

SÃO TOMÉ E PRÍNCIPE

An Uncertain Future

Oil Contracts and Stalled Reform in São Tomé e Príncipe

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Map of São Tomé e Príncipe



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Glossary of Acronyms

JDA	Joint Development Authority
JDZ	Nigeria-São Tomé Joint Development Zone
JMC	Joint Ministerial Council
EEZ	Exclusive Economic Zone
EITI	Extractive Industries Transparency Initiative
GRIP	Gabinete de Registo e Informação Pública
NPA	National Petroleum Agency
POC	Petroleum Oversight Commission
PSC	Production Sharing Contracts

Summary

The tiny island nation of São Tomé e Príncipe (São Tomé) is at a crossroads that will shape the country's future and reveal much about the impact of internationally-backed efforts to ward off the "resource curse." Since São Tomé entered into oil exploration agreements in 1997 and in 2001 and joined with Nigeria to manage disputed offshore areas cooperatively, the country has laid much of the legislative groundwork it needs to manage future oil revenues transparently. But São Tomé's government has struggled to cope with the pressures and temptations that come with oil wealth, even though the country's offshore fields have yet to produce a single barrel.

São Tomé joined the Extractive Industries Transparency Initiative (EITI) as a candidate country in February 2008. The EITI aims to strengthen governance by improving transparency and accountability in the extractives sector through the verification and full publication of company payments and government revenues from oil, gas, and mining. But the São Tomé government was both unable and made no real effort to comply with the core requirements of EITI membership, which are full publication of company payments and government revenues from oil and gas companies, and was de-listed from the initiative in April 2010. This illustration of São Tomé's incapacity to deal responsibly with potential oil revenues comes at an alarming time; São Tomé is in the midst of a new licensing round to sell off exploration rights in 19 offshore oil blocks. The government's handling of that auction, as well of a subsequent round anticipated for 2011 for offshore areas managed jointly with Nigeria, will be another crucial indicator in determining whether the country can be a model of oil revenue management. Elections in São Tomé in 2010 resulted in a change in government, making the situation more fluid and unpredictable than it might otherwise be.

For most of its post-independence history São Tomé was one of the world's most forgotten countries. Its two small islands off the coast of Africa are home to only some 166,000 people and for decades the country's economy has been moribund. The rest of the world, including even São Tomé's neighbors around the Gulf of Guinea, typically saw little reason to engage there. But this changed practically overnight when oil agreements were signed to explore off the São Tomean coast in 2003. Its estimated but yet undiscovered reserves of 10 billion barrels of oil drew the attention of many regional powers, western governments, civil society groups, and major oil multinationals, particularly during the first half of the 2000s.

São Tomé has also emerged as a key case study of international efforts to prevent countries falling victim to the "resource curse" that has afflicted so many oil-producing countries.

Precisely because of São Tomé's small population, its future oil revenues have the potential to transform the country, rolling back the crushing rates of poverty and unemployment and improving dilapidated schools, clinics, and other services. But many of São Tomé's oil-rich neighbors such as Nigeria, Angola, Gabon, and Equatorial Guinea have all earned massive revenues from oil wealth, only to see their economies distorted by their dependence on oil while their governments have mismanaged or stolen that wealth. The hope has been that with help, São Tomé could learn lessons of these past failures and ensure that oil takes the country forward instead of holding it back.

Since the discovery of oil, São Tomé has been rocked by scandals involving allegations of government corruption. In 2003, São Tomé's government was briefly deposed in an abortive coup attempt that may have been triggered in part by expectations that with oil, the rewards of political office would dramatically increase.

2010 could represent a turning point for São Tomé e Príncipe. A new government is expected to form after an opposition party won legislative elections held in August, and by the end of the year São Tomé is expected to name which companies it has selected as the winners of an important round of bidding for the right to drill for oil in its offshore Exclusive Economic Zone (EEZ).¹ If, as many São Toméans hope, this area is found to possess commercially viable reserves, it would significantly impact the development one of the world's smallest and poorest nations and one whose government has largely respected civil and political rights for nearly two decades, holding legislative elections that were largely free and fair, although plagued by organizational shortcomings.

Unfortunately, São Tomé's government remains ill-equipped to deal with the revenues from any hydrocarbon endowment despite an initial push to enhance financial transparency and accountability after oil was discovered. The government's shortcomings in this regard were put on stark display when São Tomé was dropped from the Extractive Industries Transparency Initiative's list of candidate countries in April 2010, a failure that is discussed in more detail below. São Tomé and Equatorial Guinea are the only two countries to have been effectively expelled from the EITI, which is especially alarming given Equatorial Guinea's appalling human rights and governance record.²

¹ For more information on this, see the website of the Exclusive Economic Zone, <http://www.stp-eez.com> (accessed August 16, 2010).

² Human Rights Watch, *Well Oiled: Oil and Human Rights in Equatorial Guinea*, July 2009, <http://www.hrw.org/en/reports/2009/07/09/well-oiled-o>.

São Tomé's failure to comply with the requirements of the EITI process of the full publication of funds obtained from oil and gas and the lack of a meaningful multi-stakeholder process in the country shows that although São Tomé and the international community have invested in efforts to manage potential oil revenues, such as by putting relevant laws in place, São Tomé's government still has little political will or institutional capacity to follow through on reform. Past tenders for oil contracts—known as licensing rounds—have fallen well short of international as well as São Tomean standards. Previous licensing rounds, including early deals by São Tomé that granted exclusive exploration rights and later ones which auctioned off the right to drill in offshore areas under the shared control of Nigeria and São Tomé, have been marked by inappropriately low payments and allegations of insider dealing. If these problems are not corrected before São Tomé finalizes the 2010 auction of offshore areas under its exclusive national control, São Tomé's government risks sinking into patterns of mismanagement and corruption while squandering a unique opportunity to develop its economy and improve São Toméans' enjoyment of fundamental human rights.

