


Infrastructure Planning and Management Political Risk in Infrastructure Part 1


Today we are going to talk about political risks right, two very interesting and high-octane cases so what we will do is we will have the groups present and then we will talk about them a little bit to sort of understand what happened, what could be done, what should be done all of that, all right so group 2 can I have you guys over to present.

(Refer Slide Time: 00:33)

Group-II

Chad – Cameroon petroleum development and pipeline project

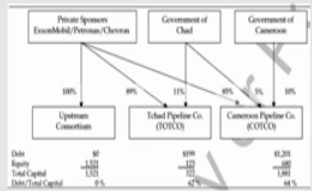




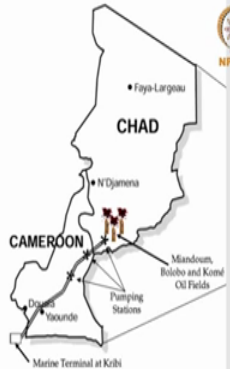
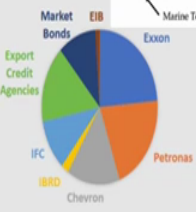
Project Description:


Export system	Field system
Transport oil from doba to Kribi	Extract oil from Doba basin
Construction of 1070 Kms pipeline	Construction of 300 oil wells
Project financing structure	Corporate financing structure


Project financing:



Date	\$B	\$10B	\$1.2B
Equity	1,131	132	188
Total Capital	1,131	132	188
Debt/Total Capital	0%	62%	64%



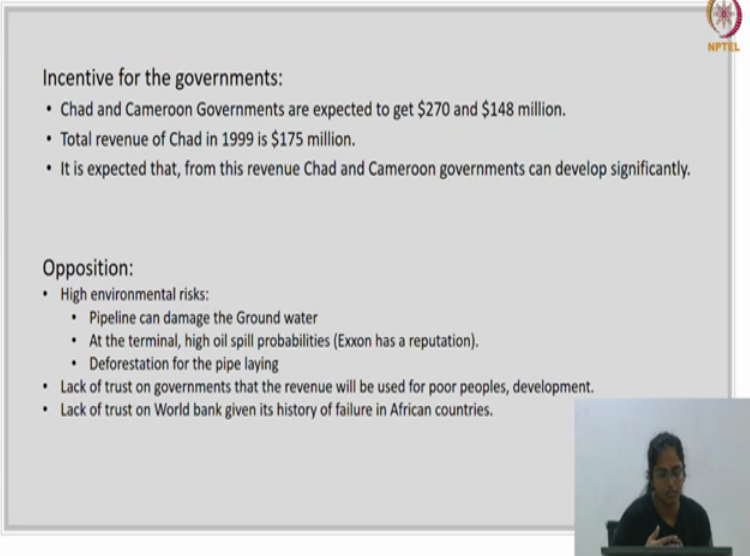


Hi guys I am Shravya, I will be presenting the Chad Cameroon Petroleum Development and pipeline project, so the basic description was they found oil reserves in Doba basin and they had

to transport it all the way from Doba basin to Kribi marina terminal through Cameroon, so they divided the project into two parts, the first one is field system, it basically is extracting the oil from the Doba basin it had construction of 300 oil wells and the second part is export system.

It is basically transporting the oil from Doba to Kribi, it had construction of one zero seven zero thousand almost housing kilometres pipeline, so they opted project financing structure for export system and corporate financing structure for field system. So this is the financing structure they created three special vehicles, upstream consortium, chart pipeline company and Cameron pipeline company. So this enabled the government, this enable even for the governments to get revenue from the project.

(Refer Slide Time: 01:53)



Incentive for the governments:

- Chad and Cameroon Governments are expected to get \$270 and \$148 million.
- Total revenue of Chad in 1999 is \$175 million.
- It is expected that, from this revenue Chad and Cameroon governments can develop significantly.

