FGC Reviews of Public Sector Contracts and Concessions

January 8, 2014

Background

The terms of reference for the Financial Governance Program, endorsed by the FGC on April 23, 2014, state that the FGC will *"provide advice on existing concessions [and] contracts the FGS has entered into, applying principles of value for money and good governance with a view to learning lessons and recommending potential remedies where necessary"*.

On March 1, 2014 the Prime Minister sent a draft concession agreement between the Ministry of Petroleum and Mineral Resources and CGG Data Services AG/Robertson International GeoSpec International Limited to the FGC for review. This review was completed on March 8, 2014. Since then, Confidential Assessments of a further eight contracts and concessions have been provided by the FGC. These independent assessments have been based on technical inputs from World Bank staff and legal advice from the African Development Bank's African Legal Support Facility.

At the FGC meeting of May 23, 2014, it was announced that the Federal Government would submit all new contracts and concessions of over US$5 million to the FGC for prior review until capable new national institutions are able to take over this function[1]. It was also announced that the FGC would be asked to review all contracts and concessions *already* signed by the Federal Government.

Subsequently, however, the FGC Chairman brought two agreements signed by Federal ministers since May 23, 2014 to the FGC's attention: in June, the Minster of Water and Energy signed a build, own and transfer (BOT) agreement for the supply of electricity with Polaris Energy SDN BHD, and in July the Minister of Petroleum Resources signed an MOU with the Mubadala Development Company for the provision of petroleum sector technical assistance services.

[1] A new *Public Procurement, Concessions and Disposal Act* was passed by Cabinet on May 22, 2014, but has yet to be approved by Parliament. Creating the capacity to implement the provisions of the law presents a serious institutional challenge, particularly given the problems donors face in deploying technical assistance teams to work alongside Somali counterparts in Mogadishu.

The Reviews

Over the past ten months, the Federal Government has sent a total of eleven contracts and concessions to the FGC for review[2]. Nine have so far been reviewed (please see the ***attached table*** for more detail). The Confidential Assessments have been shared with the FGC, and through the FGC's Chair, with the Federal Government.

Filing systems are such that some of the agreements have been delivered incomplete, and several have been hard to locate[3]; the lack of clear responsibility for procurement has also contributed to poor information-sharing across government agencies, complicating the process of responding to FGC reviews.

These contracts deal with seismic data acquisition and marketing, oil and gas exploration, fisheries development and licensing, Mogadishu port and airport development, electricity provision, regional ports and port-related infrastructure development and patrol boat construction.

It is well known that value for money and transparency are best served through competitive public tendering, other than in exceptional cases that require clear, documented justification. None of the eleven contracts were tendered competitively, nor do they respond to any pre-defined terms of reference or scope of services; instead, foreign companies and their local partners have come forward with their own draft contracts, in several cases with the apparent encouragement of the company's host country government. By way of explanation, the Federal Government points to a lack of functional procurement legislation and of any capacity to design complex specifications or manage competitive procurement, alongside an urgent need to stimulate the Somali economy.

The advice offered in the Confidential Assessments ranges from recommending that the Federal Government negotiate an improvement in terms, to proposing the cancellation of those contracts that are of dubious benefit to the country.

Of the nine contracts reviewed so far, one has been overtaken by events (Simatech International), one appears to have been withdrawn as duplicative (TGS-NOPEC

[2] This excludes the asset recovery agreement between the Central Bank of Somalia and Shulman, Rogers, Gandal, Pordy & Ecker PA, which was reviewed in November 2013 by the UNODC/World Bank's Stolen Assets Recovery (StAR) Initiative.

[3] The Ministry of Finance is still searching for a contract with Dutch Atlantic Marine and Offshore Group, as well as for MOUs with the Mubadala Development Company, with the Great Horn Development Company (September 8, 2013) and for the rehabilitation of the National Theatre; MOF is also trying to acquire a copy of the contract with CGG Data Services AG/Robertson International GeoSpec International Limited allegedly signed by the Minister of Petroleum and Mineral Resources. Parts of the Albayrak Mogadishu Port concession have not yet been located.