This report describes the lessons that have been learned from the failures of São Tomé's early oil deals, as well as past oil licensing rounds organized jointly with Nigeria in 2003 and 2005, and assesses São Tomé's prospects moving forward in light of the failure of its EITI candidacy. Transparency of oil revenues is essential to ensure that the funds are managed responsibly and in a manner that is accountable to São Tomé's people. The government should make all financial transactions related to oil licensing public and re-engage with the EITI process including a meaningful multi-stakeholder process.

The lessons are clear for São Tomé e Príncipe's government:

- Ensure that the oil revenue management law (law 8/2004) for the transparent management of oil wealth is observed, including making all financial transactions related to oil licensing public.
- Provide full documentation of all oil transactions, including of signature bonus payments, to the Public Registration and Information Office (Gabinete de Registo e Informação Pública, GRIP) for public disclosure as provided for by São Tomé Law (law 11/2007 and law 8/2004).
- Publish independent auditing reports of all financial transactions associated with oil licensing.
- Review all oil contracts and renegotiate those that are deemed to fall short of international best practice.

- Re-engage with the EITI Secretariat by ensuring that the Petroleum Oversight Commission (POC) puts the initiative into practice, including through its Multi-stakeholder Committee and by providing a work plan.
- Ensure that government officials publicly declare their assets and that this information is verifiable (as provided for by São Tomé law).
- Ensure that the Regional Government of Príncipe is fully consulted in decision making about the EEZ.
- Review the arrangements of the Nigeria- São Tomé Joint Development Zone (JDZ) with the Nigerian government through an independent public enquiry following the Nigerian elections in 2011.
- Strengthen independent oversight of the banking sector to avoid money laundering.

The Nigerian government:

- Should jointly with São Tomé hold a public review of the arrangements of the JDZ following the Nigerian elections in 2011.

This report is based primarily on field work in the country carried out by a Human Rights Watch researcher in July and August 2009, and research from outside of the country thereafter.

Background

São Tomé and Príncipe consist of two small islands in the Gulf of Guinea, about 250km west of Gabon. The islands were colonized by the Portuguese, who developed a sugar industry with the use of slave labor in the 16th century. In the 19th century, cocoa replaced sugar and remains the principle crop today, accounting for most of São Tomé's limited export revenues.³

São Tomé won independence in 1975 and began as a one-party state.⁴ In the early 1990s the country implemented democratic reforms and moved towards a multiparty system.⁵ Parliamentary and Presidential elections were held in 2006. Both polls were considered free and fair by international observers. São Tomé's multiparty constitutional democracy has produced several governments, often ruling through unstable coalitions, and resulted in the selection of 14 prime ministers in less than twenty years.

President Menezes is now serving his second five-year term, which expires in 2011. Municipal, regional, and legislative elections took place in July and August 2010, to be followed by a presidential poll scheduled for July 2011. The prime minister and head of government is selected by the National Assembly. At this writing, the prime minister is Joaquim Rafael Branco, who has served since 2008. Branco is expected to remain in the post until the results of the August 2010 legislative elections, in which the opposition party Independent Democratic Action (Acção Democrática Independente, ADI) garnered the most seats, are confirmed. At that point, the ADI is anticipated to form a coalition government and to name party leader Patrice Trovoada as the next prime minister.

The country's population of 166,000 is concentrated on São Tomé island, with only several thousand living on Príncipe.⁶ Since 1994 the island of Príncipe has had limited autonomy, with a regional parliament and a regional president accountable to the capital in São Tomé.

³ Earth Institute at Columbia University, European Business Council for Africa and the Mediterranean, and Corporate Council on Africa, *The Investor's Guide to São Tomé and Príncipe* (New York: Columbia University, 2008), p. 8.

⁴ *Ibid.*, p.8

⁵ *Ibid.*, p.8.

⁶ Economist Intelligence Unit, "São Tomé and Príncipe Country Report," July 2010, p. 4.

Gross domestic product was \$191 million in 2009 and the country ranked 180th of 183 countries for ease of doing business by the World Bank.⁷

At a Glance: São Tomé e Príncipe's Development Indicators

São Tomé e Príncipe has been on the United Nations list of “Least Developed Countries” since 1982.⁸ With a per capita income of approximately \$1000 in 2008, it more recently has been classified as a lower-middle income country, although it is one of the poorer countries in that grouping.⁹ In 2009, São Tomé e Príncipe was ranked 131 out of 182 countries in the United Nations Development Program (UNDP) Human Development Index.¹⁰

Poverty is a serious concern in São Tomé e Príncipe. According to the World Bank, “approximately 54 percent of its population of 166,000 is poor and 15 percent live in extreme poverty.”¹¹ Infant and child and infant mortality rates, at 64 and 98 per 1000 live births, respectively, remained essentially unchanged from 1990 to 2008.¹² UNDP figures show that 12.2 percent of São Tomé e Príncipe's government expenditures were allocated to health as of 2006, the most recent figure available.¹³ Life expectancy stood at 66 years in 2009.

In 2003 São Tomé suffered a serious challenge to its democratic system in the form of an attempted military coup.¹⁴ The prospect of commercially exploitable oil reserves off São Tomé's shores had raised expectations of the government and the funds at its disposal. This was probably a contributing factor for the coup, which occurred just after the government, in coordination with Nigerian authorities, had launched a tender to allocate the right to drill in designated areas (known as “blocks”) that the two countries had agreed to develop jointly.

