



# Columbia Center on Sustainable Investment

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## Do Companies Have Personalities and Why Does It Matter?

### Interview with Tom Mitro

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***Tom, can you tell us about the various company personalities and how they express themselves?***

There are first different risk appetites: Usually the International Oil Companies (IOCs) juniors and explorers are the risk takers and when there is a commercial discovery, their business model is to flip all or a portion of the license to the majors usually around the time of the submission of the Development Plan. IOCs majors generally prefer to avoid the exploration risk unless the probability for a big find is high. Governments need to be aware of this dynamic specific to the oil industry not to be caught by surprise by the strategies of the company or the type of company being attracted.

Among the majors, there are also different risk-taking profiles. An example is ExxonMobil, which is quite rigid with their threshold of project returns and has very standardized and centrally-driven rules of operations. This limits the leeway of local management in terms of negotiating or interpreting the terms of a deal.

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***Does nationality and where headquarters are located affect the company's personality and negotiation strategy?***

Yes, a mix of nationalities, culture and interests of the home countries will impact the behavior of the companies during negotiation and their engagement with the government in general.

Typically, the negotiation style of the Europeans also tends to entail greater cultural/historical awareness as well as an understanding of the local context and attitudes than that of the Americans, partly due to European post-colonial connections.

The Americans are very much focused on the technical data and are led by an engineering culture; they will often try to convince governments with technical data, and argue that certain negotiating proposals are inconsistent with "standard" or "best" practices. These assertions can be difficult for the government to dispute without analyzing comparative deals in other jurisdictions, putting them at a disadvantage.

However, the engineering culture of these companies might also lead them to be more consultative during the project than other companies. They may be more likely to consult with or notify the government about how they are interpreting and implementing a contractual or tax language. However, they may still unilaterally apply their interpretation without approval if the government is not in a position to provide a compelling opposing technical or legal argument. In general, they may believe that they are in a better position to influence outcomes if they have maintained a good relationship with the government. It should be noted that this is not universal. Depending on the issue, U.S. companies can be just as capable of taking extreme positions without consultation. One example relates to a country where the fiscal terms contained an exploration incentive in the form of a tax credit for whenever the reserves added by a company in any one year were greater than that year's production. At least one U.S. company decided to accelerate reserves additions and delay some previous year revisions in order to "bunch up" reserve additions such that it ended up generating a much higher tax credit for a particular year. This was done without notifying the tax authorities of the more aggressive technical interpretation, which made the company's position less obvious and transparent.

The European companies (especially noting a few of the French, Italian and Portuguese companies) tend to have a more commercial style and tend to purely push commercial positions without relying strictly on technical arguments or best practice. This involves taking positions on issues that may or may not be consistent with practice in other places. This commercial style sometimes goes hand in hand with a less consultative style when taking positions in negotiations, tax calculations, and Profit Sharing Agreement (PSA) returns, because these companies often consider it the government's responsibility to identify and raise objections. For example, in one

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country where I was working one European company (non-operator) held different equity shares in two separate Joint Venture (JV) blocks. (The state oil company also held equity interests in both of the blocks.) The European company led a JV audit of the operator in which they raised an audit objection which would have the effect of reallocating common costs of the operator from one JV Block to the other. The audit objection had limited technical justification and had more of a commercial motivation intended primarily to move costs from a JV Block where that company bore a higher equity share of costs to the other block where they had a much lower share. This had a negative impact on the state oil company as the reallocation recommended in the JV audit had the effect of shifting more costs on to the JV Block where the state oil company held a much larger stake.

Understanding how these approaches may vary by company might be used to better design the scope and focus of JV and tax audits, reporting requirements, and terms of agreements.

### ***What about the Asian companies? Do they behave differently?***

In some ways yes, because their roles and needs are different.

Chinese companies want resources needed to power the Chinese economy, and they tend to have access to cheap capital. Rather than trying to achieve the best, more narrowly defined petroleum project deal, they will pursue deals that achieve their home country objectives. This kind of motivation has led them to close resource for infrastructure deals. They will also invest with a clear mandate, and rarely have space to deviate from it.