Opposition:

- High environmental risks:
 - Pipeline can damage the Ground water
 - At the terminal, high oil spill probabilities (Exxon has a reputation).
 - Deforestation for the pipe laying
- Lack of trust on governments that the revenue will be used for poor peoples, development.
- Lack of trust on World bank given its history of failure in African countries.

So incentives for the government basically the Chad and Cameroon, in this countries if they are really backward countries so this is a great revenue opportunity, so the problem is how they are going to use this revenue once they get the revenue even when it is very backward country so even for the sponsors they had some risks like political risks, they cannot trust the government enough to continue the project, I mean start the project, even for the starting of the project.

So opposition obviously for the oil pipeline system means they had high environmental risk, pipeline can damage the groundwater, terminal oil, high oil spill conditions. Exxon had a reputation like in 1989 it already had when oil spill problem, so after that the people were not

trusting enough for the, were not enough trusting government to give the revenue for the betterment of the people like poor people.

And also they could not trust even the World Bank because there have been many African countries in which oil development has been done but even in those countries, even in those countries they could not do much for the people like poor people.

(Refer Slide Time: 03:20)




World bank involvement

- Without World bank, there would be no project considering the high loan from world bank to the governments.
- So, given its high influence, World bank tried to restructure the project in order to address the risks.

NPTEL


So for equity from the government whichever equity from the government is coming it was all in the form of loan from World Bank so for the project to continue World Bank had to give some money to these countries so it had some level of influence, so it tried to restructure the project in order to address all there is that were voiced out.

(Refer Slide Time: 03:46)




Changes proposed

- They conducted meetings with 250 international NGOs and nearly, 900 village meetings.
- The plan of the pipeline was modified to protect some wildlife habitats and indigenous people.
- The sponsors increased the benefits from compensation and resettlement plan.
- All the project processes are to be made more transparent.
- Proposed a Revenue Management Plan for the effective use of revenue.




So they proposed some changes like first they conducted meetings with many NGOs and villages and then the plan of the pipe in was modified because some to facilitate, to protect more habitats and to get less resettlement of the people and then the sponsors also increased the compensation plans, the important thing was the revenue management plan which they proposed like it is a main thing for World Bank to give the loans.

(Refer Slide Time: 04:25)



Revenue Management Plan

- Over \$1.8 billion is expected to come as revenue.
- 16% was income tax and remainder was royalties and dividend.
- Income tax can be spent by the government at its discretion.
- \$25 million signing bonus was also left to the government.
- But in royalties and dividend, the following distribution was suggested:
 - 10% - poverty reduction programs for future generations
 - 85% - investment in basic infrastructure (health, education, rural, water, infrastructure)
 - 15% - for programmes in Doba region by government.
- A nine members(7 from government and 2 from trade unions) Oversight Committee is to be formed to monitor the implementation of the plan.
- RMP was made a contractual obligation for and EIB.
- The future lending was also linked with the implementation.



So in the revenue management plan it gave a detailed plan of how to use the revenue that was generated from the project it was expected like 1.8 billion is expected as revenue and from in that

16 person was income tax, they said government can use the income tax as they according to their wish and but the remainder they had to, they prepared a detailed plan like 10 percent they have to give for poverty, future generations, 85 percent for basic infrastructure health education rural water and 15 percent for the programs in Doba like whatever the programs that are being constructed in Doba region, in main Doba region.

And they created a Oversight Committee, the plan was to create a oversight committee of nine members, seven from the government and two from the trade unions and also they ensure that if this has to happen they made the they made RMP as a contractual obligation for the loans and they also linked the future lending with RMP implementation but even after the implementation after this much planning and all for five years they could not get it like in 2006, yeah in 2006 the contract was again restructure.

Even after that they, the country did not implement the necessary steps for the poverty reduction and all so in 2008, by 2008 I think Chad government had repared the whole loan amount so yeah they could not.

