ever recover this money?
- LOANS: By the end of 2018, Congo owed $1.84 billion to commodity traders Glencore, Trafigura and Orion Oil for oil-backed loans the companies had contracted with SNPC. None of these loans are identified in SNPC's accounts. How has this money been spent?
- DIVIDENDS:
    - In its 2018 accounts, SNPC declared paying $140 million in dividends in 2017. However, in its 2017 accounts, SNPC declared no dividend payments. Why is there a $140 million discrepancy in SNPC's reported dividends for 2017?
    - In 2016, SNPC paid $15.93 million in dividends to the state, according to its accounts. However, the Treasury reported receiving nothing, according to the EITI report for that year. Was that $15.93 million paid and, if so, to whom? SNPC said that the $15.93 million was an "accounting observation, not a transfer," according to the EITI report.
- In 2014, Eni may have written-off $283 million of SNPC's current liabilities – why? What did Eni receive in return?

* In 2018, SNPC was carrying $2.83 billion in current liabilities owed to "diverse creditors" (page 40, 2018 accounts). According to the accounts, this figure primarily comprises "debts to oil partners connected to carries of oil production costs." However, this carry "debt" only comes to $2.41 billion (see 'Compte avances partenaires pétroliers' table, page 62, 2018 accounts), which leaves $423 million unexplained. A similar discrepancy of $327 million was present in SNPC's 2016 accounts – between the $2.38 billion total in the 'Evolution des comptes des partenaires' table (page 9) and the $2.71 billion in 'Compte d'avance partenaire' table (page 43).

which reveals $1.3 billion in receivables (money it is owed) that it has been consistently failing to recover.

Of this $1.3 billion, $132 million relates to other companies in the SNPC Group, according to SNPC's accounts. This figure has declined since its peak at $202m in 2014, but has increased overall from $65m in 2011. SNPC has five subsidiaries, according to its website. This includes Coraf, Congo's controversial oil domestic oil refinery, which, like SNPC, was run from 2011 to 2018 by Denis-Christel Sassou Nguesso.

The remaining $1.18 billion remains largely unexplained and has steadily increased from $123m in 2011.

It is not unusual for a company to be owed money; what is unusual, however, is the size of this sum, which exceeds SNPC's annual turnover. SNPC's accounts cite a loan agreement between the company and the state, which may account for at least part of the $1.18 billion. Beyond this, to whom is SNPC lending money and why? How likely is the company to recover this?

In a country with a long history of diversion of public funds by political elites and in a company with a track record of corruption, these transfers demand close scrutiny.

OIL-BACKED DEBT: DO WE HAVE THE FULL PICTURE?

Taking a step back, SNPC's accounts reveal that it has committed more future barrels of oil than previously reported.

In December 2018, the IMF estimated $1.84 billion in outstanding "oil prepurchased debt" (to traders Glencore, Trafigura and Orion Oil) and the Congolese government estimated 1,061,043 million XAF (approximately $1.78 billion) in debt to unnamed traders.

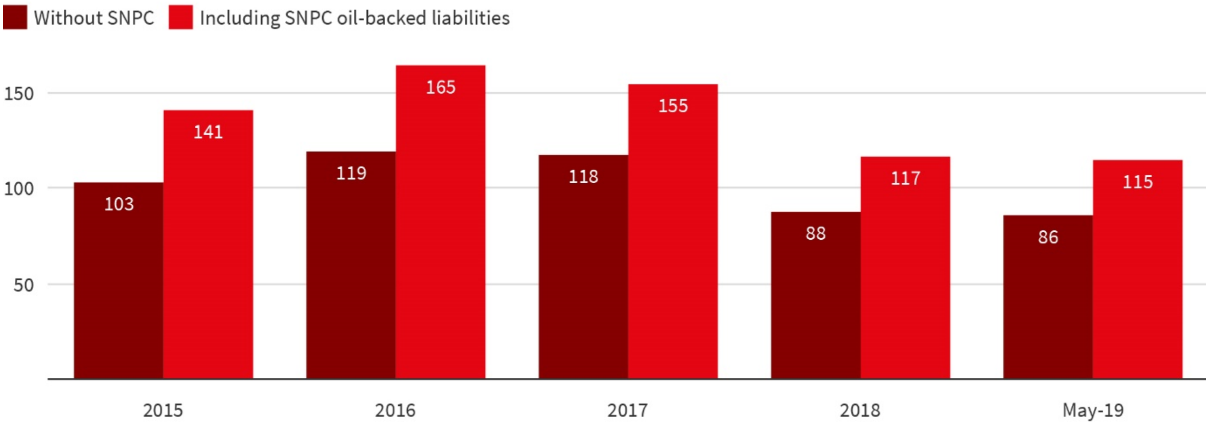
Our analysis of SNPC's 2018 accounts indicates that up to $3.3 billion could be added to these figures.[4] This $3.3 billion includes a further $606 million owed to a consortium of banks led by the pan-African conglomerate Ecobank, which is secured against oil.[5]

Overall, this could bring Congo's total public debt up from $9.5 billion to almost $13 billion, adding over a third to the IMF's latest estimates (see chart 4).