The mandates can vary. Often they merely want to gain access to oil or gas reserves that cannot be easily revoked by the producing country. Other times they will invest in an oil project with JV partners to gain information and experience about technical aspects of projects. Another objective of the investment can be to use home country contractors or banks in the project. There is always some attention to the economics of the project but it tends to be more of the other factors that drive it. Usually it is some sort of combination.

As for Japanese firms, in my own experience, they tend to only invest in equity shares and rarely publicly raise anything that could create a dispute; they typically tend to follow the conciliatory position.

### ***Does a company's nationality influence the types of provisions they prioritize in agreements?***

Yes, in particular because the type of home-country laws will affect the type of provisions that are pushed for. For instance, American companies subject to the

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Foreign Corrupt Practices Act will always make sure that anti-corruption clauses are included in the contract.

Moreover, U.S. Tax Law changes over time, which has an impact on the Foreign Tax Credit that U.S. companies operating abroad are entitled too. Therefore, at a minimum, the American companies will insist on a clause that requires deals to be renegotiated if the US changes its tax law, to take into account the current stand of the U.S. tax administration on the foreign tax credit. In many cases, where fiscal incentives are negotiated, U.S. companies will also insist that provisions require the generation of local income tax receipts in the name of the U.S. company, even when the state oil company is responsible for paying the tax on behalf of the U.S. company, or where incomes taxes are reduced due to a tax holiday. (even if those income taxes are subject to a tax holiday). The Guyana PSA and Angola LNG agreements, for instance, both include such provisions.

Most PSA or concession agreements ask for the contract confidentiality clauses to include a waiver for any home country disclosure requirements. This waiver was historically asked for by U.S.-listed companies subject to the Security and Exchange Commission's reserves, production and spending disclosure requirements, but certainly could have been used to also cover contract and tax payment disclosures that would have been required under the Dodd-Frank Act if its rules of implementation had not been repealed. Ironically the main argument used by the oil company lobbyist (the American Petroleum Institute) to convince the Trump Administration to overturn the Dodd-Frank disclosure requirements was that it would cause them to violate confidentiality requirements of their PSAs and concessions ignoring the fact that these types of waiver clauses would actually have permitted this.

Another example: in the 1990's and 2000's, European companies' oil and gas contracts generally explicitly noted the contracts' subjugation to bilateral investment treaties or tax treaties. Contracts involving U.S. companies included these provisions less frequently since the U.S. had fewer of these types of treaties.

The contents of fiscal stabilization clauses also differ by nationality. In the negotiations that I was involved with, the stabilization clauses negotiated by U.S. companies tended to be more legally-driven and very detailed about remedies, whereas those negotiated by the Europeans tended to be more general with less specific detail about how they would be enforced. This might relate to the fact that the U.S. legal framework tends to be more detailed and more litigious in general.<sup>1</sup>

Similarly, some companies prioritize establishing specifics in arbitration clauses, to exert greater control over the venue, rules, and timing of potential disputes. ExxonMobil seems especially focused on this, perhaps because of its experience in Venezuela.

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<sup>1</sup> See forthcoming interview with Salli Swartz for further explanation on this.

***When it comes to financing and credit risks strategies, what kind of behavior can be observed?***

Some companies (examples are Chevron and ExxonMobil) have a core corporate strategy of maintaining very high credit ratings in order to keep borrowing costs low and to sustain steady dividends to shareholders. They achieve this by maintaining a healthy balance sheet with low debt ratios and limited contingent debt. This translates into a resistance to providing parent company guarantees to their national oil company partners (or any other parties for that matter), carried interests or accepting any form of credit risk on their behalves. One example of this occurred in the Angola LNG project: the national oil company had a virtually spotless record of paying its cash calls and funding its obligations on time over a period of several decades, yet their IOC partners resisted accepting any of their credit risk when it came to cash calls or project funding for new projects.

Another thing to note is that the IOC majors do not like the higher costs and restrictions typically associated with project financing.<sup>2</sup> Thus, they typically avoid project-specific financing unless there is a clear tax incentive to do so (e.g. tax deductibility, cost recovery, special incentive). Instead, the majors prefer to rely on the strength of their consolidated corporate balance sheet to carry out general borrowing and commercial paper operations not tied to individual projects. The smaller independent companies, in contrast, almost always rely on project financing due to their smaller size, limited balance sheet, and lack of diversification. Whereas state oil companies (China, Japan, etc.) will rely on loans from their state-owned banks to finance projects.

