QUESTIONS FOR A MULTI-STAKEHOLDER DIALOGUE ON RESPONSIBLE INVESTMENT IN WEAK GOVERNANCE ZONES

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Investor roles in weak governance host societies

Preamble:

Before addressing this question, it is important to note that investment practices are only one way by which private sector actors may unwittingly or otherwise exacerbate weak governance, human rights violations and, sometimes, armed conflict. The trading practices and operational decisions of companies in WGZ's, though not, or not yet, within the explicit remit of the CIME or the Guidelines, are also areas where collective remedies are needed.

Second, while there is much that companies can do to assist host governments to ensure fiscal probity and responsible economic management, the first obligation of responsible corporate conduct is to ensure that their otherwise routine investment, production and trade activities do not contribute to corruption, human rights abuse, or armed conflict. In zones of weak governance or open violent conflict, where authorities lack the will and capacity to enforce their own laws, it is unacceptable for companies to limit their CSR to complying with host country law. While this is necessary, in such contexts it is insufficient. In such contexts, companies may find that unaccountable governments manipulate legal statutes for corrupt purposes, and in ways that not only do harm to civilian populations, but also render vulnerable the security of company contracts, titles, operations and staff safety.

In order to ensure that company activities in WGZs "Do No Harm", companies need to incorporate proactive conflict-impact and humanitarian assessments into their calculations of political risk, that is, companies need to recognise and assess the potential negative impacts of their own activities on the country and populations with whom they are engaged. A number of multistakeholder initiatives, including the Global Compact and the Voluntary Principles on Security and Human Rights have developed guidelines for such assessments. Companies should be encouraged to make them part of their due diligence practices.

While the present discussion necessarily focuses on technical issues related to the CIME's mandate and the remit of the OECD Guidelines, I would like to recall the participants to the fact that what is at stake is not simply the credibility or profitability of OECD investment, but the physical, social, and economic well-being of millions of people throughout the developing world.

And while the background paper euphemistically refers to a time and place called " pre-reform DRC", let's recall that this was a period of outright civil war which involved 7 neighbouring countries, and which caused the deaths of 2 million people, even as it enriched many private sector actors. I say this to remind us of what is really at stake and also to put into perspective the nature of the larger policy challenges and the present inadequacy of policy responses.

1. Do companies have a role in helping to support reform of economic and political institutions in host societies?

Companies can play a role in assisting host governments to undertake reforms that reduce corruption, promote transparency, strengthen clear and just procedures for dispute resolution that protect legitimate property rights. In WGZ's, these capacities are typically weak , sometimes due to lack of administrative resources and know-how, sometimes due to a deliberate design to protect corrupt officials from accountability. Progressive companies that value their reputations, also, clearly, have an interest in doing so. In the absence of effective government partners, progressive companies will remain vulnerable to less scrupulous competitors, and sustainable development will continue to be bartered for short-term gain on the part of corrupt actors.

2. **If companies have such a role,**

- **Is this role different in weak governance zones than it would be elsewhere?**

In principle, this role should be the same regardless of context. In practice, however, WGZ's represent a special case and place different demands on companies. As noted above, where governance is robust, it is sufficient for companies to abide by national law, because authorities are equipped and capable of supplying oversight and enforcement. By contrast, in WGZs, these government capacities are weak or absent, authorities are not held accountable, nor do they hold accountable private activities that are not law abiding. In these cases, relying on legal formalities will do nothing to protect legitimate company interests nor to ensure that company investments do not inadvertently feed corruption, aid and abet human rights abuse or fuel armed conflict.

- **How are they to tell the difference between positive contributions to the reform process and inappropriate involvement in local politics (which Recommendation II.11 of the Guidelines asks them to avoid)?**

This is a critical issue and one that bears further policy attention. Clearly, even the most well-meaning initiatives by companies to support host state reform will carry the risk of inappropriate involvement in host country politics or the appearance of misconduct, which can be just as problematic. These risks can be mitigated in a number of ways:

1. Companies should be encouraged to develop common guidelines by which to determine legitimate efforts to promote reform from inappropriate involvement in local politics. These guidelines can build on the OECD GL existing provisions against bribery, corruption, uncompetitive contracting, etc. They should also seek to clarify ways that companies can promote technical capacity while remaining neutral on economic policy decisions, which are the sovereign prerogative of national governments.