Geophysical Company ASA), one has been restructured and allegedly signed (CGG/Robertson GeoSpec International), one is being considered for cancellation (Somalia-FishGuard Ltd.), one is under investigation to establish its current status, with a view to cancellation (AMO Shipping Company Ltd,) and two are under discussion with the contractor (Albayrak Turizm Inşaat Ticaret A.Ş, Favori LLC). No action has been taken on one (Soma Oil and Gas Exploration Limited), while a Confidential Assessment of the final contract (Great Horn Development Company) has only recently been delivered.

The nine contracts are discussed in the order in which they were received.

CGG Data Services AG/Robertson GeoSpec International Ltd., and TGS-NOPEC Geophysical Company ASA

A draft of the CGG/Robertson contract was given to the FGC on March 1, 2014 at the initiative of the Prime Minster. The contract sets out the terms of a partnership between the Ministry of Petroleum and Mineral Resources with CGG/Robertson on the collation, analysis and marketing to international oil exploration companies of data on Somalia's petroleum deposits. The Confidential Assessment of March 8, 2014 observed that the contract providers are market leaders in their field and had offered terms that, while not unreasonable, could be improved upon -- particularly in relation to the length of the exclusivity period, the specification of audit procedures and the Federal Government's contract termination rights. The Prime Minster then directed the Economic Subcommittee of the Cabinet to review the agreement. The Minister of Petroleum and Natural Resources subsequently informed the Cabinet that the contract had been modified in line with the Assessment and on this basis was authorized to sign.

On July 15, 2014, also at the initiative of the Prime Minster, a draft contract between the Federal Government and TGS-NOPEC Geophysical Company ASA was shared with the FGC. The contract had been initiated by Galmudug Region, and related to the collection and marketing of oil and gas data in that region. A Confidential Assessment comparing this contract and the draft CGG/Robertson agreement was delivered on September 6, 2014. The Assessment found that the two agreements were incompatible because they overlapped with respect to services to be provided and geographical coverage. In addition, it was felt that the draft CGG/Robertson agreement offered superior terms on revenue sharing, data ownership and the length of the exclusivity – while also providing for the rebuilding of Somalia's national petroleum database and associated training.

Information received by the FGC indicates that TGS-NOPEC has been notified that its services are not required.

An issue has arisen in relation to the CGG/Robertson agreement, as reported in ***the*** attached ***Letter of October 20, 2014 from the Finance Minister to the FGC*** (previously released as part of the FGC's Periodic Report #3). The Minister's letter points out that a Ministry of Finance analysis of the new contract found that only a limited number of the suggested changes to the draft contract had been made, and that these did not adequately address the Confidential Assessment's substantive concerns – and that the Minister therefore "plans to write to the Prime Minister, informing him that the amendments to the contract have not been made satisfactorily, and on the need for negotiations in order to comply with FGC recommendations".

Mogadishu Port Container Terminal & Simatech International

A concession covering the lease and operation of the Mogadishu container port was signed on November 10, 2012 between the Mogadishu Sea Port Authority, and Mogadishu Port Container Terminal & Simatech International. It was sent to the FGC for review on March 2, 2014, and a Confidential Assessment was provided on April 23, 2014. The Assessment found that that the lease did not offer a solid basis for the management of container traffic at the Mogadishu Port. It did not cover the essential financial and technical issues that should form part of any such government contract; it was silent about institutional roles, the contractor's reporting and information requirements, invoicing methods, tax obligations, custodianship of the property, and end-of-lease obligations (vis-à-vis structures erected on the land, environmental cleanup measures, etc.). The charges specified in the lease were also abnormally high when compared with international norms.

This agreement has now been overtaken by events. On September 13, 2014, the Managing Director of the Mogadishu Ports Authority issued a circular to all companies working in Mogadishu Port informing them of the port concession signed on 24 October, 2013 between the Minister of Public Works and Reconstruction, Marine Transport, Ports and Energy and Albayrak Turizm Inşaat Ticaret A.S. (Albayrak), and asked these other companies to vacate the port premises and remove all equipment by the end of September.

The FGC understands that the Federal Government plans to follow up this general notice with a specific termination letter from the Managing Director of the Mogadishu Port Authority to Mogadishu Port Container Terminal & Simatech International.

