Global legal challenges facing the petro-chemical industry

University Club of Toronto

Peter J. Rees
Legal Director, Royal Dutch Shell plc
May 8, 2012
Peter Rees, QC, was appointed Legal Director of Royal Dutch Shell plc in January 2011. In this post he has ultimate responsibility for the Shell global legal function and advises Shell group management on all legal matters of group-wide importance. The Shell legal function comprises some 1,000 staff, of which around 700 are lawyers or intellectual property professionals. The Shell legal function includes the ethics and compliance office.

As Legal Director, Peter is also a member of the Executive Committee.

Peter started his legal career in 1979 at the international law firm Norton Rose. He became a partner in 1987 and Head of Dispute Resolution and a member of the Executive Committee in 1997. In 2006 he joined Debevoise & Plimpton as a partner in its London office. In 2009 Peter was appointed Queen’s Counsel.

He attended Downing College, Cambridge University, where he took his law degree. He also has an MBA from Nottingham Trent University. Peter is a Fellow of the Chartered Institute of Arbitrators, a Chartered Arbitrator, and an accredited adjudicator and mediator.

Peter is a former chair of three organisations: the International Construction Projects Committee of the International Bar Association; the Technology and Construction Solicitors’ Association; and the Board of Management of the Chartered Institute of Arbitrators. He is a member of the Council of the International Chamber of Commerce UK and of the European User’s Council of the London Court of International Arbitration. Born in 1957 in the United Kingdom, Peter is married to Nicola. He has a daughter, Megan.
The petro-chemical industry has long faced many global challenges: technical, logistical, political, environmental and legal. In this speech, Shell Legal Director Peter Rees examines the scope of those challenges, and focuses on three major ones on his agenda today: Financial transparency, piracy, and contracting/procurement. In doing so, he demonstrates how the role of the corporate legal counsel has become central to resolving the major challenges facing global corporations today.

Exactly 52 years ago today, in 1960, Time Magazine published a major cover story about Shell, its global operations and challenges. This is how it began:

“Along the steaming, mud-covered delta of Africa’s Niger River, bare-chested men labored amid crocodiles and screaming parrots this week to push shafts of steel deep into the earth.

“On the choppy waters of the Persian Gulf, others perched on a crablike platform and sent a snag-toothed bit boring into the ocean bed.

“Around the world, hundreds of men labored just as sweatily in 35 other countries – from the pampas of Argentina to the back hills of New Zealand – to probe the earth in an eager quest for the substance that makes the world’s wheels go round: oil.

“The men on the Niger, the men in New Zealand’s back hills are all employees of a single company, Royal Dutch Shell, the world’s second-biggest oil company, and by far the most international in scope, organization and spirit.”

All that talk of steam, sweat and bare chests in exotic locales is a bit reminiscent of a bad romance novel. But I digress.

The fact is today, many of the places we drill are even more challenging and remote. And these days, we willingly provide our workers with shirts. That aside, you could write virtually the same thing today, and you would still describe Shell accurately.

The petro-chemical industry has long faced global challenges – technical, logistical, political, environmental and legal. The challenges get greater with each passing year on all these fronts.
Now, let me put those big numbers in a
global context.

For all of Shell’s size and reach, we
produce just 2% of the world’s oil and gas.
So to account for all the oil and gas
produced to meet the world’s energy
demand each day, you have to multiply
Shell’s scale by a factor of 50. That factors
in the dozens of major public and private
energy companies, hundreds of service and
engineering companies, and thousands of
logistics companies that comprise our
industry.

It’s a very complex business. And the future
is not going to get any simpler or easier.

Consider these facts:

- In the coming years, hundreds of millions
  more people will emerge from energy
  poverty, buying their first washing
  machines, refrigerators, computers and
cars.

- By 2050, our children will share this
  planet with 9 billion people, up from 7
  billion today.

- That is like adding another China and
  another India to the world. We will be
  creating the equivalent of one new city
  with a million people every week.

