

## The remarkable story of the nationalization of PNG's largest mine and its second largest development partner, all in one day

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I was in Port Moresby last week for our [third budget forum](#) with PNG's National Research Institute. We'll be blogging about that in due course. But the week was dominated by the PNG's Government's takeover of Ok Tedi and the Sustainable Development Program, which was front-page news for several days.

It is a critical but complex issue which I wrote about earlier this year ([here](#) and [here](#)). Though the subtleties and implications are manifold, a simple summary of what happened last week is that in a single day, Wednesday, legislation was introduced into and unanimously passed by the PNG parliament to give the PNG Government ownership of the country's largest company, Ok Tedi Mining Limited, and control over the country's second largest development organisation, the PNG Sustainable Development Program.

The short version of my argument is that, while the Government has achieved a stunning victory, it is quite possibly a temporary one, and it is an outcome which represents poor public policy and a setback to development in PNG.

The long version follows below, starting at the beginning.

### Background

The [PNG Sustainable Development Program](#) (SDP) was set up after BHP's exit from the Ok Tedi mine in PNG's Western Province just over a decade ago. Essentially, BHP wanted to shut down the mine, which had caused great environmental damage and become a reputational risk to the company. The PNG Government, however, wanted the mine to continue because it needed the tax revenue. BHP agreed to give away its ownership of the mine in return for a guarantee that it would not be sued for environmental damage. BHP did not want to gift its shares in Ok Tedi to the PNG Government because of well-established concerns about corruption and limited capacity within the PNG public sector. The compromise reached was an agreement that PNG would give its shares to a new trust fund, SDP, which would be registered in Singapore as a public company to be run by a board of directors, some nominated by BHP, the others nominated by a variety of PNG institutions. SDP was established in 2002. After a third shareholder exited, SDP was left with 63% of Ok Tedi's shares. The remaining 37% were held by the Government.

SDP was set up with two main tasks: to invest two-thirds of its Ok Tedi dividends into a long-term fund which would be available to the people of Western Province after mine closure; and to spend the other one-third on development projects throughout PNG.

With last decade's resource boom, Ok Tedi became much more profitable than had ever been envisaged. It is now PNG's largest mine and revenue earner. In 2011, it paid K1.2 billion in tax. The original idea that the mine would close shortly after 2010 has been replaced by a plan to extend mine-life by shifting from open-cut to below-ground mining, which would require new legislation.

SDP's funds also grew rapidly over the decade. The value of its long-term fund reached \$US 1.4 billion in 2012. Its annual development expenditure expanded, making it the second largest donor in PNG, after AusAID.

There was recurring tension between SDP and the PNG Government over the last decade, but Sir Michael Somare, then as Mining Minister, had helped negotiate the deal, so while he was Prime Minister (from 2002 to 2011) SDP was safe.

All that changed when Peter O'Neill became Prime Minister. This took a while to become evident. In 2011, I undertook an [evaluation of SDP](#) [pdf], along with Dr Eric Kwa, then at UPNG, now Secretary, Law Reform Commission. We were unable to meet the PM, but we met his Treasurer, Don Polye, who was full of praise for SDP.

Once Peter O'Neill won the 2012 elections, however, he started speaking out against SDP, essentially arguing that both the links from BHP to SDP and from SDP to Ok Tedi should be broken. Towards the end of 2012, Ross Garnaut, Chair of SDP since its inception, handed over the reins to Sir Mekere Morauta, who, as PM at the establishment of SDP, had also helped negotiate the deal. [Comments](#) made by Garnaut at the time about revenue from Ok Tedi ("It's very tempting for political figures to think of better ways of using it right now rather than putting it into long-term development.") led to the PM banning his entry to the country.

(An aside on another SDP board member: there was a remarkable [announcement](#) in the media recently that Jacob Weiss, a former IMF employee, who helped establish SDP and who served on its Board as the Central Bank's representative for the last ten years, was stood down earlier in the year by the SDP Board on conflict-of-interest grounds, including his "appointment as the leader of the Government team set up to take over PNG SDP's shares in Ok Tedi." It doesn't get much stranger than that.)

It became clear under PM O'Neill that legislation would only be passed to extend the life of Ok Tedi if SDP exited. Under its new Chair, SDP took a pragmatic and conciliatory approach. At its Annual Meeting a few months ago, Sir Mekere appeared to [acquiesce](#) to its removal from Ok Tedi provided that there was a negotiated agreement, including a "fair and transparent" process.