Since the IOCs' majors tend to finance projects from general corporate debt, they are more likely to push to obtain local tax deductions on "intercompany" loans from their parent company to the local subsidiary. When this happens the "transfer price," i.e., interest rates charged, must be clearly delineated and limited. In one recent high profile example, failure to do so resulted in the Australian government claiming huge tax payments from Chevron. Whenever corporate financing is used (as opposed to project financing), the risk that transfer pricing practices will reduce government take will be higher. The set-up of the internal financing transactions of a company can appear arbitrary and not directly comparable to arm's length rates unless the government establishes specific limits in its laws and contracts.

The implication for host governments and national oil companies (NOCs) is that without a clear understanding and establishing specific guidelines, these financing preferences and practices of the IOCs may end up limiting the government's own financing alternatives, resulting in higher NOC financing costs or in the government effectively "subsidizing" IOC financing costs.

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<sup>2</sup> “Project financing is a loan structure that relies primarily on the project's cash flow for repayment, with the project's assets, rights and interests held as secondary collateral.” (Investopedia).

### ***What are the various negotiation tactics that governments can adopt?***

There are a few typical types of behaviors that IOC's exhibit, and it is important for government partners to understand these in order to adjust their approach:

IOCs will bring different types of expertise to the table: geologists, engineers, lawyers, tax experts, and economic analysts—all who work in professional silos without any broader perspectives or mandates. Typically, the IOC would attempt to isolate each issue and to negotiate and settle them individually on a narrow technical basis. To counter this approach, governments should generally avoid agreeing on issues individually and instead require all of the relevant issues to be considered as one whole package by focusing on tradeoffs between unrelated issues. For instance, the government could say: "We won't agree to accelerate depreciation on your project capital expenditures unless you implement an ambitious local procurement plan," even though the two issues are quite unrelated. This type of conversation and linkage of issues could serve to mitigate the often narrowly focused technical strength of the other side.

Some IOCs, in particular some American companies or those that don't typically grant much authority to the local management and technical teams, will fly people in for negotiations. ExxonMobil, which is much more centralized in its management, does this, but other companies also fly in negotiators for certain higher level negotiations. For a "fly-in" headquarters negotiating team, time is of the essence as this type of team typically plans on being in country for a limited amount of time and wants to avoid spending weekends in country; for this reason, they will have pressure to achieve results quickly. Governments need to be aware of this phenomenon and not to yield to time pressure. Quite often delays in meetings or in reaching agreement can work to the advantage of the government.

Some companies will also fly in the CEO with the objective of shortcutting the technical negotiation process through some political outreach, such as meeting the President, the Prime Minister, or Energy Minister. With this in mind, the technical teams should prepare the President or the Prime Minister to ensure that undue concessions are not granted or promised without a full understanding of the details. Similarly, some home countries with traditional diplomatic relations will try to use their embassies to pressure the government representatives, especially in cases where aid packages or diplomatic recognition are at stake. Recent examples include Chinese aid programs. Here too the governments should be prepared to resist the pressure or at least consider negotiating a tradeoff for any concession.

The last thing worth mentioning: some IOC local representatives will try to establish very friendly personal relationships with government or NOC officials in order to avoid or minimize conflict and pave the way for quicker decisions. Yet the "friendly" personal relationships should not be confused with the company's commercial or negotiating strategies or their level of transparency. For example, many local company

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representatives attempt to establish relations by keeping host government informed of all the “good” things that happen in their company (discoveries, cost containment), yet rarely mention any “bad” things that the company experiences (overruns, late submissions, lack of local content progress, spills, etc.). Awareness of this phenomenon is important to put “relationships” into context.

***What’s your best advice to governments?***

Well, in short, what is certain is that understanding the styles, management orientations, operating philosophies, strategies and home country influences of an IOC can create tangible benefits for any host government preparing and developing its own negotiating, policy-setting, or financing strategies.

Background information on the IOCs can often be obtained from the IOCs own website, SEC filings, management disclosures, contract databases (ex: resourcecontracts.org), news stories, the experiences of other countries (New Producers Group), or from internal government and NOC meetings. Time spent on these efforts pays dividends in achieving more balanced, equitable, and sustainable agreements and developments.

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