(Refer Slide Time: 06:20)

The screenshot shows a presentation slide with the following content:

Project Description:

Export system	Field system
Transport oil from doba to Kribi	Extract oil from Doba basin
Construction of 1070 Kms pipeline	Construction of 300 oil wells
Project financing structure	Corporate financing structure

Project financing:

The slide also features a map of Chad and Cameroon, a flowchart of the project financing structure, and a pie chart titled 'Market Banks' showing the following distribution:

- Market Banks: 40%
- Export Credit Agencies: 20%
- Other: 20%
- Other: 20%


Group two has done a fair job of presenting the key facts of the case right which I do not know if I can still run through this but essentially I think we are all familiar with the project pipeline to be constructed going all the way through Cameron, why do you have to go all the way through

Cameron, what is the purpose of constructing the pipeline right you have got oil right, so all you have to do is construct an oil field, what is the purpose of the pipeline.

So we have got to get into a port somewhere so you can export it, you can export it to a refinery, refine it all of that, so it has to go through Chad and Cameroon and what do we know about Chad and Cameroon? Right, these are not necessarily the most stable countries in the world at that moment, neither economically, politically, socially Chad is, both Chad and Cameroon have somewhat of civil war raging they have got quasi dictatorships so it is not a very, they are not very politically stable areas right.


But this is the project and we will get to a few, in fact this part here right at the bottom on the that you can see I am going to just totally expand on that a little bit later and look at the financing and all of that okay, want to go through this later okay.

(Refer Slide Time: 07:31)



Chad-Cameroon pipeline, what are the issues?

- Should the project be funded?
- Pros
 - Economic and social development of Chad
- Risks
 - Will the funds be misused?
 - Will the project be expropriated?
 - Will the sponsors get the expected returns?



So Chad Cameroon pipelines the key issue is okay I have got this pipeline, we know that the governments of Chad and Cameroon are involved, we have Exxon Mobil which is going to be the private entity that is essentially going to develop this project, we all know that Exxon is an oil major they develop, refine, export, sell petroleum all of that but there is the issue of funding because none of these people have the money to put on this project by themselves.

We all know that there is a mix of debt and equity so while Exxon will put in a certain amount of equity into the project there is some debt that needs to be borrowed right and so one of the candidates to lend to this project is the World Bank, why is the World Bank a good candidate to lend to this project? So they have good reputation except so essentially there are two or three aspects to this.

One you want the World Bank because they have money, two you want the World Bank because they have money at relatively cheap rates because they are looking more at development rather than commercial investment, three you want the World Bank because they are also a large international player that may have some ability to arm, twist or coerce or convince the Chad and Cameroonian governments to play ball.

Because they are not lending only to this project right most of these kinds of multilateral organizations are probably lending to the government in other spheres as well right and so you always have that threat of if you do not really do a good job on this project I will withdraw funding from elsewhere right and so there is some kind of pressure that you might want to bring to bear so the World Bank is clearly a logical person to look at right for funding this kind of a project okay.

So from the World Bank's perspective this is the question right, should the project be funded right, it is very simple straightforward technical project right you have a you know a field system and then you have a pipeline that takes it to the course right it is not an engineering marvel, it is reasonably challenging right we understand that there are advantages, there are pros and the pros are you are actually going to create some wealth in Chad and Cameroon right because on what else does that economy run?

It isn't as if they have a thriving agricultural sector or a marketing sector or a services sector where they have IT and banking I mean essentially these are relatively poor countries so for those countries to develop there should be some source of wealth right and in this case the source of wealth is hidden under the ground in the form of petrol right so if I am able to bring that out of the ground if I am able to sell it then that money can go back into those countries and people can start developing better roads, hospitals, etc.

So clearly the pros of this project are not only will the world get oil but that is the secondary benefit Chad and Cameroon can actually use the money from this project because it is their oil to develop right, great. The cons as the group brought out with, you are going to make, you are going to create more wealth in that country but are you sure that that wealth will be used for development right, what happens because you have power-hungry dictators you have civil war, etc.