Soma Oil and Gas Exploration Limited

Soma Oil & Gas Exploration Limited was established in 2013 to pursue oil and gas exploration opportunities in Somalia. A contract was signed between the Minister of

Natural Resources and Soma on August 6, 2013 and embodies an 8-month period of exclusivity, now completed, in which seismic surveying would be carried out onshore and offshore in areas of Soma's choice that are not the subject to prior grants of petroleum rights; the contract then allows Soma a further year of exclusivity to negotiate Production Sharing Agreements (PSAs) with the Federal Government in areas of "potential prospectivity" to the company, up to a total of 60,000 km sq. (declared to be the maximum permissible under the Petroleum Law of 2008). The PSAs thus negotiated would remain in force for 8 years; should a "commercial discovery" be made, up to 25 years of exploitation would be permitted following agreement on a detailed development plan. The contract makes clear that exploiting an area of potential that falls within "the boundaries of a Federal Member state" requires advance confirmation that the Federal Government has jurisdiction to grant a PSA.

This concession was sent to the FGC on March 2, 2014 and a Confidential Assessment was provided on April 23, 2014. The Assessment noted that the contract is a well-drafted and professional document. It pointed out that the agreement could be improved on in some ways (e.g. by the Somali Petroleum Corporation taking an increased share in the PSAs and in the provisions made for local community development), and recommended that the Federal Government discuss possible improvements with Soma.

The more important issues this agreement gives rise to relate to contracting in the oil and gas sector as a whole, where non-competitive procurement and the ambiguities that currently surround Federal-state legal and fiscal relations carry significant downside risks for the country. These issues are addressed in the Recommendations section of this paper and in the attached ***Note on Oil and Gas Contracts***.

Favori LLC

This concession was signed on June 30, 2013 between the Minister of Information, Post, Telecommunication and Transportation and Favori LLC. The agreement authorizes Favori to upgrade and manage the Mogadishu International Airport for a period of 15 years; Favori is to be responsible for airport renovation, day-to-day management, ground handling, security, catering, terminal management, cargo management, and the operation of "governmental owned commercial units in front of the main terminal building". Airport renovation encompasses the construction of terminal buildings, the widening and paving of internal roads, lighting, and the construction of offices and other facilities necessary to the provision of the described in the agreement. An initial premium of US$1.5 million paid by Favori will be recovered from the payments to the Federal Government of 45% of Favori's net earnings, which begin in Year 4 of the concession.

The agreement was shared with the FGC on March 2, 2014, and a Confidential

Assessment was provided on April 23, 2014.

The Assessment pointed out that the agreement lacks precision, and that this could give rise to misunderstandings -- for example, over the exact nature of certain planned improvements (e.g. "widening of the internal roads of the actual terminal building”), and of the equipment to be provided. Other examples of vagueness include an absence of discussion of Favori’s fee structure, or of how Favori proposes to calculate its costs (other than by using “international accounting standards of profit and loss”). With respect to revenue sharing, the contract does not specify any revenue targets or financial performance benchmarks/levels of service. While either party may terminate the agreement at 90 days notice "by giving reasonable reasons", it is not clear who is responsible for defining what is ‘reasonable’. The Assessment therefore proposed that the Federal Government approach Favori to request adjustments to those terms of the agreement that are unclear or deficient.

The Minster of Finance's letter of October 20, 2014 to the FGC indicates that the Federal Government and Favori LLC have in principle agreed to renegotiate the terms of the agreement in line with the recommendations in the Assessment, while taking account of Parliament's concern that the terms of the contract should be aligned with the Somali Constitution and national law. The main purpose of these discussions would be to achieve greater contractual clarity and precision, particularly in relation to the basis for revenue sharing. The Federal Government previously informed the FGC that it planned to begin discussions before the end of 2014 using an inter-governmental team from the ministries of Transport, Finance and Foreign Affairs. The African Development Bank's African Legal Support Facility has been helping prepare the groundwork for the discussions.

AMO Shipping Company Ltd. (AMOSC)

This service contract for the supply of six patrol vessels was signed between the Minister of Defense and AMOSC on July 29, 2013. The cost to the Federal Government of the contract is €132 million. It was sent to the FGC on March 2, 2014 and a Confidential Assessment was returned on June 1, 2014.

