INVESTOR BRIEFING
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Shell, Eni & company executives face corruption charges: Key issues for investors

INTRODUCTION

On 8 February 2017, Italian prosecutors requested that Shell, Eni and several Eni senior executives including the current CEO Claudio Descalzi, be tried for alleged international corruption offences over the 2011 purchase of the Nigerian OPL 245 oil block.[1] Shell, Eni and Mr. Descalzi have all denied the charges. The oil block could, if estimates prove accurate, increase Shell's proven global oil reserves by a third, and add two thirds to Eni's.[2] A preliminary hearing will take place on 20 April 2017.

The prosecutors also confirmed that they will separately seek charges at a future date against four senior Shell executives including the current Shell Foundation Chairman Malcolm Brinded, who at the time of the deal was Shell's head of Global Exploration and Production.[3]

These developments were followed by reports in early March of charges being filed by Nigerian authorities against Eni and Shell relating to the purchase of OPL 245.[4]

As well as raising specific issues for Eni and Shell, this matter highlights the risks to companies and shareholders more broadly from a lack of transparency around company payments to governments and the ultimate beneficial ownership of companies, as well as the need for more robust corporate anti-corruption policies and practices.

In this context, investors should be troubled by the voiding on 14 February, following intense and prolonged oil industry lobbying, of an SEC rule (known as the Cardin-Lugar rule).[5] This rule would have required oil and gas and mining companies to disclose in detail the payments they make to foreign governments. Had such a rule been in place in 2011, it likely would have prevented the circumstances which have led to Eni and Shell facing corruption charges. Investors should expect and counter extractive industry lobbying to undermine the corresponding EU, Norwegian and Canadian legislation following the US reversal.

This briefing outlines the recent legal developments in Italy. It provides background on the OPL 245 deal which has led to the Italian charges, as well as ongoing investigations in Nigeria and the Netherlands. We suggest questions investors should ask Shell and Eni. The briefing also outlines the relevant legislative transparency protections and why investors should work to counter efforts to dismantle such regulations.

MAJOR RISKS FOR INVESTORS

- Potential loss of oil block key to Shell's and Eni's future reserves
- Potential convictions for corruption
- Inadequate anti-bribery & corruption policies & board oversight
- Repeal of anti-corruption regulations at the request of extractive industries.

ITALIAN CORRUPTION CHARGES

Charges are being sought by the Milan prosecutor against 11 individuals, including Eni's current CEO, Claudio Descalzi and his predecessor Paolo Scaroni. The prosecutor has also requested that Shell and Eni in their corporate capacities stand trial. The prosecutor claims that $1.1 bn of the money paid by Shell and Eni to a Nigerian government escrow account was, with the knowledge of those charged, transferred to a company controlled by a former oil minister and then used to pay bribes to then Nigerian President Goodluck Jonathan, Oil Minister Diezani Alison-Madueke and Attorney General Mohammed Adoke. The prosecutor further alleges that money was also channeled to Eni and Shell executives with $50million in cash delivered to the home of Eni's current Chief Operations Officer.

The preliminary hearing is scheduled for 20 April,[6] at which a judge will decide whether to accept the prosecutor's requests. If the judge approves the charges, a trial will likely start later this year and may last for around 1 year. The separate request for charges against 4 Shell personnel is likely to be made within weeks. If all parties are tried, all charges may be heard together.

In response Eni commented that *"Eni is entirely free of any involvement in the alleged corrupt conduct subject to investigation. The Board of Directors also confirms its total confidence that the company's CEO, Claudio Descalzi, was not involved in any way in the conduct under investigation, and maintains their upmost support for him as CEO."*[7]

Eni's 2017 AGM at which Descalzi will seek re-election is scheduled for 13 April, 1 week before the preliminary hearing. Investors should not vote for his re-appointment in the current circumstances. Moreover, investors should withhold support on relevant board reappointments until questions over the involvement of senior management in corruption and the adequacy of the board's oversight have been satisfactorily answered.