- The energy industry globally is going to
  have to spend trillions of dollars over the
  next four decades to find, develop and
  produce the energy needed to meet
  these people’s needs.

- That energy will come from more
  challenging and expensive sources,
  including oil sands, shale gas, liquid-rich
  shales, as well as advanced biofuels,
  hydrogen, wind and solar.

But the challenges go beyond allocating
capital and developing more sophisticated
technologies. For while energy underpins
the world’s well-being, producing it also
puts enormous pressure on our environment
and social fabric. Resolving the tensions
between these competing needs means
making difficult judgments: technical,
financial, legal and moral judgments.

And in the way the world is moving, the
legal judgments are becoming more and
more entwined with the moral judgments.
Hard law and soft law are getting more and
more difficult to differentiate, and the
industry is being held to account to both.

There’s a wide range of global legal
challenges facing the petro-chemical
industry today, including:

- Extraterritoriality – nations that seek to
  impose their laws and jurisdictions
  outside traditional geographic and
  jurisdictional boundaries.

- There’s increased regulation in almost
every aspect of our operations, from
deep-water drilling to oil trading, from
what we can and can’t say to our
shareholders to how we pay our
executives.

- There’s the interaction of the laws of
  states, the obligation to do something in
  one nation that is illegal in another.

- There’s the impact of politically
  motivated actions on the rule of law and
  sanctity of contract, resulting in actions
  such as expropriations or retrospective
  laws.

- There’s the increasingly uncertain
  business environment caused by the
  breakdown in trust between
governments, corporations and civil
  society.

And those just scratch the surface. There is a
reason why we have more than 700
lawyers at Shell, working in more than 40
countries.

In the interests of time, I want to cover just
three of the major issues on my plate at the
moment. I categorise them as follows:

- The one that looked insoluble, but which
turned out not to be.
- The one that looks insoluble and
continues to be.

“And in the way the world is moving,
the legal judgments are becoming more
and more entwined with the moral
judgments. Hard law and soft law
are getting more and more difficult to
differentiate, and the industry is being
held to account to both.”
And the one that looks perfectly soluble, but which legislators are making insoluble.

Financial transparency
I’ll start with the last one, which is about the issue of financial transparency.

The English barrister, F.E. Smith, who became Lord Chancellor of England and Winston Churchill’s closest friend, was known for his incisive wit and precision of expression. In one case, he was making lengthy submissions to a judge who was clearly struggling with the complexities of the dispute.

The judge interrupted him and said: “Mr. Smith, I have listened to you now for an hour and I am afraid I am none the wiser.” To which Smith responded: “No wiser, my Lord, but much better informed.”

Keep that response in mind, because it is relevant to this topic.

There is a move afoot to require companies from the natural resource industries to disclose the amount of money they pay to governments for the right to extract their natural resources. It began in the United States and has now spread to Europe.

Why? So the people in those countries can see how much money their government is receiving for those public resources. The thinking is they can then hold their governments accountable for what is received. Some even argue it would reduce corruption.

It all sounds laudable when put in this way. But as with most legal issues, the devil is in the detail. In fact, what is being proposed won’t achieve any of those aims. Let’s take a closer look at each claim.

First, people will not find out how much their government is receiving. That’s because the only corporations this legislation can apply to are those under U.S. or European jurisdiction. The biggest energy companies in the world, the national oil companies and quasi-nationals from Russia, China, Asia-Pacific, South America and the Middle East, don’t fall under U.S. or European jurisdiction.

So, the total amount many governments receive will not be revealed by this legislation.

Will it reduce corruption? No. The legislation only requires a company to disclose how much it paid to the government. It is not corruption to pay a government taxes, royalties and signature bonuses for the rights to extract oil and gas; that’s what governments do – they sell their mineral rights to the highest bidder.

But this legislation does pose competitive harm to the companies required to comply with it.

Let’s say you are from a country not subject to this legislation. You and the government official negotiating the contract both know what the competition is likely to bid, because they have had to disclose what they bid for previous, similar contracts. Meanwhile, what you pay will never have to be revealed. And neither you, nor the government official, is caught by the US or European anti-corruption legislation.