While the contract has certain deficiencies from a Somali perspective, the over-riding issue is its affordability. There is no provision in the 2014 Budget for these outlays, and no realistic prospect that the contract can be financed from Treasury resources. The contract stipulates that 25% of the contract was payable upon signature, a condition that was not met.

The Assessment advised cancellation on the grounds of unaffordability. The Federal Government is reviewing this option and plans to hold discussions with AMOSC.

Albayrak Turizm Inşaat Ticaret A.Ş.

This major concession addresses the renovation and day-to-day operation of Mogadishu Port. The agreement was signed between the Minister of Public Works and Reconstruction, Marine Transport, Ports and Energy and Albayrak on October 24, 2013. It grants Albayrak the "exclusive right to finance, rehabilitate, operate, manage, maintain, develop and optimize the Port of Mogadishu” for a period of 20 years, with the possibility of renewal. The concession was sent to the FGC for review on April 22, 2014 and a Confidential Assessment was provided on June 1, 2014.

The Assessment found that the agreement establishes the basic parameters of a workable commercial relationship, but lacks important clarity. There are no measurable performance indicators. There is no clear analytical basis for the division of revenue between Albayrak and the Federal Government. The agreement's dispute resolution mechanisms appear inadequate, given the inexperience of Somalia's maritime regulator. The Assessment also indicated that the length of the concession was worth reconsidering, with a promise of renewal if key performance indicators are met. International experience, it was noted, shows that ambiguity in a contract of this kind can lead to labor disputes, non-competitive port costs and repressed government revenues. The Assessment recommended that the Federal Government seek an amicable renegotiation of the contract's more troubling clauses.

The Prime Minister instructed the Cabinet Subcommittee on Infrastructure to discuss the agreement in light of the Assessment, and asked the Minister of Ports and Marine Transport and the Minister of Finance to undertake a review, including of the contract's implications for employment in the Port. A report was prepared for the Prime Minister by the two ministries, and shared with the FGC on October 6, 2014. The report noted that the agreement has the potential "to bring the Mogadishu port to prudent industry practices and standards", to increase Mogadishu's overall productivity, and to thereby enhance the prospect of peace and stability. It also drew attention to the lack of a "credible procurement and concessions process", and recommended that the "Federal Government of Somalia would be best-served to review the difficult and unclear parts of the contract", and that the agreement should be renegotiated "without compromising its overall integrity". The report proposed that clear performance guidelines should be introduced; costed and timed investment plans should be submitted, both by Albayrak and the Federal Government; and that steps should be taken to ensure that the performance of the company is supervised by a qualified supervising engineer (to be recruited if necessary from abroad).

In light of the urgent need to reorganize Mogadishu Port, the Cabinet endorsed the handover of the management of Mogadishu Port to Albayrak, and on September 13, 2014 all pre-existing port operatives were given notices of termination and requested to remove their equipment. The Minister of Finance informed the FGC that Federal Government revenues from Mogadishu Port increased appreciably in October and November.

In November, the Minister for Ports and Marine Transport visited Albayrak in Turkey, and discussed possible amendments to the agreement.

Somalia Fish-Guard Ltd.

This wide-ranging concession was signed between the Minister of National (sic) Resources and Somalia-FishGuard on July 25, 2013. It was shared with the FGC on April 29, 2014 and a Confidential Assessment was delivered on July 4, 2014.

The Assessment pointed to a number of difficulties in the agreement. One is its level of ambition: it is most unusual to contract a single firm to manage every aspect of the fisheries sector, including policy advice, legislative drafting, licensing, patrolling/enforcement, research, conservation and industrial development. The length of the exclusivity is well above industry norms. The agreement does not clearly specify the capital, equipment, facilities, training and personnel that would be provided, nor does it establish delivery schedules or embody quality standards/performance benchmarks. While the cost-sharing responsibilities of the parties are imprecise, the share of gross revenues accruing to Somalia-FishGuard is high when compared with other such contracts. The agreement also embodies a potential conflict of interest: Somalia-FishGuard is responsible both for selling fisheries licenses and for conserving the country's fisheries resources (these responsibilities are typically separated in fisheries service contracts).