Shell's response stated: *"Based on our review of the Prosecutor's file and our understanding of the facts, we don't believe a request for indictment is justified and we are confident that this will be determined in the next stages of the proceedings. We continue to take this matter seriously and co-operate with the authorities."*[8]

THE ALLEGED CORRUPT PURCHASE OF OPL 245

In 2011, Nigerian subsidiaries of Shell and Eni paid US$1.3bn for OPL 245.[9] $1.1bn was paid by the companies to an account created at JP Morgan in London by Nigerian government officials with a separate agreement to transfer it to Malabu Oil and Gas (Malabu), a company widely believed at the time of the payments to be controlled by convicted money-launderer and former oil minister Chief Dan Etete. In July 2013, a British High Court ruled that Etete was indeed the owner of Malabu.[10] As Etete had awarded the oil block to Malabu whilst oil minister, he had effectively given himself one of the most lucrative oil blocks in Nigeria.

Shell and Eni deny paying any money to Malabu and claim to have paid the money to the Nigerian Government. However, High Court proceedings in London and other evidence seen by Global Witness reveal that, in reality, Shell and Eni were aware and in agreement that the deal was for the benefit of Malabu, knew that Etete was the owner of Malabu, and had even met with Etete face-to-face on several occasions.

According to the Wall Street Journal,

> *"Italian magistrates have maintained that Mr. Descalzi, then the head of exploration, and Paolo Scaroni, Eni's CEO at the time, knew the government escrow account was a stopover for the money before it moved onto an account controlled by Mr. Etete and was eventually paid as kickbacks."*[11]

Due diligence reports commissioned by Eni during the negotiation process prove that the company knew about Etete's involvement from the early stages. A 2007 report states that Malabu is *"controlled by the former petroleum minister, Dan Etete. The company was awarded OPL 245 by the Abacha administration, while Etete was still petroleum minister"*,[12] while the 2010 report is even more explicit: *"whatever the formal ownership structure of Malabu, all of the sources to whom we have spoken are united in the opinion that Dan Etete is the owner of the company"*.[13]

However, Eni continues to deny any knowledge of Etete's involvement. In response to a question from Global Witness at its 2014 Annual General Meeting

Eni, in its written answer, replied that *"no clear evidence was found during the preliminary audits conducted by the Eni legal department under the anti-corruption procedures, particularly in relation to his [Etete's] connection with the company".* In light of the due diligence reports' explicit references to Chief Etete, it was put to Eni that they had lied to their investors about their knowledge of Etete's involvement in Malabu. Eni did not respond.

There is evidence that Shell managers were in direct contact with Etete during the negotiation of the deal and worked with others at Shell's headquarters in the Hague to decide how much to offer him. A meeting with Etete is referred to in an email from Shell's John Copleston read out in 2013 court hearings in London: *"Our initial response is that it will remain very difficult to meet Chief's expectations in terms of the cash Shell is able to put up front on the table […] Peter has to talk to The Hague and we will come back with a figure [. . .] As always, the issue will be the extent to which the Chief is ready to be sensible . . . Meanwhile we are getting along very well personally – lunch and lots of iced champagne – and this time round we are at least negotiating face to face".*[14]

Global Witness believes that "Peter" could have been Peter Robinson, Shell's Vice President for Commercial Sub Saharan Africa, who took part in the negotiations for Shell. His superior at the time was Malcolm Brinded, Shell's Head of Upstream. Robinson, Brinded and Copleston are among the Shell executives facing a separate charge request from the Milan prosecutor.

In 2015 Eni commissioned an external audit of the case from Pepper Hamilton, a U.S. law firm, which it has shared with investigators and it claims did not find evidence of illegal conduct. However, Eni would not originally disclose publicly the name of the law firm, and has still not released the terms of reference or detailed findings of the investigation. However, in response to questions from shareholders Eni has admitted that the investigation did not include interviews with any of the Eni staff under investigation. Eni has self-reported the OPL 245 deal to the U.S. authorities for review under the Foreign and Corrupt Practices Act.[15] No information has been provided by Shell as to whether it has commissioned an independent review of its involvement in the deal or whether it has self-reported the deal to the U.S. authorities.

Documents seen by Global Witness indicate that over US$801 million of the money transferred to Malabu was later transferred to a further five shell companies with hidden owners, raising concerns as to who truly benefitted from this deal. Etete told a UK court in 2013 that he received $250m in total for his role in the deal.[16] The ultimate recipients of the rest of the money are not yet known.