⁷ The World Bank, “Doing Business 2010,” <http://www.doingbusiness.org/exploreconomies/?economyid=162> (accessed August 17, 2010).

⁸ See United Nations, “Least Developed Countries Information,” 2009, http://www.un.org/esa/policy/devplan/profile/country_166.html (accessed August 6, 2010).

⁹ See, for example, World Bank “São Tomé and Príncipe at a glance,” December 9, 2009, http://devdata.worldbank.org/AAG/stp_aag.pdf (accessed August 16, 2010).

¹⁰ United Nations Development Programme, “Human Development Report,” 2009, http://hdr.undp.org/en/media/HDR_2009_EN_Indicators.pdf (accessed August 16, 2010) p. 145.

¹¹ World Bank, “São Tomé and Príncipe: Country Brief,” April 2010, <http://go.worldbank.org/S1B35TAGMo> (accessed August 16, 2010).

¹² See World Bank, “World Development Indicators Database: Millennium Development Goals,” http://ddp-ext.worldbank.org/ext/ddpreports/ViewSharedReport?REPORT_ID=1336&REQUEST_TYPE=VIEWADVANCED (accessed August 16, 2010).

¹³ UNDP “Human Development Report,” 2009, http://hdr.undp.org/en/media/HDR_2009_EN_Indicators.pdf (accessed August 16, 2010) p. 201, Table N.

¹⁴ Gehart Seibert, “Coup d'état in São Tomé e Príncipe: Domestic causes, the role of oil and former ‘Buffalo’ Battalion soldiers,” Occasional Paper 81 (Institute for Security Studies, November 2003), <http://www.iss.co.za/pubs/papers/81/Paper81.html> (accessed August 16, 2010).

The São Tomé coup briefly deposed the government while President Fradique de Menezes was out of the country, but one week later the coup leaders relinquished their authority in the face of mounting international pressure and the government was reinstated.¹⁵ No lives were lost in the episode, but the failed coup clearly illustrated some of the potential dangers of the promise that oil wealth brings with it.

¹⁵ Gerhart Seibert, "Coup d'état in São Tomé e Príncipe." In November 2009 a trial of 18 individuals arrested in February 2009 charged with trying to overthrow the government resulted in two convictions. During the traditional end-of-year amnesty in December 2009, President Menezes pardoned these two convicted individuals.

Oil Sector Development: Licenses for Exploration

The Gulf of Guinea is known for its oil resources, and independent oil companies began seeking exploration licences in São Tomé in the 1990s. From an early date, São Tomé officials approved several deals for oil exploration that proved controversial for being highly unfavourable terms for São Tomé. In particular, São Tomé signed contracts with the Environmental Remedial Holding Company (ERHC) in 1997, with Mobil in 1998, and with the Norwegian firm PGS in 2001.¹⁶

São Tomé's efforts to lay the groundwork for eventual development of offshore resources were initially complicated by a dispute with Nigeria over the two countries' maritime boundary. In February 2001 an agreement was reached under which both countries would jointly develop oil resources in the disputed area.¹⁷ This became the Nigeria-São Tomé Joint Development Zone (JDZ), which is administered by a Joint Development Authority (JDA) that, in turn, reports to a Joint Ministerial Council (JMC). Under this arrangement, São Tomé is to receive 40 percent of any oil revenue earned from the JDZ and Nigeria 60 percent.¹⁸ As noted, several rounds of licensing have taken place for exploitation of oil blocks in the JDZ. (The 2001 agreement establishing the JDZ was supplemented in June 2004 by a further agreement, signed by Presidents Obasanjo and de Menezes, specifically addressing transparency and governance issues. The latter agreement will be discussed further below.¹⁹)

To date there have been two licensing rounds organized by the JDA on behalf of Nigeria and São Tomé. The purpose of open competitive bidding in the awarding of oil licences was to obtain maximum value for the nation by awarding each block to the best technically and financially qualified company or consortium. The first licensing round began in late April 2003 and covered nine of the JDZ's 25 total blocks. In October 2003, 20 companies tendered 33 bids for eight of the nine blocks. Very few of the large international oil companies participated in the auction. A second licensing round opened in December 2004 for equity in JDZ Blocks 2, 3, 4, 5, and 6. Twenty-two companies participated, submitting a total of 26

¹⁶ See Gerhart Seibert, "São Tomé and Príncipe: 12 oil minister since 1999, but not a single drop of oil yet," *IPRIS Lusophone Countries Bulletin*, no. 5, March 2010, p. 5.

¹⁷ Nigeria - São Tomé & Príncipe Joint Development Authority, "Guide to the JDZ Licensing Round," November 2004 <http://www.nigeriasaotomejda.com/PDFs/JDZ%20Brochure.pdf> (accessed July 22, 2010).

¹⁸ Human Rights Watch interview with Luis Prazeres, National Petroleum Agency director, São Tomé, July 28, 2009.