2. Companies should undertake due diligence in advance of entry into markets in WGZ to assess the state of fiscal and economic governance, to identify problem areas, and to identify legitimate interlocutors. Where problematic areas are identified, for example, corruption in state-owned partner companies or lack of transparent taxation and accounting, companies may seek to negotiate remedial technical assistance into PSAs.

3. Companies should undertake engagement with other concerned stakeholders, particularly relevant civil society organisations to build legitimacy for reform and to manage perceptions of inappropriate involvement. Ultimately, it is citizens who should hold their governments accountable, and they should be supported in doing so.

4. Companies should seek to align themselves with and make use of relevant industry and multistakeholder codes of conduct and relevant international initiatives, for example, the Extractive Industry Transparency Initiative. A serious commitment to these initiatives will enhance company reputations, the credibility of their efforts to support reform, and offer additional assurance against inappropriate conduct.

- **How are they to distinguish between their own roles and those of host governments, international organisations and home governments (e.g. their diplomatic services, ODA programmes, etc.)?**

As a rule of thumb, companies should undertake to ensure that their own investment and operational decisions and practices do not contribute to corruption, human rights abuse, and violent conflict. Too often, pressure from international advocacy groups for companies to demonstrate their commitment to CSR has led to a proliferation of expectations and demands on companies to become the surrogate provider of public goods (health, education, infrastructure) where governments have abjured their responsibility for doing so. While companies may, in the interests of establishing a social license to operate, undertake to provide public goods, they should be aware of the risks that these entail, not least is relieving pressure on governments to reform, while also redirecting popular resentments against governments to company proxies. Companies should not, however, be expected to act like governments. In all instances, companies that seek to contribute to the provision of public goods should seek to do so in partnership with appropriate national and local authorities, or other international donor-funded projects, in ways that help authorities to build capacity and earn popular legitimacy. Doing so will also help to establish clear roles between public authorities and private sector actors.

3. Investors in the DRC responded to threatened or actual abuse of political power by cultivating political ties so as to establish a kind of "home made" investment protection. How do efforts of this type affect the development of the rule of law in weak governance host societies?

The answer to this is obvious: these activities might provide short-term investment protection to companies, but they also perpetuate a cycle of corruption and impunity, the misappropriation of national assets by privileged elites, often through coercion, and condemn affected populations to poverty and exploitation.

4. The DRC case study suggests that investors in weak governance host countries have to be well informed about the local political situation and about each other's activities.

- **What should a company do if it obtains information about wrongdoing by private actors or public officials? Should companies be encouraged to bear witness to wrongdoing? Under what circumstances should companies consider that they have whistle-blowing responsibilities?**

Again, companies should start by improving oversight and monitoring over the activities of their own personnel, as well as their supplier companies and by taking decisive and public action against those within their own ranks who have been found engaged in wrongdoing. In the absence of this, any action to report wrongdoing against other private sector actors or public officials will lack credibility. Much will also depend on the nature of the wrongdoing in question. Where it is a case of corruption, companies might arguably have more discretion in determining how to respond. However, where it is a case of gross violations of human rights, the use of slave labour or other crimes against humanity, then companies have an obligation to report such violations to home governments, international organisations, including the International Criminal Court.

- **If companies have a responsibility to make their knowledge about wrongdoing public, how can they protect themselves against retaliation by host country actors?**

In many instances, companies may incur huge risks, including economic or physical retaliation, for naming and shaming public officials. Where these fears are well-founded, companies might seek to encourage others, including home governments and international organisations, to act on the information they have. Companies can also protect themselves by taking proactive measures, for example, by committing to multistakeholder efforts such as the EITI and the Voluntary Principles.