Yet, we may still not have the full picture. In the past, Congo's debt has been shrouded in secrecy. Until recently, even the existing administration and Congo's financial advisors, not to mention Congolese citizens, struggled to identify what is owed to whom and on what terms.

CHART 4: CONGO'S TOTAL PUBLIC DEBT

In percent of GDP



Source: IMF, 07.2019 ; Global Witness, 01.2020

In 2017, Congo's debt-to-GDP ratio rocketed by 33 percentage points overnight as the IMF learnt of an additional debt owed to Glencore and Trafigura. While there is reportedly a moratorium in place on repaying Glencore and Trafigura amid negotiations to restructure that debt, another Swiss commodity trader, Mercuria, may have taken their place pre-financing SNPC, according to press reports and three well-placed sources.

Oil-backed loans from oil companies are highly risky both in terms of public finances and corruption, as we have explained here, here and here.

SNPC'S DEBT COULD BECOME CONGO'S DEBT

If Congo's oil runs out, which one day it will, or if demand dries up, which one day it could, SNPC's debt will be outstanding and could end up on the state's account. Some of SNPC's debt already has – that contracted with commodity traders Glencore, Trafigura and Orion Oil, which in January 2020 is subject to stalling restructuring negotiations.

While the company might not have an explicit state guarantee, as a fully state-owned enterprise responsible for managing the state's oil revenue in an oil-dependent economy, it certainly has an implicit one. For Congo, SNPC is "too big to fail."

"Over-indebted state-owned enterprises [SOEs] are a growing concern," the IMF wrote in its latest Global Financial Stability report. "Should these SOEs encounter financing difficulties and require sovereign support, it could have a significant impact on the government's fiscal position, particularly in countries with high debt."

In some countries, like Angola and Senegal, the IMF includes national oil company or other SOE debt in the country's public debt statistics and resulting debt sustainability analyses. This is not the case in Congo, meaning we may have an incomplete picture of its public finances.

The Congolese government and the IMF should carefully consider SNPC's liabilities in future fiscal planning, including any debt sustainability analyses. The IMF, national EITI committee and Congo's authorities and citizens should demand clarity from SNPC over the money it owes to IOCs, the money it is owed by its subsidiaries, the state and other undefined debtors, and its missing millions. Congo's officials should revisit and, where appropriate, renegotiate any outdated and unfair production sharing contracts. Any sums invoiced to SNPC by IOCs for costs or investments on its behalf should be subject to an independent and public audit.

Global Witness welcomes the publication of SNPC's accounts and the oil sector contracts, which represents a major milestone in terms of oil sector transparency. Credit is due to the company, to the government and to the IMF without whose pressure the accounts may never have seen the light of day. However, transparency is not an end in itself, and the files raise more questions than they answer.

www.globalwitness.org

---

[1] Congo's share of total oil and gas production in 2017 came to the US dollar equivalent of around $1.44 billion, according to EITI (page 12). Of this, $302,392,594, or 21 per cent, went towards repaying oil-backed loans from commodity traders (page 13). See chart 1. From January to October 2019, 41 per cent of the total Congo paid to service its debt to commodity traders went on interest, indicating that these loans are expensive. See: https://www.finances.gouv.cg/sites/default/files/documents/Situation%20de%20la%20dette%20publique%20%20_31_OCTOBRE_%202019.pdf, accessed 20.1.20.

[2] We focus our analysis on the debt in SNPC's accounts that the company will repay in oil or that is secured against oil. The company was carrying a further $643 million in debt in December 2018, which we do not explore. SNPC's audited financial statements from 2012 to 2018 are published on the Congolese Ministry of Finance website: https://www.finances.gouv.cg/fr/documentation, accessed 20.1.20.

[3] For the purposes of comparing across different national oil companies (NOCs), we calculated the leverage ratios using the debt-to-equity formula, i.e. by dividing total liabilities by total equity. Using this formula, SNPC had a leverage ratio of 2.59 at end 2018, which compares to some other NOCs as follows: Sonangol, Angola (1.47); Petronas, Malaysia (0.5); and SOCAR, Azerbaijan (1.6). Typically, a debt-to-equity leverage ratio greater than 2.0 indicates a risky scenario. On this basis and in comparison to other NOCs, we therefore conclude that SNPC is "highly leveraged". See: https://www.investopedia.com/terms/l/leverageratio.asp, accessed 20.1.20.

[4] This $3.3 billion figure includes: SNPC's $2.41 billion current liabilities to licence partners; SNPC's $299 million outstanding financial debt to Eni; and SNPC's $606 million debt to the Ecobank-led consortium of banks. In our view, these liabilities represent future pledges against oil (in other words, they are "oil-backed debt") because they are to be repaid in oil, either directly or via cost oil, or are secured against oil.

[5] In October 2014, SNPC signed-up to a five-year $914 million credit facility with the consortium, of which $770 million was disbursed in March 2015, according to its 2018 accounts. This debt was restructured in July 2018 and is secured against oil, principally from three permits – Chevron's Lianzi, Total's Moho Nord and SNPC's own MKB.