¹⁹ The Federal Republic of Nigeria and the Democratic Republic of São Tomé e Príncipe, "The Abuja Joint Declaration Regarding Transparency and Governance in the Joint Development Zone," June 26, 2004, <http://www.nigeriasaotomejda.com/pdfs/abuja%20joint%20declaration.pdf> (accessed, July 22, 2010).

proposals. An investigation by the São Tomé's attorney general concluded that the December 2004 award process was "subject to serious procedural deficiencies and political manipulation, including the award of interests to many unqualified firms or firms with inferior qualifications, technically and financially," but no action was taken.²⁰

In January 2006 Chevron began exploratory drilling in the JDZ in the blocks it obtained in the 2003 bidding round. In May 2006 the company announced it had discovered oil but subsequently stated that the amounts were not commercially exploitable. This announcement further slowed industry enthusiasm but prospecting has continued. In 2010 Jorge Santos, executive director of the JDA, announced that drilling in blocks 2 and 3 had found oil and gas, although official drilling results have not yet been disclosed.²¹ Santos also has declared that preparations are underway for a new licensing round in 2011 to auction for JDZ Blocks 7, 8, 9, and 10, after seismic surveys are complete.²²

On March 2, 2010, at the American Association of Petroleum Geologists (APPEX) conference in London, São Tomé launched a licensing round for oil blocks in the 160,000 sq-km Exclusive Economic Zone (EEZ), which lies south of the JDZ. Seven blocks will be auctioned initially, ranging in size from 2,800 sq-km to 18,200 sq-km. Interested companies have until September 15, 2010 to study seismic data and submit their bids.²³ According to the National Petroleum Agency (NPA), eight companies have expressed interest in this inaugural EEZ licensing round: two US major companies, Chevron and ConnocoPhillips; two US junior companies, Marathon and Murphy; Brazil's Petrobras; Ireland's Tullow Oil; Germany's RWE; and Indian national oil company, Oil and Natural Gas Corporation (ONGC). São Tomé is expected to award the licenses by the end of 2010.²⁴

²⁰ Procuradoria Geral da República São Tomé e Príncipe, "Investigação e Avaliação Segundo Leilão Zona de Desenvolvimento Conjunto," December 2005, p. 10.

²¹ "São Tomé and Príncipe," *IPRIS Lusophone Countries Bulletin*, p. 15.

²² *Ibid.*, p. 15.

²³ Human Rights Watch interview with NPA director Luis Prazeres, about plans for licensing round, São Tomé, July 28, 2009.

²⁴ For further details, see the website of the Exclusive Economic Zone, http://www.stp-eez.com/EEZ_Rnd1.htm (accessed, July 22, 2010).

Institution Building and Oil: Short-Lived Efforts

When the prospect of oil began to be taken seriously in São Tomé in 2001, the government and international community made some important—although poorly sustained—efforts to ensure the transparent and accountable management of oil revenues.

São Tomé already had an existing Petroleum Law dating from 2000, but undertook to improve its management of the oil sector in various ways. For example, following the July 17, 2003 coup, a National Forum was organized to promote reconciliation after the government was restored. There was broad recognition at the time that oil wealth anticipation among São Tomeans could contribute to future instability and as a result, that issue became a focus for discussion with local populations and the community at large. The Forum included members from some 56 communities to discuss the potential impact of oil on the economy of the country. Overall, some 3,500 citizens were engaged in the exercise.²⁵

A further step was taken in June 2004 when Presidents Obasanjo and de Menezes signed the Abuja Joint Declaration Regarding Transparency and Governance in the JDZ. It stated that:

Transparency is critical to good government and enhances the ability of our citizens to monitor the activities of government on their behalf and for the efficient and effective development and use of our oil and gas resources.²⁶

The Abuja declaration was explicitly designed to prevent the sort of opaque practices that frequently mark oil negotiations and licensing. Notably, it provided under Article 7 that considerable information should be made public—including payments to the JDA by oil companies and data on Nigeria and São Tomé’s use of funds received through the JDA—on the website of the JDA.²⁷ But very quickly the declaration was proven to be ineffective, as significant financial data was not published on the website.

²⁵ Gisa Weszkalyns, “Hope & Oil: Expectations in São Tomé e Príncipe,” *Review of African Political Economy*, 35, 3 (2008), pp. 773-782.

²⁶ The Federal Republic of Nigeria and the Democratic Republic of São Tomé e Príncipe, “The Abuja Joint Declaration Regarding Transparency and Governance in the Joint Development Zone,” June 26, 2004, <http://www.nigeriasaotomejda.com/pdfs/abuja%20joint%20declaration.pdf> (accessed July 22, 2010).

²⁷ *Ibid.*

Next, São Tomé's Oil Revenue Management Law was enacted in December 2004.²⁸ It established a single national oil account (Conta Nacional de Petróleo) held at the New York Federal Reserve Bank and the creation of a "Futures Fund" to ensure that oil proceeds are available for future generations.²⁹ There are strict limits on the drawdown of funds. The law also promotes transparency in oil-revenue management. It provides that two audits should be conducted each year by the auditor-general and a reputable international audit firm. Information on oil-sector activity, including oil tenders and contracts, is to be made public. In addition, the NPA advises the government on how to manage oil and gas exploration.

One important feature of the Oil Revenue Management Law was that it created a Petroleum Oversight Commission (Comissão de Fiscalização do Petróleo) consisting of 11 members.³⁰ This includes the president and prime minister, and also ministers, civil society representatives, and other elected members. Additionally, the São Tomé government's use of oil funds and compliance with the oil management law is subject to oversight by the National Assembly's oil audit committee.³¹

Steps have been taken to enhance transparency beyond the commitments contained in the Abuja Declaration. For example, the Gabinete de Registo e Informação Pública (GRIP) is mandated to keep public archives of all documents and information related to oil and its revenues.³² In addition, São Tomé e Príncipe was accepted as an Extractive Industry Transparency Initiative (EITI) candidate country in February 2008, subject to a two-year deadline to have its compliance with the initiative assessed, a process known as "validation."