A new Fisheries Law was passed by Parliament in October 2014. While the agreement is silent on the respective responsibilities and revenue rights of the Federal State versus the country's various regions, this issue is specifically addressed in the new law.

On November 21, 2014 the Minister of Fisheries and Marine Resources wrote to Somalia-FishGuard drawing its attention to these problems, and proposing that the current agreement be replaced by a more tightly focused instrument concentrating on support for the creation of a Somalia Fisheries Protection Force.

Great Horn Development Company

This framework agreement (FA) was signed between the Minster of Ports and Marine Transport and the Great Horn Development Company (GHDC) of Djibouti on April 29, 2014. The FA provides GHDC (and its potential sub-contractors) a six month period of exclusivity in which to plan, develop/rehabilitate and operate various ports and related road infrastructure (the ports in question are a new commercial port for Mogadishu at Elma'an, new fisheries harbors at Gara'ad, Egue and Barawe, and the existing ports of Kismayo and Bosaso). The FA was shared with the FGC on October 20, 2014 and a Confidential Assessment was delivered on December 4, 2014.

The Assessment noted that the FA makes no mention of the role of any regional administration. Given that the Puntland and Jubbaland regional administrations exercise *de facto* control over the ports of Kismayo and Bosaso, it is unclear how the FGS can deliver on the exclusivity granted GHDC in the FA. This underscores the need for a dialogue between the Federal Government, the various port authorities and the regional governments to establish the rights and obligations of different levels of government in relation to port management.

Observations and Recommendations

Observations

It is clear from the process of locating contracts, reviewing them and seeking feedback on Confidential Assessments that the Federal Government currently lacks systems for handling complex contracts, or conducting government-wide reviews of the strategic issues that they embody. This lack of institutional capacity has contributed to delays and miscommunication, and has slowed the process of responding to Assessments. It has also contributed to the sub-optimal terms of the contracts. This is not a situation that is susceptible to instant improvement, and thereby underscores the need for the FGC's interim review role (below). That said, there is a need for donors to give higher priority to delivering practical, on-the-ground assistance to procurement *implementation.*

Donor resources applied to the review process have not been adequate, and have depended excessively on the ability of World Bank technical staff to offer analysis in addition to their regular assignments. A glance at the response times in delivering Assessments in ***the attached table*** shows that the CGG/Robertson agreement was turned around in a week, but that it has subsequently taken much longer to produce Confidential Assessments. This underlines the point made in the Independent Review of the FGC carried out in November: that to be effective, the FGC needs to be properly resourced by the donor community.

Recommendations

The Federal Government has already indicated that all draft contracts valued at more than US$5 million should be reviewed by the FGC prior to signature, but it is not clear how widely this decision has been publicized among Somali stakeholders. Nor does this injunction directly 'institutionalize' good procurement practice.

In light of this, it is recommended that the Federal Government should take three measures that would make a rapid, positive contribution to public contracting, and thereby to Somali financial governance as a whole.

The first measure would be for the Federal Government to issue a public policy statement clarifying the FGC's ad interim role in reviewing contracts and concessions.

The second measure would be to for the Federal Government to put in place an interim system for reviewing new contracts and concessions. It is clear that the new procurement institutions envisaged under the *Public Procurement, Concessions and Disposal Act* will not be able to discharge their allotted functions for some time, and that it is unrealistic to try and establish competitive tendering immediately. The norm today is that private companies approach Federal Government ministries and agencies with draft contracts and concessions. Under an interim approach, the ministries/agencies could instead forward these draft contracts and concessions to a special procurement board. This (interim) board could be chaired by the Ministry of Finance, and could include representation from the Attorney General's office as well as legal expertise from the African Development Bank's African Legal Support Facility. The board would advise the ministry/agency if the draft contract/concession was in Somalia's best interest, and if the terms needed renegotiation. After board clearance, drafts valued at over US$5 million would be forwarded to the FGC, which would provide a Confidential Assessment (which might propose further renegotiation). The ministry or agency would then send the draft contract, along with the advice provided by the board/FGC, to the Council of Ministers for decision. FGC Assessments would subsequently be made public. Any contracts or concessions signed without following this approach would have no validity.