5. The DRC case study shows that oil and mining companies provided "monetisation" services that converted the DRC's natural resource assets into (mainly) financial assets that accrued to state-owned enterprises or to the Treasury at a time when few financial and fiscal controls were in place.

- Does companies' provision of these services influence the nature of their responsibilities in weak governance host countries? If so, how?

- How can these companies avoid giving the appearance that they are aiding and abetting people who might be in a position to take advantage of the weak financial and fiscal controls in the host country?

Since the second part of this question already suggests the answer to the first part of the question, I will answer them together. In terms of consequence, the monetisation services provided by companies are no different than other legal payments to government coffers, whether signature bonuses, concession payments, and tax payments. Where few financial or fiscal controls are in place, all of these revenues are equally vulnerable to corrupt self-dealing by powerful government officials. To the extent that these monetisation services provided additional revenues, the impact is one of degree not of kind. As to how companies can avoid the appearance (or fact) of aiding and abetting, one answer is for companies to make public the revenues that the provide to governments, thereby increasing pressure on government officials to mitigate corruption, while also providing information by which citizens may begin to hold governments accountable for fiscal malfeasance.

On a related note, in the DRC as in other resource-rich conflict settings, some companies provided financing to elites (both government and insurgents) in the form of resource-backed loans or "booty futures", that is the direct company financing of combatant groups in anticipation that their victory would reward the company with lucrative resource concessions.[1] As well as violating standards of competitive contracting, this sort of financing directly fueled armed conflict and the violent and often illegal seizure of property. Where host governments are unable, home governments should prohibit their companies from engaging in this practice and hold companies accountable.

[1] Michael Ross, Booty Futures: Africa's Civil Wars and the Futures Market for Natural Resources, Mimeo, December 18, 2002.

6. **Is there any special role that financial companies can play (besides their important and often legally required contribution to helping combat money laundering) in improving the institutional framework in weak governance host countries?**

Yes, the can use their leverage over companies and government creditors to insist on fiscal probity, transparency, and accountability.

Corporate governance – creating shareholder value with integrity

7. **The Disclosure Chapter of the Guidelines encourages companies to apply high standards of financial and non-financial disclosure. Do companies have an extra duty of transparency when investing in non-transparent host countries or are their responsibilities in this area the same in all host countries?**

Yes, for the reasons suggested above. And, as above, companies should be urged to join in the promotion of the EITI as an international and inclusive set of standards.

8. **OECD societies have valid reasons – grounded in the public interest -- for holding large, publicly-listed companies to higher transparency standards than smaller and/or unlisted companies. The case study of publicly-listed junior mining companies with DRC investments suggests that the juniors have smaller, less open boards than large companies; are less likely to report on company policies, management practices and performance in non-financial areas. The small unlisted mining companies in the case study are found to be less transparent than both large and small publicly listed companies in the financial and non-financial areas.**

    - **Should junior and small unlisted companies be encouraged to use their boards to assign high strategic priority to the ethical management of their investments in weak governance zones? If so, how could this be done (e.g. add board members, create a special committee with access to relevant expertise)?**

    - **Recommendation II.8 of the Guidelines asks companies "to develop and apply … management systems that foster a relationship of confidence..." with the societies in which they operate. The Disclosure chapter encourages them to communicate information on "systems for managing risks and complying with laws, an on statements or codes of business conduct". How do these recommendations apply to small unlisted companies and to junior companies in weak governance zones? Should they be encouraged to adopt internal compliance and external non-financial reporting practices that the case study shows to be common among larger extractive industry companies?**

    - **Is asking the juniors and the small unlisted companies to open up their boards, adopt advanced compliance programmes and engage in extensive non-financial reporting equivalent to asking these companies to act like large publicly listed companies? If so, is this reasonable?**