São Tomé officials also have put in place measures governing the oil contracting process. The National Assembly approved in July 2009 a new law requiring the government to hold public tenders for the licensing of oil blocks. If these are not successful in attracting suitable bids, the new law permits the government to enter into direct negotiations with oil

²⁸ Law No. 8/2004.

²⁹ Human Rights Watch interview with Acácio Bonfim, director of the International Bank of São Tomé e Príncipe (BISTP), São Tomé, July 28, 2009.

³⁰ Columbia University Oil Advisory Group, "Sao Tome and Principe Model Oil Revenue Management Law," June 2004, <http://www.laohamutuk.org/Oil/PetRegime/stpdraft-en.doc> (accessed July 22, 2010).

³¹ Human Rights Watch interview with Idalécio Quaresma, president of the National Assembly Oil Audit Commission, São Tomé, July 30, 2009.

³² GRIP was created by Law No. 11/2007. Human Rights Watch visited the GRIP office in São Tomé and met with staff on July 30 and 31, 2009.

companies.³³ (This law draws some lessons from the problems of the second JDZ licensing round in 2005, discussed below.) The new law allows an oil company to request direct negotiations with the government for any block not awarded by public tender. As in 2005, a number of blocks did not attract bids or the bidders were unsatisfactory. These negotiations must be public and notice of 15 days must be given for other companies to express an interest in order to allow public scrutiny and permit competition.

This new law also authorizes the government to create a consortium with the national oil companies of other countries and through this acquire a stake of 10-15 percent in the JDZ and EEZ. This revision to the 2000 Petroleum Law was to bring existing oil legislation in line with the Oil Revenue Management Law.³⁴

³³ Human Rights Watch interview with Eugénio Tiny, vice-president of the National Assembly, São Tomé, July 31, 2009.

³⁴ Human Rights Watch interview with António Quintas do Espírito Santo, Oil Commission member and administrator of GRIP, São Tomé, 30 July 2009.

Mismanagement, Controversy, and Signs of Corruption

Despite the momentum of its early efforts to ensure that oil revenues were managed appropriately, in practice the São Tomean government's commitment to the principles of transparent and accountable management has often fallen woefully short. These failures are perhaps most evident with regard to erratic oversight, public concern over exclusive deals, problematic bidding processes, and lost revenue.

For example, the trouble that São Tomé may experience managing any future oil wealth is illustrated by the shifting nature of its political landscape. The country has had twelve oil ministers since 1999. Prime Minister Branco—a former oil minister himself—appointed four different ministers of natural resources between June 2008 and August 2010. Most notably, it is evidenced in the country's expulsion from the Extractive Industries Transparency Initiative in April 2010.³⁵

Joint Development Zone

Serious concerns also have arisen in connection with São Tomé's role in efforts to auction off oil blocks in the JDZ. All development contracts signed for the JDZ and associated revenue-sharing deals are subject to approval by the Joint Ministerial Council.³⁶ The JDZ oil contracts have been plagued by problems. The second licensing round, for example, raised questions in Nigeria about the distribution of signature bonus payments.³⁷

In São Tomé, however, it was the second licensing round in 2004-2005 for the JDZ that was particularly controversial. A May 2005 investigation by the São Tomean National Assembly questioned the inclusion in the bidding of several small Nigerian companies with little

³⁵ Letter from Peter Eigen, chairman of the Extractive Industries Transparency Initiative, to President Menzes, April 29, 2010, http://eiti.org/files/2010_04_29_letter_he_president_menezes_sao_tome_e_principe.pdf (accessed August 19, 2010).

³⁶ "Treaty between The Federal Republic of Nigeria and The Democratic Republic of São Tomé e Príncipe on the Joint Development of Petroleum and other Resources, in respect of Areas of the Exclusive Economic Zone of the two States," <http://www.nigeriasaotomejda.com/PDFs/treaty.pdf> (accessed August 18, 2010). See part two, especially articles 6.2, 7.4, and 8.2 (f), (g), and (h).

³⁷ The signature bonus system is common in many oil-producing countries. A payment is made up front to the host country for the right to develop a block commercially before work begins. In this case this money was released by Nigeria to São Tomé on completion of the Second Round of Licensing and transferred to São Tomé's oil account at the New York Federal Reserve Bank. In Nigeria an investigation has been ongoing about misappropriation of millions of US dollars from the JDZ signature bonus money for Block 1. This money was deposited in a Nigerian bank, Hallmark Bank, owned by Marc Wabara, a close associate of former Nigerian president Olusegun Obasanjo. Mr Wabara allegedly used these funds to invest in international capital markets and when these investments failed, the bank collapsed in 2008 prompting his arrest and detention. He has been able to raise the funds and is being investigated by Nigeria's Economic and Financial Crimes Commission over the misuse of US\$56 million of signature bonuses.

apparent expertise or capacity to develop any of the blocks.³⁸ The NPA issued a report in May 2005 that was critical of various aspects of the second rounds process as being “economically inefficient and legally problematic.”³⁹ And a report by the São Tomean attorney-general in December 2005 criticised the criteria used for awarding the licences and for providing the JDA and JMC too much discretion over the adjudication process. The report’s findings also questioned whether the Nigerian government was implementing full transparency in the licensing procedures for the JDZ, as per its commitment in the Abuja Declaration signed with São Tomé in June 2004.⁴⁰

São Tomean officials and international observers have said that the Nigerian side exercises greater influence with regard to JDZ projects, creating an imbalance of power.⁴¹ For example, then Prime Minister Rafael Branco on April 23, 2010, declared that his country’s authorities were being sidelined in the preparations for the planned 2011 licensing round for the JDZ. If this is the case, it would be an infringement of the JDZ agreement that would disadvantage São Tomé in negotiating its rightful share of any future licensing.⁴²