THE CASE FOR MANDATORY TRANSPARENCY

Global Witness and others - including investors - have long called for laws requiring extractive companies to disclose their payments to governments on a project level basis. Had such laws been in place at the time, the OPL 245 scandal would almost certainly not have happened.

Absent transparency rules, the corrupt money trail only came to light because a middleman who had acted for Malabu in negotiations with Eni, sued Malabu in UK commercial court for fees he claimed he was owed for his cut of the sale of OPL 245. These cases put previously secret information into the public domain, revealing how Eni and Shell had acquired OPL 245 from Malabu and Etete, and, also confirmed that Etete was a beneficial owner of Malabu.

Had Shell and Eni, been required to publish details of this deal would they have gone ahead with the deal as concluded? If the Nigerian government had known their payment to Malabu would have been so easy to track, they too may have thought twice.

TRANSPARENCY RULES UNDER THREAT

The US first passed the Dodd-Frank Act in 2010, Section 1504 of which requires companies to report payments to governments for oil, gas and minerals. The SEC then set about drafting a rule that would detail the requirements for companies, and implement the law.

In 2013, the EU passed similar legislation, the Accounting and Transparency Directives,[17] which requires the disclosure of project-by-project payments to governments by extractive companies. The UK and French implementing laws came into effect in 2015, with over 100 oil and mining

companies publishing details of approximately $150 bn in payments to governments around the world for that year. Disclosing companies include Shell, BP, Total, Rio Tinto, and BHP Billiton. Statoil reports under a corresponding Norwegian law.

In 2014 Canada followed suit with the Extractive Sector Transparency Measures Act which came into force on June 1, 2015.[18]

In 2012, the American Petroleum Institute (API), an influential US oil industry lobby group whose members include Shell and a number of other big oil companies, brought a case against the the SEC's regulation implementing Section 1504 (the "Cardin-Lugar Rule"). This delayed implementation of the US legislation and meant that the US now lagged behind the EU as the leader on extractive industries transparency. The oil industries' intensive lobbying against the Cardin-Lugar Rule stands in marked contrast to their public claims to support transparency.

In 2016, the SEC finalised the Cardin-Lugar Rule allowing a 2 year phase-in period. To address company concerns regarding host country prohibitions on required disclosures, the rule provided for applications for exemptive relief on a case-by-by case basis. The rule was publicly welcomed by investors with $5.6 trillion in assets under management.[19]

However, in early 2017 in its first act, the newly elected US Congress voted to rescind the Cardin-Lugar Rule and President Trump signed this into law on 14th February. Section 1504 remains in place but these developments mean that for the moment there is no mechanism to implement it.

The dismantling of this transparency provision has drawn criticism from investors.[20] It is likely, based on their lobbying via trade associations in the US, that extractive companies will now seek to undermine the corresponding EU, Norwegian and Canadian laws. Investors should confirm their support for such laws and push for US listed companies to make such disclosures as would have been required under the Cardin-Lugar Rule. Claims made by the API that publishing project-level payments will harm companies' competitiveness have been refuted, as companies reporting under the European laws have continued to win extractive licenses around the world.

EXTRACTIVES INDUSTRY TRANSPARENCY INITIATIVE

Founded in 2002 the EITI is a voluntary scheme implemented in over 51 countries for extractive companies to declare what they pay to governments, and for governments to declare what they receive. Once adopted by a country the reporting requirements within the EITI become mandatory for relevant companies. The EITI standard requires project level payment disclosures thereby aligning with Section 1504 and EU law.[21] However not all EITI countries were implementing the project level disclosure standard. The EITI board recently reaffirmed this requirement and set an implementation deadline of December 2018. By 1 January 2020, all countries must ensure that privately held companies disclose their beneficial owners as part of their EITI reports.

FOLLOW THE MONEY - BENEFICIAL OWNERS

The OPL 245 deal also would not have taken place had Etete not been able to hide his ownership of Malabu. The UK, Norway and Ukraine are creating the world's first public registries of beneficial ownership, so that investors, taxpayers and other interested parties can see who really owns and gains from companies. The EU has also recently agreed that all Member States will have to create national registries and that members of the public will have access providing that they can pass a "legitimate interest" test. The OPL 245 deal demonstrates the need for the similar laws to be passed in other countries including the US so that criminals – including corrupt officials – cannot disguise their identities to carry out corrupt dealings. As of September 2016, institutional investors managing over $740m in assets have sent letters to the U.S Congress calling for an end to shell company secrecy.[22]

RECOMMENDATIONS FOR INVESTORS:

- Encourage extractive companies to disclose payments to governments on a project by project basis regardless of the revocation of the Cardin-Lugar rule in the United States.