If these are OECD operating companies, then, in principle, they should be encouraged to adopt the best corporate governance practices of major MNCs and to comply with all the relevant guidelines in terms of transparency and disclosure. I think that the critical question is less should than how. Quite clearly, due to their lesser visibility, and, in the case of small unlisted companies, their imperviousness to shareholder accountability, these companies have fewer incentives to adopt best practices and face no penalties for non-compliance. For the same reasons, it seems unlikely that any efforts to encourage them to voluntarily reform their corporate practices or the investment practices is likely to bear any fruit. More robust incentives and disincentives are needed, and these may be beyond the current remit of the CIME or the OECD Guidelines. One way that the CIME may promote improved performance of junior and unlisted companies is through strengthening supply chain accountability of larger MNCs, who very often partner with or purchase from juniors and unlisted companies. Another may be to provide market incentives for all companies that demonstrably comply with the Guidelines by encouraging member states to incorporate performance obligations to companies that they finance through Export Credit arrangements and to provide preferential financing to those who demonstrate compliance. While this latter option is controversial and bound to elicit strong opposition from all companies, without something like it, the playing field will remain tilted in favour of small, unaccountable companies at the expense of larger, more progressive MNCs. However, it is in the interests of progressive corporations, as well as the sustainable development of host countries to recognise that the Guidelines as currently structured have little purchasing power on the behaviour of juniors and unlisted companies. And as long as that is the case, the Guidelines will have little positive impact on improved business conduct in weak governance zones.

Doing business with weak governance state-owned enterprises (SOEs)

9. The case study shows that many OECD-based companies had joint ventures and other business relations with SOEs in the DRC and suggests that these SOEs' governance rules were weak.

- **Are companies' responsibilities the same when they enter into joint ventures with weak governance SOEs as their responsibilities with stronger governance SOEs?**

No, for reasons suggested above, companies that engage with SOE's in weak governance zones cannot rely on national laws to ensure that these arrangements do not contribute to corruption, human rights abuse or armed conflict.

- **What SOE characteristics should an investor look at when considering whether or not to enter into partnerships with weak governance SOEs and when deciding how such partnerships should be managed?**

As part of their wider due diligence in zones of weak governance or violent conflict, companies should first look to the unintended harm that may accrue from otherwise routine investment and operational decisions. They should also be especially vigilant of local partners, whether state-owned or not. Where this diligence reveals that prospective partners have insufficient safeguards against corruption, bribery, money-laundering, or have been alleged by civil society or international human rights monitors of having engaged in and/or profited from violations of human rights, or are actively involved in armed conflict, companies should seek to build in safeguards into PSAs that address these issues. They may also stipulate that they and host countries sign on to relevant international standards as a condition of their contract. Doing so would help protect progressive companies from complicity liability. If host country partners do not agree to abide by higher standards, companies would be wise to refrain from entering into such partnerships. It is worth noting here, that there are already several cases of litigation against companies that knew or should have known of their host partners misconduct for their role in aiding and abetting war crimes, crimes against humanity and gross violations of human rights.

- **Guidelines Chapter X asks companies to conform "transfer pricing practices to the arm's length principle." Is this is an especially important consideration when structuring transactions with business partnerships with weak governance SOEs?**

I am not sufficiently knowledgeable of this concept to answer the question intelligently.

10. **Most of the larger multinational enterprises in the DRC mining sector tend to be shareholders in mixed public/private companies. In this respect their positions and interests are similar to those of the DRC citizens. In addition, large publicly listed companies tend to have significant expertise in corporate governance, involving elaborate and transparent governance practices.**

- **Should such companies be encouraged to seek to protect the interests of host country citizens (as shareholders in these partially state-owned companies) or are their responsibilities limited to protecting the interests of their own shareholders?**

Absolutely. All companies should undertake to ensure that their own actions do not lead to outcomes that are detrimental to host country citizens, particularly citizens in the communities in which their operations are located. Progressive companies understand the need to work with citizens to obtain a "social license" to operate, and have developed models for community engagement, revenue management, and social projects that seek to share the economic benefits of their investments as well as to take into consideration the interests of local populations in how these projects are structured and managed. This has long been the case in countries of the developed world, and should also be considered a normal part of doing business in WGZs. In addition, however, as shareholders in mixed joint ventures, larger MNCs have a legitimate shareholder right to demand accountability from these companies and the leverage to make a difference, something that local citizens in weak governance zones do not have.