But the problems in the 2004-2005 round were not only due to serious procedural deficiencies and possible political manipulation from Nigeria. According to officials involved in the process, São Tomé also shares in the blame.⁴³ According to the attorney general’s report, São Tomé officials involved in that process held stock in bidding companies and the companies may not have been technically qualified to undertake these projects.⁴⁴ In some cases, the report said, such companies had offered lower signature bonuses than those offered by more qualified companies.⁴⁵

Despite widespread unease, the JDA pushed ahead and in May 2005 it announced the selection of companies for the second round licenses, awarding stakes of between 5 and 85

³⁸ Such as Broadlink Petroleum, Godsonic Commerce Co. Ltd, and Filtim-Huzod Oil and Gas. See Procuradoria Geral da República São Tomé e Príncipe, “Investigação e Avaliação Segundo Leilão Zona de Desenvolvimento Conjunto,” December 2005, annex D.

³⁹ Procuradoria Geral da República São Tomé e Príncipe, “Investigação e Avaliação Segundo Leilão Zona de Desenvolvimento Conjunto,” December 2005, annex E.

⁴⁰ Ibid.

⁴¹ Minutes of the 12th EITI Board meeting, April 15, 16, 2010, <http://eiti.org/files/2010-05-26%20Final%20Minutes%20of%20the%2012th%20Board%20Meeting.pdf> (accessed August 2, 2010), p. 6.

⁴² “São Tomé and Príncipe,” *IPRIS Lusophone Countries Bulletin*, April 2010, p. 15.

⁴³ Human Rights Watch interview with officials engaged in this process, São Tomé and London, August and September 2009.

⁴⁴ Procuradoria Geral da República São Tomé e Príncipe, “Investigação e Avaliação Segundo Leilão Zona de Desenvolvimento Conjunto,” December 2005

⁴⁵ Ibid.

percent in five blocks. Production Sharing Contracts (PSC) were ultimately signed on three of the blocks (Blocks 2, 3, and 4), while ownership of Blocks 5 and 6 have been in legal dispute over preferential rights with the Environmental Remedial Holding Company (ERHC). São Tomé's initial revenue from the JDZ, in the form of its share of signature bonuses paid by the companies that had finalized PSCs as of 2005, amounted to US\$78.8 million, of which a quarter was used to repay debts to Nigeria and the rest used for government current expenditures.⁴⁶

Since 2005 the original ownership of the exploration licenses in the JDZ has significantly altered through acquisitions and a major takeover by Sinopec of Addax. In March 2006 the JDA signed a PSC with a consortium comprised of US company Anadarko, Addax and ERHC for a signature bonus of \$40 million for Block 3 and a PSC for Block 4 with the same consortium, as well as a number of small Nigerian companies for a signature bonus of \$70 million. A PSC was also signed for Block 2 with ERHC-Addax and Sinopec of China with a signature bonus payment of \$71 million to be shared between São Tomé and Nigeria.⁴⁷

The Cost of Early Deals

As of now, ERHC and Exxon continue to enjoy first pick (pre-emptive rights) on up to eight blocks in the JDZ, while ERHC and UK-based Equator Exploration (a company that had acquired PGS' pre-emption rights in 2004) hold the right to obtain two blocks in the EEZ and an option to acquire up to 15 percent paid working interest in two additional EEZ blocks.⁴⁸ Equator Exploration, for its part, was allocated Block 5 and Block 12 in the EEZ and in mid-2010 began to negotiate the production sharing contracts. The government has asked for signature bonus payments of \$2 million for Block 5 and \$2.5 million for Block 12 according to the Economist Intelligence Unit.⁴⁹ In February 2010, the São Tomean government reached formal agreements to award blocks 4 and 11 to ERHC for no signature bonus payments.⁵⁰ The government has contracted a private company to negotiate production sharing contracts with both companies for these blocks in 2010.⁵¹

⁴⁶ Duncan Clarke, *Crude Continent: the struggle for Africa's Oil Prize* (London: Profile Books, 2009) pp. 184-192.

⁴⁷ Sinopec replaced Pioneer in February 2006 as a member of the consortium awarded a 60 percent stake in Block 4.

⁴⁸ Procuradoria Geral da República, "Investigação e Avaliação Segundo Leilão Zona de Desenvolvimento Conjunto," December 2005. New agreements were also reached in 2003 with ExxonMobil and PGS that were more favorable to São Tomé.

⁴⁹ Economist Intelligence Unit, "São Tomé and Príncipe Country Report," July 2010.

⁵⁰ Prior to the 2010 EEZ licensing round, the government invited Equator to make its first choice of two blocks according to the Exploration and Production Option Agreement which Equator has with the government. The company insists it has financing for its obligations. See, Economist Intelligence Unit, "São Tomé and Príncipe Country Report," July 2010, p. 18.