I leave you to draw your own conclusions about the implications.

In case there should be any doubt, let me be clear: Shell supports financial transparency reporting. Two weeks ago, Shell published the total amounts we paid to governments last year in most of the main countries in which we operate. We did this in advance of any mandate to demonstrate our commitment to disclosure. We believe it is important that companies be open regarding how much they pay to governments.

We also believe governments should be encouraged to be open about what they receive and how they spend it. People should know what their governments receive for rights to extract natural resources.

“Shell published the total amounts we paid to governments last year in most of the main countries in which we operate. We did this in advance of any mandate to demonstrate our commitment to disclosure. We believe it is important that companies be open regarding how much they pay to governments.”
But they should get the full picture, and the only entity in the position to provide the full picture is the government.

There are a few governments that do just that. Nigeria and Norway, for example, comply with EITI, the Extractive Industries Transparency Initiative. EITI encourages governments to disclose and verify all amounts they receive from all entities that extract their natural resources. This way, people get the full picture and not a distorted or partial one.

As F.E. Smith might have said to a smarter judge, they are both better informed and wiser.

Shell is a founder and board member of EITI and firmly believes its approach is the most effective way to provide revenue transparency. But that does not seem to be direction in which legislators are heading. Instead, governments generally seem to be favoring legislation that would force US and European companies to disclose what they are paying for individual projects – so all the downside and none of the benefit.

But what happens when that mandate conflicts with what other governments require? Some governments require you to enter into confidentiality agreements barring you from disclosing what you are paying them. Some even make it a criminal offence to do so. So to comply with the legislation in one country to disclose this information, we would have to violate the law of another country.

What should we do?

The Dodd-Frank legislation in the United States says it does not matter that to disclose the information would be illegal in another country, you still must disclose. And therein is my dilemma: Do I advise my company to be illegal in the United States or illegal in another country?

Again, an issue that looked perfectly soluble, but which the legislators are making insoluble.

Now, let me turn to the one that looks insoluble and continues to be: Piracy.

Piracy

Back in the 18th century, it was considered perfectly legal for a ship’s crew to hang pirates if there was no legal process available, as in international waters. This was considered a necessity, since captured pirates were considered too dangerous to keep on board during lengthy voyages at sea.

While the administration of the ultimate penalty seems severe today, it largely eliminated piracy by the late 19th century. Of course, we don’t hang pirates today – and I hasten to add I am not advocating that we resume the practice! But the fact is no one really has a clue what to do with today’s pirates.

There is no international body empowered to try and imprison them. Nobody wants to hold pirates on a ship until they return to port, because they can only be tried if the vessel subject to the pirate attack was under the flag of your nation. Not surprisingly, trying pirates is not the sort of business flag countries like Panama, Bermuda and the Marshall Islands are eager to embrace.

Jurisdiction is the issue. Piracy, by definition, happens on the high seas, outside anyone’s jurisdiction. And if you can’t hang them, you can’t imprison them and you can’t take them back to shore, what do you do?

This is not just a practical problem, but a legal one as well, for my industry and others that must ship products through seas where pirates operate. We and other oil companies have little choice but to ship our products either through the Suez Canal, down the Red Sea and out into the Indian Ocean, or down the west coast of Africa.

In the past two years, there were about 15 pirate attacks a month on vessels in the Indian Ocean, of which about 20% were successful. Attacks off the coast of West Africa ran averaged about seven a month.
So what can we do to resolve the problem?

Initially, vessels used defensive tactics such as higher seaboards, putting razor wire round the ship or employing water cannons. But when some vessels began carrying armed soldiers or guards, a different set of legal questions came into play:

- What legal considerations apply to arming vessels?
- What is the attitude of the nations under whose flags these vessels operate?
- What liabilities will they incur if a death occurs during a pirate attack?
- What is the attitude of the vessels’ insurers? Will they deny insurance claims?
- What will the attitude be of the armed guards’ countries if they are killed or if they kill or injure someone?
- And what if that someone isn’t a pirate, but an innocent bystander, such as a fisherman or a crew member caught in the cross-fire?
- To what extent can consent from the flag country and insurers give you some protection?
- To what extent can drawing up detailed rules of engagement for armed guards provide safeguards if there are subsequent injuries or deaths?
- Where can criminal charges be brought? Which countries will have jurisdiction over civil claims?