- **Recommendation II.6 of the Guidelines asks companies to "uphold good corporate governance principles", while Recommendation II.3 asks them to "encourage local capacity building through close cooperation with the local community, including business interests". Should large companies be encouraged to share their governance expertise with their SOE partners?**

Yes, they should be encouraged to do so. The question is how they may do so effectively without incurring retaliation for their efforts.

Corporate tax payments into weak governance fiscal systems

11. **Do companies that make large tax and royalty payments to weak governance fiscal systems have a role in supporting reform of these systems?**

Yes. As indicated above, where companies know that local governments to whom they provide revenues are not ensuring the responsible management of these revenues, then their investment activities are further corroding good governance, and all of its attendant negative impacts on sustainable development and human security. However "legal" these payments may be, when they are knowingly paid to corrupt governments, they are facilitating the perpetuation of corruption, poor governance, impoverishment and human suffering, all of which may also undermine companies' international reputations as well as their local "social license to operate".

12. **If it is agreed that companies have such roles, then**:

- **how do these relate to those of other actors, notably host governments and international financial institutions (whose mission is *inter alia* to promote public sector reform)?**

- **how can companies most effectively go about supporting reform? Should companies refrain from signing contracts with governments that prohibit them from publishing their payments to host country treasuries? Are there countervailing concerns about business confidentiality that cannot be met through appropriate contracting?**

In the first instance, the obligation for fiscal probity in the management of public revenues lies with governments. About this, there can be no argument. However, there are ways that international financial institutions as well as companies can shape the incentive structure for host government reform or the incentives against it. To be most effective, companies that are committed to promoting fiscal probity and responsible management of public assets in host governments should work together with international financial agencies to promote fiscal transparency. For their own part, companies should, both individually and collectively, adopt the same safeguards currently used by IFIs (including the IFC) as well as those being developed by the EITI. They should also seek out broader partnerships with IFIs to coordinate efforts to promote public sector reform. At the very least, companies should take note that, in countries where the IMF has refused its lending facilities on account of those governments lack of fiscal probity, it is probably an authoritative indication that any profits to be had will also be had at the expense of good governance, sustainable development, and human security. In such cases, companies who nonetheless choose to invest may soon find themselves the target of advocacy attacks and legal action.

Eradicating bribery of public officials

13. Chapter VI of the Guidelines asks companies to promote employee awareness of and compliance with company policies against bribery and extortion and to adopt management control systems that discourage bribery and corrupt practices. Do participants agree that these recommendations are particularly relevant for investors in weak governance zones, where bribery and corruption is common?

Yes, they are particularly relevant to investors in WGZs, where bribery is more systemic and its consequences more corrosive to local governance, sustainable development and basic justice. The more relevant question, however, is how to ensure that companies are, in fact living up to this Guideline and others. Again, this points up the need for, and the interest of progressive companies in undertaking to promote, clear, common performance criteria that allow an objective determination of compliance and non-compliance. It might be controversial to say, however, there is nothing to prohibit companies from voluntarily committing themselves to objective, verifiable, performance criteria to ensure that their investments do in fact adhere to the Guidelines. The longer they refrain from doing so, or protest that doing so would compromise the " voluntary nature" of the guidelines, the more the Guidelines risk losing credibility and the more attractive other forms of regulation, including the sanctions of hard law, will seem attractive to other stakeholders.

14. Recommendation VI.2 of the Guidelines asks companies to "ensure that remuneration of agents is appropriate and for legitimate services only". When a company's agent or other business partner is found to have bribed public officials, is it sufficient for the company to severe its relationship with the agent or should it be encouraged to take additional remedial actions? If so, what kinds of actions would be appropriate?

One could only wish that proof of bribery would be enough for companies to sever relationships with agents or business partners. One could wish, too, that proven cases of bribery would be brought before national or other courts with jurisdiction. Bribery is recognised as a criminal offence in most national jurisdictions as well as in some international legal norms. As such, offenders should be held legally accountable.