⁵¹ *Ibid.*

Stalled Reform

The 2004 Abuja Declaration was, in principle, meant to have drawn on lessons of the past and prevented opaque practices in further oil negotiations and licensing but systemic problems have remained. Beyond the problems identified above related to mismanagement and potential corruption, São Tomé suffers from a series of institutional failures ranging from weak capacity to the lack of political will to adhere to commitments undertaken. For example, to date there has been no action to publish information on the website of the JDA—including payments to the JDA by oil companies and data on Nigeria and São Tomé’s use of funds received through the JDA—as promised under the declaration.⁵²

Despite the promising discussions during the National Forum of 2003, tensions remain over limited development and the failure of politicians to deliver social benefits. For example, there is resentment by residents on Príncipe island that the regional government of Príncipe island was excluded during the setting up of the JDZ. Similar resentment exists with regard to decision making for the EEZ. The president of the Regional Government of Príncipe island, José Cassandra, told Human Rights Watch that he felt that on licensing of oil exploration in the EEZ his government should be an equal beneficiary with São Tomé although the population of Príncipe island is significantly smaller.⁵³

São Tomé’s Failed EITI Candidacy

There is a disjuncture between the São Tomé government’s political rhetoric and the lack of real success in building serious institutional capacity to manage any future oil rents. This was highlighted by São Tomé being one of only two countries (the other is Equatorial Guinea) to have its candidacy in the Extractive Industries Transparency Initiative (EITI) end with expulsion.⁵⁴ This throws further doubt on the ability of São Tomé’s institutions to manage this process in an open, accountable, and transparent manner.

As early as March 2004 in Washington, DC, President Fradique de Menezes committed to

⁵² The Federal Republic of Nigeria and the Democratic Republic of São Tomé e Príncipe, “The Abuja Joint Declaration Regarding Transparency and Governance in the Joint Development Zone,” June 26, 2004, <http://www.nigeriasaotomejda.com/pdfs/abuja%20joint%20declaration.pdf> (accessed July 27, 2010).

⁵³ Human Rights Watch interview with José Cassandra, president of the Regional Government of Príncipe Island, São Tomé, July 29, 2009.

⁵⁴ Letter from Peter Eigen, chairman of the Extractive Industries Transparency Initiative, to President Menezes, April 29, 2010, http://eiti.org/files/2010_04_29_letter_he_president_menezes_sao_tome_e_principe.pdf (accessed August 18, 2010).

“making all payments to the Joint Development Authority public along the guidelines of the Extractive Industries Transparency Initiative.”⁵⁵ São Tomé was accepted as an EITI candidate country on February 22, 2008, and was given until March 9, 2010 to undertake validation. However, little progress was made on meeting the requirements for this process other than officials attending a number of workshops and the appointment of an EITI National Coordinator, Genoveva da Costa. An international workshop on oil revenue management in São Tomé attended by President Menezes in October 2007 raised concerns over slowness and capacity to prepare for candidature criteria.⁵⁶

The EITI Board, in its April 2010 meeting, held a frank discussion about the lack of progress in São Tomé. The minutes of this meeting explained that Prime Minister Branco had requested a voluntary suspension from EITI, citing the challenges associated with joint management of the JDC. According to the prime minister, progress was stalled for 18 months due to the need for coordination between officials from both countries. Although the EITI Board agreed that “the Nigerian authorities are in a stronger position and progress had been difficult,” it did not concur that this was the sole problem leading to the lack of progress. To the contrary, the EITI Board took important note of the following:

There did not appear to have been regular meetings of the MSG [multi-stakeholder group, a key requirement of the initiative], and there had been no strong or clear evidence of continued political commitment to the process.⁵⁷

Moreover, São Tomé’s request for voluntary suspension was inconsistent with EITI’s rules. As EITI Board chair Peter Eigen explained in a letter to the government, “The EITI rules ... permit voluntary suspensions in countries that are experiencing exceptional political instability or conflict. In the case of São Tomé e Príncipe, the Board did not consider that such circumstances existed.” The result was that the country was de-listed from the initiative, which is tantamount to expulsion.

⁵⁵ “Creating a Stable Base for Transparency in São Tomé’s Oil Sector,” H.E. Fradique de Menezes, President of São Tomé e Príncipe, Center for Strategic and International Studies, Promoting Accountability and Transparency in Africa’s Oil Sector Conference, Washington, DC, March 30, 2004.

⁵⁶ The conference highlighted ambiguity over the role of the Petroleum Oversight Commission (POC) and that to put the Initiative into practice, EITI criteria require the creation of a multi-stakeholder committee, but the role of this structure could be included in the POC. See, “National Discussion on Oil Revenue Management in São Tomé and Príncipe (STP) and Regional Coordination Meeting of Civil Society for Portuguese Speaking Countries in Africa,” International Alert, Publish What You Pay, UNDP, October 29-31, 2007, São Tomé, http://www.international-alert.org/pdf/National_Discussion_Oil_Revenue_Management_STP.pdf (accessed May 25, 2010). NGOs involved in promoting EITI are Webeto, International Alert, and FONG, the last of which represents over 85 São Tomean civil society organizations.

⁵⁷ Minutes of the 12th EITI Board meeting, April 2010, p. 6. <http://eiti.org/files/2010-05-26%20Final%20Minutes%20of%20the%2012th%20Board%20Meeting.pdf> (accessed August 2, 2010), p. 6.

The evident lack of political will cited by EITI's Board also hampered São Tomé's progress in other ways. The São Tomé government's use of oil funds is regulated by various laws, discussed above. Some of these, such as the 2009 law requiring public tenders, were responses to problems that emerged during licensing rounds. The value of such laws, however, is negated if they are not implemented. Actual compliance by the São Tomé government with the governing oil management law came into question in 2005, when the National Assembly's oil audit committee undertook an investigation.⁵⁸

Capacity constraints also place São Tomé at a disadvantage. In early 2010, as noted, the government began work to creating a national oil company, Petrogás, and to seek to form a consortium with Angola's Sonangol and Portugal's Galp Energia. This arrangement has become politicized, with the former economy minister of São Tomé, Teotónio Torres, accusing Angola and Portugal of wanting to "rob" São Tomé's oil in an effort to emphasize his nationalist credentials during the 2010 election campaign.⁵⁹

⁵⁸ Human Rights Watch interview with Idalécio Quaresma, president of the National Assembly Oil Audit Commission, São Tomé, July 30, 2009.