I have just asked nearly a dozen legal questions, to which there are no definitive answers. What advice would you give when the question arises: others are arming their ships, what should we do? How do we fulfill any duty of care we may have to the crews of our vessels? Are we in breach of our duty if we don’t arm? Or do we put our crews in more danger if we do?

These are no longer hypothetical questions. For example, two Indian fishermen were killed by Italian navy personnel on duty on an Italian flagged oil tanker as the vessel was sailing along the Indian coast. It appears they mistook them for pirates. India arrested the two Italian sailors. Italy accused India of breaching its territorial jurisdiction by arresting them in international waters.

Last month, Italy announced it had paid $380,000 to the families of two fishermen as a gesture of goodwill, but not as an admission of responsibility for the deaths. In response, the relatives agreed to withdraw their cases against the sailors. But the Indian state has not dropped its criminal charges against the two men and they are awaiting prosecution.

In February, Danish naval forces opened fire on a suspected pirate ship when it refused to stop. Two hostages being held by the pirates were killed. While it appears the pirates killed the hostages, the question arises: Would they have been killed if the navy had not attacked?

So, as with financial transparency, I leave you with a dilemma: Do I advise my company to arm our vessels or not arm them? And what do I advise will be the legal consequences if we do or don’t?

Okay, so far I sound like a guy with a lot of problems and no solutions. So I’ll conclude with an example of a major issue for which, I am proud to say, we have created a solution.

Contracting and procurement

Shell signs about 1 million contracts a year with more than 120,000 suppliers in practically every country in the world, generating an annual spend of $65 billion.

In the past, these contracts involved more than 100,000 different sets of contractual Terms & Conditions, or T&Cs, in more than 100 different legal jurisdictions. It was not the most efficient way to contract and purchase. Contracts were taking far longer
than they should to negotiate, taking up unnecessary amounts of management and legal time.

This resulted in very different terms and conditions, and usually different prices, for the supply of fundamentally the same product in different parts of the world. This is a legal problem not just for Shell, but for nearly every multinational company in the world.

The solution is easy in theory: standardisation. But given the scope of our operations, is standardisation even possible in practice?

Well, since January 2010, the in-house legal team supporting Shell’s procurement function standardised the legal terms and conditions for all of Shell’s procurement contracts. We now have one standard set of T&Cs used by all of Shell’s businesses and functions.

How was it done? The core team consulted Shell lawyers, representing more than 100 countries, and the global network of Shell procurement professionals to develop a single starting point for the T&Cs. The goal was to make all the terms of the T&Cs enforceable in all jurisdictions.

They had to meet local legal and fiscal requirements as well as reflect the different needs of the businesses and functions that would use them. The T&Cs also would be used by our project contractors and joint ventures.

We adopted a fair starting point for the T&Cs to save time by eliminating the usual negotiating posturing. Our T&Cs are “fair market” and not skewed towards us.

In the beginning, some feared starting negotiations “from the middle.” They worried it would result in a worse outcome for Shell overall if suppliers still applied the traditional negotiating approach of starting at two ends of the spectrum and landing somewhere in the middle.

That has not proved the case, fortunately, because of the second change we implemented. Having a “fair” set of T&Cs has meant we can now adopt a different approach to negotiations. We simply attach the T&Cs to the tender invitation, and tell suppliers any mark-up of the T&Cs will be rejected.

Instead, they are invited to rank a limited number of reservations on the T&Cs as part of their tender response. We can only make this approach work because the T&Cs reflect a fair allocation of risk.

Shell’s standard model contracts library was rolled out in January 2011. Tracking data show the standard T&Cs are being used by more than 1,000 procurement professionals in Shell each month.