It seems from press reports that there were some discussions, but evidently agreement could not be reached. And so, after an escalating war of words, Prime Minister O'Neill not only introduced legislation this week, but had it passed by parliament, all in the same day, to nationalize both Ok Tedi and SDP. According to reports, some members absented themselves from the vote, including Sir Michael Somare, who spoke against it, but no-one voted against it.

## Legislation

The legislation, available [here](#) [pdf] and [here](#) [pdf], has three main objectives, which the next three sections discuss in order:

- to remove SDP from its current position as majority owner of Ok Tedi
- to remove BHP's immunity from environmental liability
- to give the state the power to "restructure" PNG SDP.

## Ok Tedi

Although the Prime Minister has denied it, this is clearly an act of expropriation. The PM has argued that it is not, because Ok Tedi already belongs to the people of PNG or Western Province. But this could be said

about any resource project: clearly the resource belongs to the people of PNG, but not the assets used to dig up the resource. Applying the Prime Minister's argument would imply that all multinationals running resource projects in PNG should have their assets seized by Government. Like it or not, 63% of Ok Tedi shares belong to SDP, and SDP is a Singapore-registered company.

The legislation gives the Prime Minister the discretion to decide whether compensation is to be paid, to whom, and the amount. The legislation imposes no obligation on him to pay compensation, and provides no guidance on the amount. It would certainly seem unlikely that the consequence of this legislation would be compensation at fair or market value.

SDP has indicated it will take legal action against the expropriation, which it considers unconstitutional. However, as the new legislation notes, the PNG constitution only protects PNG citizens from expropriation so SDP may not succeed in a domestic court challenge.

Given that SDP is registered as a Singapore company, it may also challenge the seizure of its assets in the Singapore courts or, say, in the International Centre for Settlement of Investment Disputes, of which PNG is a member. I don't know enough to comment on the likely ruling. There is no investment treaty between PNG and Singapore. However, the PNG Investment Promotion Authority [claims](#) that PNG gives most favoured nation status in regards to investment to all APEC nations, which would cover Singapore. In any case, any international challenge, let alone an adverse ruling, would certainly be bad for PNG's reputation.

### **BHP environmental liability**

The effect of the removal of BHP's immunity from environmental liability is unclear, and again beyond my expertise. The 2001 Ok Tedi [Ninth Supplemental Agreement](#) [pdf], which the new legislation amends, prevented the Government from taking legal action against BHP, but not individuals, and a suit was [brought](#) against BHP in 2007. Various out-of-court agreements were reached and compensation amounts paid with different landowner groups prior to BHP's exit. The new legislation claims to authorize any such groups to sue BHP once more. Even if such agreements can be simply legislated away, since BHP is not present in PNG, it is not clear how any case could succeed against it there.

Could an environmental suit be brought offshore? The citizens of Bougainville filed a class action in the United States against Rio Tinto in relation to environmental damage from its Panguna mine, but this case was eventually dismissed. In addition, the various agreements reached long ago between BHP and different claimants will continue to protect BHP from further court action, at least offshore.

Finally, as part of the original SDP establishment, there was an agreement that, should there be a case for environmental damages against BHP, SDP would pay the damages (see the end of SDP's [first annual report](#) [pdf]) from its Ok Tedi dividend receipts. The legislation purports to remove this obligation from SDP, making BHP directly liable. However, PNG's jurisdiction over agreements entered into by foreign entities would seem to be lacking.

### **Sustainable Development Program**

The clause giving the state the right to restructure SDP is also an attempt at nationalization. At the moment, there is only one Government representative on the PNG Board, a Treasury nominee. The new legislation purports to give the Government the unconstrained right to appoint SDP directors and direct SDP operations. This edict cannot be enforced since SDP is a Singapore-registered company and so beyond the jurisdiction of PNG law. However, any Government decision requiring restructuring could lead to SDP being unable to operate in PNG, since it could have the implication that, without restructuring, it would only be able to operate in breach of PNG law. In this case its \$US 1.4 billion trust fund would simply accumulate offshore.

### **Risks and implications**

These developments carry with them several severe risks, and negative implications for development in

PNG.

First, there are the risks at Ok Tedi, both environmental and financial. The one mine the PNG Government has had majority ownership of (the Tolukuma gold mine) is widely regarded as a failure. More generally, the Government's record in managing its own enterprises (power, airlines, telecom, etc) is deplorable. A [recent ADB report](#) found that "the poor performance of SOEs [state-owned enterprises] is due to weak governance arrangements, conflicting mandates, the absence of hard budget constraints, and lack of accountability" (p. vii). Will Ok Tedi be the exception to this rule? PM O'Neill has promised independent management, but the ADB report found that political involvement in the selection of SOE directors has been common (p. 13).