⁵⁹ "Angola acusada de querer 'roubar' petróleo de São Tomé e Príncipe," *RTP Africa*, July 14, 2010.

Prospects Moving Forward

São Tomé completed an electoral cycle for local, regional, and legislative elections in July and August 2010 and is preparing for a presidential poll in July 2011. The legislative elections of August 2010 were marked by allegations that money was used for vote-buying.⁶⁰ A scandal had already broken out involving the Central Bank which, according to local newspapers, had allegedly used the national currency (dobra bills) previously taken out of circulation and then illicitly put back into circulation as facilitation payments by various party activists, prompting a criminal investigation.⁶¹ There have also been allegations that the Angolan state oil company, Sonangol, provided funds to two of the main parties contesting the election, the Democratic Convergence Party-Reflection Group (PCD-GR) and the Movement for the Liberation of São Tomé and Príncipe – Social Democratic Party (MLSTP-PSD).⁶²

As a new government forms and the politics around licensing rounds in 2010 intensifies, the institutions and safeguards introduced to provide transparency, accountability and best practice will be put to the test. When the chairman of the EITI Board wrote to President Fradique de Menezes on April 29, 2010 to explain its decision to de-list the country, he explained that “São Tomé e Príncipe should re-apply when the circumstances for rapid implementation were more favourable.”⁶³ Much will need to happen before São Tomé is ready to confront the challenges of managing its potential oil resources and ensuring financial transparency and accountability. For example, the United States Department of the Treasury in July 2010 issued an advisory for its Financial Crimes Enforcement Network for enhanced due diligence of São Tomé e Príncipe, due to its “lack of a comprehensive [anti-money laundering and counterterrorist financing] regime.”⁶⁴

⁶⁰ Abel Veiga, “African island nation of São Tomé votes for parliament,” Agence France-Presse, August 1, 2010.

⁶¹ “Mais de oito bilioes estao desaparecidos,” *O Parvo*, no. 323, July 28, 2009.

⁶² “São Tomé and Príncipe: Angola also supports Democratic Convergence Party,” *Africa Monitor*, July 13, 2010.

⁶³ Letter from Peter Eigen, chairman of the Extractive Industries Transparency Initiative, to President Menezes, April 29, 2010, http://eiti.org/files/2010_04_29_letter_he_president_menezes_sao_tome_e_principe.pdf (accessed August 18, 2010).

⁶⁴ Financial Crimes Enforcement Network, “Guidance to Financial Institutions Based on the Financial Action Task Force Public Statement on Anti-Money Laundering and Counter-Terrorist Financing Risks,” July 16, 2010, http://www.fincen.gov/statutes_regs/guidance/html/FIN-2010-Ao10.html (accessed August 18, 2010).

Conclusion

São Tomé, despite taking steps to put in place control measures, has failed in practice to adhere to its own or international standards. The expulsion of São Tomé from EITI is an embarrassing indictment of official efforts. Although the EITI Board has invited São Tomé to rejoin the process at a later date, it had made clear that São Tomé must first address the obstacles to its compliance with the initiative's requirements. Whether it will do so is an open question. São Tomé has little time to waste. With a licensing round for the EEZ set to be complete this year and a new round for the JDZ scheduled for next year, a great deal is at stake.

Will the lessons of past mistakes be learned? Will the institutions created to enhance transparency and accountability of oil revenues work? As in the first and second licensing rounds for the JDZ in 2003 and 2005, the EEZ licensing round may once again be handicapped by the government's obligation to honor preferential rights held in the EEZ by two companies, ERHC Energy and Equator Exploration. And the failure of São Tomé e Príncipe to become an EITI implementing country throws doubt on whether any signature bonus payments made during this licensing round will be independently audited.

The government's poor handling of past licensing rounds has already cost the people of São Tomé in lost revenue because it could have perhaps negotiated better terms for itself, and by extension, the public. In the JDZ, it awarded blocks to companies lacking deepwater experience and even almost lost its signature bonus payments following the collapse of a Nigerian bank in 2008. Such failures will reduce the number and level of bids for the EEZ. The Economist Intelligence Unit recently warned that the "EEZ licensing round could prove as disappointing for the government as the last licensing round was for blocks in the JDZ, during which ERHC also acquired without having to pay a signature bonus."

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An Uncertain Future

Oil Contracts and Stalled Reform in São Tomé e Príncipe

The tiny island nation of São Tomé e Príncipe is at a vital crossroads that will shape the country's future and reveal much about the impact of internationally-backed efforts to ward off the "resource curse." Since São Tomé entered into oil exploration agreements in 1997 and in 2001, the country has laid much of the legislative groundwork it needs to manage future oil revenues transparently. But São Tomé's government has struggled to cope with the pressures and temptations that come with oil wealth—even though the country's offshore fields have yet to produce a single barrel.

São Tomé's future oil revenues have the potential to transform the country, rolling back the crushing rates of poverty and unemployment that afflict it and improving dilapidated schools, clinics and other services. However, São Tomé is a long way from where it needs to be if it wants to avoid the fate of its corruption-plagued neighbours in the region. Sao Tome has some important upcoming opportunities to implement reforms, and the government's actions over 2010 and 2011 will determine whether this happens or whether the extra time is squandered while existing problems take deeper root.