- Publicly express support for EU and other international transparency legislation.

- Express to companies their view that shareholder capital should not be expended, either directly or via trade association membership, think-tank contributions or other third party lobbying activity, on efforts to repeal, challenge or weaken any such legislation.

- Support payment transparency on a project by project basis globally through the EITI. Investors can write to the investor representative on the international board Mr Sasja Beslik.

- Support collaborative investor efforts in support of beneficial ownership transparency for U.S. companies.

CONCLUSION

As Shell and Eni face corruption charges, ongoing investigations, and the possible loss of a valuable asset as a result of a 2011 deal, the laws enacted since then to prevent opaque money trails from companies to governments and onwards to corrupt officials are under threat. Buoyed by their successful lobbying efforts in the U.S., extractive companies will likely turn their sights on corresponding legislation elsewhere. Given the risks highlighted by Shell's and Eni's current predicaments, investors should continue to demand company disclosures of payments to governments, push-back on industry efforts to dismantle such risk-mitigation laws, and voice their support for such measures. For Shell and Eni shareholders, many crucial questions remain unanswered in relation to what the companies knew and when they knew it about the money trail for their purchase of OPL 245. As the case moves its way through the courts, shareholders must challenge the companies on the steps they have taken to address the corporate failings and allegedly criminal actions of senior managers to prevent any similar incidents.

QUESTIONS FOR SHELL

> What provisions has Shell made for potential financial impacts of the corruption allegations relating to the OPL 245 deal?

> What level of oversight is being exercised by the Board of Directors over the ongoing investigations and legal developments relating to the OPL 245 deal?

> Has the Board of Directors commissioned an independent investigation of the company's involvement in the OPL 245 deal?

> If so, will Shell disclose the terms of reference and the detailed findings of such an investigation for shareholders to assess?

> If not, why not given the seriousness of the allegations arising and the failings they suggest exist within the company's anti-corruption policies?

> Has Shell reviewed its anti-corruption procedures since the OPL 245 deal? If so, have any steps been identified and/or taken to address the concerns highlighted by the OPL 245 deal?

> Has the Nomination and Succession Committee of the board considered recommending an appointee with specific expertise related to anti-corruption, given the risks it poses to the industry?

> Has Shell self-reported the OPL 245 deal to regulators? If not, does Shell plan to do so?

> If Shell executives are tried in Italy or elsewhere in relation to corruption, what action does the Board of Directors plan to take e.g. termination of employment, and/or remuneration claw-backs?

QUESTIONS FOR ENI

> What provisions has Eni made for potential financial impacts of the corruption allegations relating to the OPL 245 deal?

> What actions has Eni taken to review its anti-corruption procedures in response to allegations of corruption in the OPL 245 deal as well as allegations of corruption in Iraq, Kuwait, Libya, Brazil and Algeria? If Eni intends to update its anti-corruption procedures what is the timeline for doing so?

> If current Eni executives are tried in Italy or elsewhere in relation to corruption, what action does the Board of Directors plan to take e.g. termination of employment, and/or remuneration claw-backs?

> In relation to Eni's investigation of the OPL 245 deal:

> Will Eni disclose the terms of reference and the detailed findings of the Pepper Hamilton investigation commissioned by the Eni Board for shareholders to assess?

> Why were senior executives who are now facing charges in Italy not even interviewed as part of the company's internal investigation? These executives include CEO Claudio Descalzi and COO Roberto Casula.

> What steps (if any) have been taken to examine the actions of current CEO Claudio Descalzi and current COO Roberto Casula in the OPL 245 deal?

> Why were the relevant executives not suspended during the investigation?

> In contrast, why was Independent Board Member Karina Litvack, an expert on corporate governance, removed from her position on the company's risk and control committee?

> Did the former Independent Board Member Luigi Zingales resign over concerns regarding corruption at Eni as has been reported?

ENDNOTES

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