Will the funds be misused right and where do you think we could they could be what do you do you think they could be misused for right, essentially for buying weapons to continue to propagate these wars right so you do not want certainly the party in power which is not necessarily a democratically elected party to now become so rich that they can actually buy much larger guns, weapons, etc. wipe out the opposition and continue dictatorial rule that is probably the outcome that you do not want, you want them to take this money and invest it into infrastructure, education, health services, all of that.

And one of the problems of actually using this to fund weapons right is that one consequence of having those weapons is somebody might blow up the pipeline itself right in some ways you are funding the project in order to blast the project, sort of, kind of logic right so that is the con okay. So the pros are this is a way Chad can develop and I cannot see many other ways in which Chad is going to develop right and we all want countries to develop I think we are all sort of humanitarian equitable.

The risk is will it develop or will it sort of degenerate into sort of a bigger more heavy layer of civil war okay, so this is the question on which it is difficult to have, political risk is too high which means the risk of taking appropriate in those funds for military purposes is high therefore there should be more stringent clauses, excellent can you tell us a little bit about what you would like, what could be a more stringent clause that you might want to put it?

Okay so the money that is coming in right, so I am repeating this by the way also because it is being recorded and the point that Harsh is making is that therefore the safeguard is that the money that comes in there must be some mechanism by which it is used for the development of the country right. Now for those of you who voted in favor of the project does such a safeguard

exist right, so again Shravya presented there was something called a revenue management plan that came in which seems to do exactly what Harsh is talking about right.

It says okay you know you get your revenue here is a management plan and it can be and I think Shravi you even had some data no? 85 percent in this, etc. you had some data that is in the case, Harsh or anyone from the let us not invest in this project group, have they not answered your question? There is no regulatory body Partik says that makes sure that those things are happening right do the rest of you agree?

Well there is the World Bank but is there a regulatory mechanism, is there an oversight mechanism or not? There was a committee formed right tell us a little bit Jaykishan about that committee, so essentially there was a committee formed to oversee this project nine member committee right, what was the problem with that committee those who do not want the project to go forward?

So majority was from the government and therefore you know seven out of nine were from the government right and therefore you know what is the sanctity that they will actually act in the best interest of the overall nation, they will act in the best interest of the government, the best interest of the government at that time is possibly investing in weaponry to stabilize their situation okay and therefore yes there is a revenue management plan, it does have a governance mechanism right but the question is that governance mechanism the right kind of governance mechanism okay.

Is it a biased governance mechanism okay, any other objections for the group that said, what about the quality of the revenue management plan itself right what do you guys think of the quality of the new management plan, so if the plan mentions that you know here are certain categories of expenditure but it does not go a step further and try to allocate the revenue among those categories and therefore what could conceivably happen is that I would say okay you know I will figure out and I would not invest in weapons but you know what I am going to invest all of that money into roads through which my tanks can go through the countryside right and not invest a single paisa on water, on health, on security and that is perfectly permissible under the plan right because I am allowed to invest in basic infrastructure that is what I am doing right.

There are no caps, there are no limits it does not say 20 percent needs to go here, 40 percent needs to go there, it essentially says, what is it 85 percent right and goes into this larger in fact if I have that in the background, so it has a certain percentage of money, I mean does not have a certain percentage it will go to seat sector so I can take all of it and lump it into roads right and that may not necessarily lead to the development of the country either right.

So essentially the case against the project right is that it is not politically stable as Harsh pointed out right there have been attempts to ensure and therefore they need to be more safeguards to make sure that the money that is generated from the project is put to the best use of the country, they have created a revenue management plan, they have created an oversight structure but neither the revenue management plan, neither is the revenue management plan specific enough nor is the (())(14:52) oversight structure unbiased enough okay.

But now since most of you said you would like the project to go through what is your response, what do you have to say okay so what the Yamini says is look even if they use some amount of money for weaponry there will be some money that is being used for you know infrastructure development, social development, etc. so at least something will happen right the weaponry is a in some ways you could argue that buying weapons is a given right you know worst case if you do not do this project they will go to Sudan and get the get the money from that right I think there is a reference to that in the article as well.