Second, there are the risks to the Government's reputation, and to PM O'Neill's as a business-friendly prime minister. There is a tendency to regard SDP as a special case due to its unique circumstances. However, resource investors have to think long term and must be wondering whether after a decade or two they could also be in the Government's firing line, and find their own assets under threat. A protracted court challenge, as now seems likely, would certainly damage private sector confidence in the country. The Investment Protection Act specifically [prohibits](#) expropriation of foreign assets, but this action shows that legislation offers little protection.

Third, there are risks to the credibility of the PNG Government. For the last few years, the Government has been putting together a plan to establish a sovereign wealth fund (SWF). Putting together a SWF requires the ability to make long-term commitments. This is no doubt a challenge for any government. But what PNG has just shown is that it is willing to renege on contracts and change its mind on long-term endeavours within the space of a decade. Even if a SWF is established in PNG, and progress has recently stalled, it is unclear, based on the SDP experience, how long it would last.

Fourth, there are the risks to the use of Ok Tedi dividends. Corruption in the PNG government is a serious and widely acknowledged problem. The 2011 [review](#) of SDP which I co-authored found room for improvement, but also high compliance with its program rules, and "many and varied" achievements. It is implausible that the Government will make better use of Ok Tedi dividends than SDP.

Fifth, there is the risk to SDP funds and projects. If SDP ceases operations, its various subsidiaries (in areas such as sustainable forestry and microfinance) will be forced out of business. And having its long-term funds accumulate in Singapore, unavailable for use in PNG, is hardly in PNG's interest. Nor is the distribution of the funds as compensation for environmental damages.

### **Likely outcomes**

There is no doubt that Prime Minister O'Neill has had a daring victory. The issue is a controversial one in PNG, but the fact that no-one in parliament was prepared to vote against the bill speaks volumes. The Prime Minister has not hesitated to play the nationalist card. He has labelled the SDP Chair as the voice of foreign interests.

Indeed, SDP's independence has been its undoing. Imagine the outcry if it was not SDP but BHP or Rio Tinto which was under attack. But SDP has no foreign government to go in to bat for it, and few corporate friends.

Nevertheless, while the issue is complex and more analysis is clearly needed, the Government's victory might well be a temporary one. One obstacle is the Western Province landowners who have recently voiced their [opposition](#) to the deal. They published a letter in the *National* newspaper on Friday September 13, expressing support for existing ownership arrangements and saying that they would not agree to an extension of the mine "unless the current arrangements are maintained." Without community consent to a mine-life extension, Ok Tedi can't continue beyond about 2015. However, the local communities also need the mine to continue, so it is unclear how long they will maintain their opposition.

Other factors make the situation look much less favourable to the PNG Government. First there is the prospect of court challenges by SDP. Second, as argued above, an outcome of last week's legislation might be that SDP's \$US 1.4 billion long-term funds will end up locked up in Singapore unable to be used in PNG. This gives SDP the leverage which may well force the PNG Government back to the negotiating table.

### **International and Australian reaction**

So far the issue has attracted little attention outside PNG, though it was featured in an ABC Four Corners program [last night](#). The nationalization may also embarrass the PNG Treasurer, Don Polye, who has just been given the rotating position of Board of the IMF and World Bank Chair of Governors. (I am surprised that the issue was not raised by the IMF at the [conclusion](#) of its annual assessment of PNG economic policy the week before last.)

How will the Australian Government respond? So far it has been missing in action on this issue. At the time of the ban on Ross Garnaut, then Foreign Minister Bob Carr [declared](#) the issue to be simply "a consular" one. He could not have been more wrong. Australia is providing the PNG Government with half a billion dollars of aid every year. It should not be too much to expect that this aid would be accompanied by a frank dialogue around core policy issues. However, Australia now needs PNG to implement its asylum-seeker policy. I hope that the Coalition will be more forthright, but I fear that the overriding aim will be to maintain a good relationship.

Disclaimer: These are my personal views. With Dr Eric Kwa, I completed an independent evaluation of PNG SDP in 2010-11, which can be found [here](#) [pdf]. I have worked twice for Professor Ross Garnaut, the former SDP Chair, in 1999 (on *Australia and the Northeast Asian Ascendancy*) and in 2008 (on the *Garnaut Climate Change Review*).

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