The third measure would be to publish all contracts and concessions awarded by the Federal Government on the Ministry of Finance's website within two weeks of signature. In time, as competitive procurement becomes established, all bid documents and all shortlisted bids should also be published.

In addition, it is proposed that the Federal Government take action to manage the process of oil and gas concessioning. Legal confusion exists between the 2008 Petroleum Law and Somalia's Provisional Constitution over the respective rights of the Federal Government and Regional governments to issue oil production contracts – a situation that poses serious dangers to the country. The FGC, moreover, is likely to receive an increasing volume of such contracts for review, some negotiated by the Federal Government, others by Regional authorities (see also the attached ***Note on Oil and Gas Contracts***). Given this situation, ***it would be prudent for negotiations on any further oil and gas production agreements to be postponed until new legal and fiscal frameworks for the sector have been established.*** It should be feasible to establish these frameworks by the latter part of 2015. At that point, the FGC could advise the Federal Government on how to structure public tendering processes in the sector, and could review draft negotiated PSAs against the new frameworks.

Contracts/Concessions and MOUs sent to the FGC's IFI delegates for review					
Contract (CT)/concession (CN)	**Sector/service provided**	**Date signed/by whom**	**Sent to FGC**	**Reviewed**	**Status**
Contracts with the Federal Government					
CGG Data Services AG/Robertson GeoSpec International Ltd. (CN, reviewed in draft)	collation, analysis and marketing to oil exploration companies of data on Somalia's petroleum deposits; rebuilding of Somalia's national petroleum database and associated training	(February 26, 2014), Minster of Petroleum and Mineral Resources	March 1, 2014	March 8, 2014	Renegotiated and reportedly signed; the adjustments made do not appear to address the substance of the Confidential Assessment adequately
Mogadishu Port Container Terminal and Simatech International (CN)	lease and concession for operating the Mogadishu container port	November 10, 2012, General Manager of Mogadishu Sea Port Authority	March 2, 2014	April 23, 2014	Overtaken by events
Soma Oil and Gas Exploration Limited (CN)	seismic surveying and oil and gas production	August 6, 2013, Minister of Natural Resources	March 2, 2014	April 23, 2014	No action taken
Favori LLC (CN)	renovation and day-to-day operations of Mogadishu International Airport	June 30, 2013, Minister of Information, Post, Telecommunication and Transportation	March 2, 2014	April 23, 2014	Under discussion between the parties
AMO Shipping Company Ltd. (CT)	supply of marine patrol boats	July 29, 2013, Minister of Defense	April 1, 2014	June 1, 2014	Under review by the Federal Government
Albayrak Turizm Inşaat Ticaret A.Ş. (CN)	renovation and day-to-day operations of Mogadishu Port	October 24, 2013, Minister of Public Works and Reconstruction, Marine Transport, Ports and Energy	April 22, 2104	June 1, 2014	Under discussion between the parties
Somalia-FishGuard Ltd. (CN)	protection, licensing, policy and institutional development of Somali's	July 25, 2013, Minister of National (sic) Resources	April 29, 2014	July 4, 2014	Under review by the Federal Government

	fisheries sector				
TGS-NOPEC Geophysical Company ASA (CN, draft)	acquisition and processing of geophysical data and its promotion, marketing and licensing to oil exploration companies and other parties	(May 30, 2014), Federal Government (ministry not specified)	July 15, 2014	September 6, 2015	Reportedly withdrawn
Great Horn Development Company (MOU, Framework Agreement)	harbor and fishing port development, road construction	September 8, 2013 (MOU); April 29, 2014 (Framework Agreement), Minster of Ports and Marine Transport	October 10, 2014	December 4, 2014	Under review by the Federal Government
Polaris Energy SDN BHD (BOT CT)	Electricity generation, transmission and distribution	June 2014 (undated), Minister of Water and Energy	November 5, 2014	In progress	
Contracts with regional governments					
Galmudug Somali Petroleum Corporation and Petro Quest Africa (CN)	oil production sharing agreement	February 2, 2013, Galmudug State and Galmudug Somali Petroleum Corporation	September 23, 2014	In progress	
Contracts not yet sent for review					
Dutch Atlantic Marine and Offshore Group (CN)	equipment, services and training to develop a national coast guard	July 2103, Minster of Defence			
Mubadala Development Company (MOU)	petroleum services capacity building	July 2014, Minister of Petroleum and Mineral Resources			
The National Theatre (MOU)	infrastructure rehabilitation	Not known			
Spectrum ASA (CN, draft)	collation, analysis and marketing of data on Somalia's petroleum deposits	(October, 2014), Ministry of Petroleum and Natural Resources			