So you might as well give them some revenue or hope that at least some of it goes into basic development you are going to be better off than you would otherwise be fine fair argument what else? Right, so essentially it comes out of saying Jaikishan's point is essentially look how else is this country going to develop right there is no other sort of mechanism like we said they do not have any other kinds of natural resources, they do not have large agricultural produce, they do not have human resources that can make them the center of say IT or whatever and you know deliver services to the world, where are they going to develop right, this is the only way that they will develop and if you continue to always look at you know the dark side of things and not invest in this country it will never develop right.

And therefore there is the necessity to develop and you have got some pretty big players out there right you have got the World Bank right so if somebody needs to keep these guys in line

who better than the world back right, Exxon at the end of the day is a global leader in sort of this industry right so it is you know they, you can depend on them to do a high-quality project, make sure that the maximum amount of oil is extracted, your costs are low, your profitability is high.


So you have put together the best players possible okay so let us take a chance right because otherwise there is no point sort of living continuing to live like you are living in Chad, there is a chance to make things better take that chance and let us try to see if we can govern the project going forward right so these are the two essential arguments okay.

(Refer Slide Time: 16:41)



How is the project funded?

- Field system?
 - Corporate Finance
 - EM's outlay = \$ 608 M
- Export System?
 - Project Finance
 - EM's outlay = \$ 321M
- Total Outlay = \$929 M




So quick analysis on funding the project because I think this is important to understand there is a field system right which is actually funded through what we call corporate finance, what does that mean, what do we mean when say the field system is funded through corporate finance, so essentially who is borrowing the money right Exxon itself is borrowing the money okay so corporate finance is Exxon is taking a loan and putting it into this project okay.

And they have their own outlay of according to the case 608 million, the export system right is actually being faster is funded through the project financier right the special purpose vehicle is created this is what we have talked about right, special purpose vehicles created the special purpose vehicle borrows okay, here Exxon Mobil's outlays 321 so totally they have a 929 million dollar outlay on the project okay.

Why not do both through corporate finance or why not do both through project finance, why do one through corporate finance, why do one through project finance, what are the advantages of corporate versus project finance yeah, okay so the field system is localized they can probably control it and therefore and the export system is going to go through Chad and Cameroon so absolutely agree so therefore the export system is project financed so the risk is shared.


But why not do the same thing for the field system, so in case of project finance the profit cannot be diverted to the parent company right and therefore you do, so essentially we have got to understand what the advantages of corporate and project finance are right so clearly one of the advantages in a you know corporate finance system all the profits go back to the parent entity quite directly even in project finance it will go back indirectly right because ultimately it is your, you are putting equity into this joint venture. So any joint venture can declare dividends that come back to you right so the money will come up.

(Refer Slide Time: 18:27)



Financing options for EM

Strategy	Field System	Export System	Total outlay
Pure Corporate Finance	\$ 608M <i>Speed</i>	\$881M	\$1489M
Full Project Finance	\$243M <i>Slow</i>	\$321M <i>Spreading Risk</i>	\$564M
Actual Strategy	\$608M <i>Speed</i>	\$321M <i>Risk Spreading</i>	\$929 M



So the charge, the thing is if you look at the data, if they are done pure corporate finance right which is this with them pure corporate finance, the advantage of pure corporate finance is speed right what kind of a credit rating does Exxon Mobil have, triple-A, they have a triple-A credit rating which means they are highly credit worthy right what does that observe these rating agencies that give you essentially a rating which tells you how likely are you to repay money that you borrow right.

Triple-A is one of the highest ratings right so essentially it says look these guys have wonderful balance sheets etc they have a wonderful past record you can almost safely lend the money right so people will be willing to lend these guys money relatively quickly at short interest rates because at lower interest rates because I am not really worried about the risk even if this project goes bad I know number one these guys will take all the necessary technical considerations to prevent that and secondly even if something happens they have got deep enough pockets to be able to repay my loan right.