All sorts of advantages have resulted. Our contracting today is faster and more certain. On average, we’ve cut in half the time it takes to negotiate contracts. And there has been a significant improvement in the prices we are paying.

The project was devised, managed and implemented exclusively by Shell’s lawyers. Doing it in-house made sense, given the volume and complexity of the commercial legal work we deal with every day. We know of no company that has implemented this scale of change to its legal contracting techniques in procurement, with or without external legal support.

An effort like this that brings the business enormous value can only help increase the appreciation of what lawyers do within a company. Today, we are no longer viewed as getting in the way of business, as people who say you can’t do this or that, or that you can only do it this way.

“An effort like this that brings the business enormous value can only help increase the appreciation of what lawyers do within a company. Today, we are no longer viewed as getting in the way of business, as people who say you can’t do this or that, or that you can only do it this way.”
That attitude has disappeared within Shell. It wasn’t always that way, however.

I’d like to close tonight by reading excerpts from a letter that Shell’s then-CEO Sir Henri Deterding sent in 1916 to the managing director of Shell’s operations in the United States:

Dear Mr. Luyks:

I duly received yours of the 22nd regarding Messrs. Rice & Lyons’ remuneration.

You gave me rather a start with your letter, because I gather from it that you employ solicitors much oftener than we would ever dream of doing.

Although we have an enormous business here, we rarely consult lawyers. We only do so when there is really a legal difference or legal difficulty, whilst it seems to me that you employ them practically in every instance.

Lawyers are not business people; however large a lawyer’s experience may be, in the conduct of business he is absolutely useless. A lawyer placed at the head of a concern would soon bring the business to rack and ruin.

He is not a creative genius, he is able to give his opinion if a case is laid before him, but to ask a lawyer to draw up a contract for you is a most foolish thing to do, and this is bound to lead to trouble.

Our custom here is to draw up a contract before having seen the lawyer and then to ask him to put it in more legal shape. Such a contract is more likely to embody the spirit of what has been agreed upon than one drawn up by a lawyer; to ask his opinion as to what you should do or not do is the worst possible way of conducting business, which should be kept as far as possible from lawyers.

It seems to me from your letter as if the lawyers are a kind of department to your business. Their idea that we should be inclined to give them a fixed fee is absurd, but what astonishes me most is their firm proposal that you should make an arrangement, by which one member of their firm should give practically his entire time to the conduct of our affairs.

We would never think of such an arrangement. I hate to see a lawyer in our office; if I want him I go to his office and limit the conversation to the shortest possible period.

Allowing a lawyer to be practically in daily touch with me would certainly take 90% of my time, which ought to be devoted to money-making and not to discussing legal squabbles or legal phraseologies.

Yours sincerely,
H. Deterding

There are many global legal challenges facing the petro-chemical industry today, some soluble and many which look like they won’t be. But what does seem to be accepted today is that we will need lawyers to help solve them.

Thank you.
Recent speeches by Shell’s senior leadership

- Energy demand, supply and downstream infrastructure challenge, Mark Williams
- Water, energy and the resource consumption puzzle: It’s time for solutions, Peter Voser
- The natural gas revolution: a secure, abundant force for good, Peter Voser
- Growing global energy demand: a defining moment for Louisiana, Marvin Odum
- Shell and corporate tax, Simon Henry
- Meeting the needs of 9 billion people, Marvin Odum
- Qatar’s role in the energy landscape of the future, Peter Voser
- New Frontier: engineers and the global energy challenge, Malcolm Brinded
- The case for shale and tight gas, Malcolm Brinded
- The integration challenge, Marvin Odum
- 9 billion reasons to address the world’s energy challenge now, Peter Voser
- Growing cities, growing responsibility, Marvin Odum
- Changing direction towards a new energy future, Jorma Ollila
- Canada: a proving ground for responsible oil and gas development, Marvin Odum
- New upstream risks and opportunities: the natural gas revolution, Malcolm Brinded

For information about Shell, including downloadable versions of these speeches and other publications, please visit www.shell.com.