Jamhuuriyadda Federaalka Soomaaliya
Wasaaradda Maaliyadda
Xafiiska Wasiirka

جمهورية الصومال الفيدرالية
وزارة المالية
مكتب الوزير

The Federal Republic of Somali
Ministry of Finance
Office of the Minister

October 20, 2014

To: FGC Members

Re: Progress Report on the Review of Government Contracts/Concessions

In my capacity as the chair of the Financial Governance Committee (FGC), the Ministry of Finance has been following up with the various government agencies and ministries to ensure that the recommendations made by the FGC following their review of the specified government contracts are implemented.

In addition, I would like to report that the Prime Minister has reiterated his support and the commitment of the government in ensuring transparency and accountability in all government dealings. It is in this regard, that he has directed the relevant subcommittees of the Council of Ministers to look into a number of government contracts already reviewed by the FGC. I have also issued reminder letters to the relevant ministries, seeking updates on the progress of contracts against the FGC recommendations.

This brief report sets out the actions undertaken by the government and the Ministry of Finance since the last FGC retreat meeting. A key summary of some of these actions are highlighted herein below :-

Favori Ltd. Airport Contract

- FGC advice on this contract was shared with the Minister of Finance on April 23rd, 2014.

- In view of the national importance of this contract and recognizant of the urgent need for the upgrade on the Mogadishu Airport, the Government and Favori, have agreed in principle to renegotiate the terms of this contract. This renegotiation is to be undertaken in line with the recommendations made by the FGC and in line with comments received from Parliament to ensure that the terms of the contract are aligned to the Somali Constitution and national laws. The amendments to be sought will seek to enhance and clarify the language of the contract especially on the provisions setting out the terms on income sharing.

- The process of renegotiation was set to be undertaken in September 2014 following certain milestones/progress in building works being achieved by Favori.

- An inter- ministerial committee comprising of representatives from the Ministry of Transport, Ministry of Finance and Ministry of Foreign Affairs has been set up to spearhead this review.

- Legal assistance is being obtained from the Africa Legal Support Facility provided by the AfDB and the new lawyer is to be engaged to assist as a priority in this review.

- Further letters and reminders seeking updates on progress made against FGC recommendations were issued by me in August 2014 to the Ministry of Transport and Civil Aviation.

Albayrak Turizm Inşaat Ticaret A.Ş

- FGC advice on this contract was shared with the Minister of Finance on May 27th, 2014, and advice on contract annexes was shared with the Minister of Finance at a later date.

- The Prime Minister (PM) during the weekly meetings of the Council of Ministers included discussions on this contract to the agenda of the Subcommittee on Infrastructure.

- The PM directed the Minister in charge of Ports and the Minister of Finance to explore the economic and legal implications of this contract, to include a review on the financial benefits such as employment creation. This report was delivered to the PM and FGC members.

- Following discussions with the cabinet and in light of the urgent needs of the Port, the cabinet endorsed the handover of the Port management to the Company. However, there is also an understanding that aspects of the contract require amendment and this will continue to be pursued.

CGG/Robertson GeoSpec

- FGC advice on this contract was shared with the Minister of Finance on March 8th, 2014.
- The PM has directed the economic subcommittee of the Council of Ministers to report on the economic/financial implications of this contract.
- Minister of Petroleum informed the Cabinet that the contract had been modified in line with FGC advice. However, the Ministry of Finance has since undertaken an initial review of the new contract and has found that only a limited number of the changes advised have been implemented.
- The Minister of Finance plans to write to the Prime Minister, informing him that the amendments to the contract have not been made satisfactorily and on the need for negotiations in order to comply with FGC recommendations.

AMO Shipping Company Ltd (AMOSC)

- FGC advice on this contract was shared with the Minister of Finance on May 27th, 2014.
- No action has yet been taken, pending advice from the AfDB lawyers on the need to, and implications of, terminating this contract.

Simatech International

- FGC advice on this contract was shared with the Minister of Finance on April 16th, 2014.
- Reminder letters seeking updates on whether FGC recommendations have been incorporated were sent out to the Minister in charge of Ports.
- Legal advice to be sought from AfDB lawyers.

FishGuard

- FGC advice on this contract was shared with the Minister of Finance on July 4th, 2014.

- Further letters attaching FGC recommendations have been sent out to the Fisheries Ministry. We have also requested an update on the progress made on the FGC recommendations so far.

- Legal advice to be sought from AfDB lawyers.

TGS-NOPEC Geophysical Company ASA (TGSM)

- This contract was submitted to the FGC for review but has not been signed by the FGS.

- Initial comments and questions were submitted by the FGC to the Minister of Finance on October 16th, 2014.

- It is our understanding now that this contract is no longer being pursued by the government.

Shulman Rogers Contract

- The Governor of the Central Bank of Somalia cancelled the Shulman Rogers contract for asset recovery.
- The government has selected a new attorney to represent it from a shortlist provided by the StAR Initiative.

Hussein Abdi Halane
Minister for Finance

A Note on Oil and Gas Contracts

There is ambiguity between Somalia's 2008 Petroleum Law (which is based on the Transitional Federal Charter) and Somalia's Provisional Constitution when it comes to determining who has authority to issue Production Sharing Agreements (PSAs).

The FGC is likely to receive an increasing volume of PSAs for review -- some negotiated by the Federal Government with a investor (such as Soma), others with regional authorities (such as the agreement between the Galmuduug Somali Petroleum Corporation and Petro Quest Africa). In addition, petroleum majors holding legacy agreements are keen to reactivate them. It is well-known that conflicts can erupt in fragile environments in which petroleum resource rights are disputed.

An FGC contract review aims to establish whether a proposed contract provides a good deal for the country. In the absence of a strategic, legal and fiscal framework consistent with the Provisional Constitution, ad-hoc FGC reviews of PSAs resulting from direct negotiations between authorities and investors cannot determine whether a particular deal is optimal for Somalia, and may inadvertently encourage an intensification of individual deal-making -- with all of the political risks this embodies. A more structured approach is needed.

The Minister of Petroleum and Mineral Resources has formally requested the World Bank to broker a series of high-level consultative meetings on petroleum ownership, control and revenue-sharing for Federal and Regional stakeholders. The aim is to reach agreements between Federal and Regional authorities that can, with appropriate technical support, be embedded into the Provisional Constitution and form a revised petroleum legal framework. Petroleum negotiation support is also part of the package. It should be possible to complete this work by August 2015.

Somali's petroleum legal framework should be in line with the Provisional Constitution and with international best practice, and should recognize both the principles of federation and of decentralization. The country's petroleum fiscal regime remains undefined, and needs to secure good value for money from Somalia's natural resources while providing sufficiently attractive incentives to potential investors to ensure that reliable players come forward. To date there is no record of exploration success in Somalia. Until this occurs, the perceived geological risk of Somali exploration blocks will remain high, relative to blocks offered by countries with significant proven reserves. Hence the importance of a competitive upstream petroleum fiscal regime.

In countries with no previous petroleum discoveries, the approach taken to exploration is similar to what we now see in Somalia. Investors submit unsolicited applications to develop production blocks, leading to direct negotiations. These generally lack transparency and accountability, and will usually result in sub-optimal deals.

Not only is it important to conduct public tendering: the way in which public tendering is organized is also important. Bidders should be subject to a pre-qualification process that reviews their exploration track record and operating experience in similar environments; this process should be rigorous enough to ensure that financially and technically competent companies with reputations to protect are the ones incentivized to step forward. Other strategic factors can be given weight in the bidding process, such as the extent of a company's commitment to developing affected communities.

Given these considerations, and the risks to the country of allowing an expansion of *ad hoc* licensing, it would be prudent for the Federal Government to postpone direct negotiations on PSAs until a new legal and fiscal framework for the sector has been established. At that point, the FGC would be able to advise the Federal Government on how to structure public tendering processes, and would then review draft negotiated PSAs against the new framework.