So I can do speed right but if I do corporate finance right their outlay is actually quite high okay the advantage with project finance the project finance is much slower okay but what you are doing is you are spreading risk right, you are only a special purpose vehicle now you are not taking the entire risk on the project, your money is no longer as much at stake right if the project goes bad people do not come back to you right they could only come back to the special purpose (())(19:49) right and you need the risk to be taken by other people as ExxonMobil I am an expert in oil exploration, extraction, may be refining all of that.

I am not an expert in managing in the social development and political development and civil wars and all of that so I need other people right so I can go to the World Bank and say let us do a joint venture right but the World Bank will say what do you I do not do joint ventures right I am a lending institute okay so how do you get other people on board, you get them on board by creating a special purpose vehicle funding through project finance because now the world bank understands that if the project goes bad they are not going to get anything back, they cannot go back to Exxon Mobil's balance sheets.

So they better get their hands dirty and ensure that the project goes well right so it is a risk spreading strategy right so essentially what you want to do is you want to go for speed and you want to go for risk spreading right and so you have this kind of a strategy right so the way you finance it also needs to be thought through right because these guys realized there is a political risk they financed it in a certain manner okay.

(Refer Slide Time: 20:53)



Financing choices

- What are the advantages of Project Finance in this case?
 - Risk sharing
 - Risk mitigation of political risks due to involvement of host governments, WB, IFC
- Advantages of Corporate Finance?
 - Lesser Transaction Costs due to AAA rating
- **Sponsors are trying to blend both!!**



So financing so what are the advantages risk sharing, risk mitigation of political risks, the advantages of corporate finance less transaction cost which means it is faster, less paperwork, etc. because they were triple-A rating right so these guys are trying to blend both okay all right.

(Refer Slide Time: 21:07)



What is the World Bank's Role

- Project Appraisal
- Ensuring economic development of Chad
 - Revenue Management Plan and Capacity Building
- Financing the project
 - Thereby infusing confidence in other investors



So what is the world bank's role in this project, what are the various things you want the World Bank to do if you are an Exxon Mobil okay what is the simplest thing you want the World Bank to do first? First give you money okay then what else right and also support with political stability right you want them to interface with the government, negotiate with them perhaps even

threaten them ensure that they stay in line so that you are not particularly care you know I mean you are not particularly concerned as Exxon Mobil about where that revenue gets used right.

Remember Exxon Mobil does not concern itself is whether that money is used for military purposes or for non-military purposes, you are worried if it is used for military purposes is will my pipeline get blown up right so you want to make sure that the project sort of goes in a you know sort of goes through and you get your return expectations and all of that you want but the World Bank itself says look I want to really appraise the project and the World Bank wants to ensure economic development of Chad.

So Exxon wants World Bank to safeguard the project, World Bank is only interested because it feels that this is a chance for Chad and Cameroon to grow right so they are very keen about revenue management, capacity building all of that right and one of the reasons they are also financing is because they also realize if they come on board, other investors might come on board right so because you say okay the world bank is involved there are strong player in this area, they can negotiate directly with governments, now I have a little bit more security in putting my money along with this right.

Because remember the World Bank is not the only lender right, there are number of other lenders that they are looking at, if the World Bank leads a round of investment others will fall right and again you diverse your risk, diversify your risk even more okay so this is sort of what is expected out of the World Bank mitigating political risks which is what you guys talked about okay.

(Refer Slide Time: 22:53)

How fair is the project?



- Downside Risks
 - Exhibit 5 - Chad and Cameroon do not seem to have much downside risk
 - Project sponsors have some downside but also a potentially large upside
- ROI
 - Chad and Cameroon invest virtually nothing
 - NPV is \$463M in the median case for Chad
 - Could have been higher, but they have no money to invest and so have to depend on private sponsors.



Now let us look at the way the project is structured right what's the project structured in a fair manner was, were Chad, Cameroon or Exxon benefiting unfairly as a result of the project what is your opinion, do you think that they were benefiting unfairly or do you think it was fair, okay how do you tell whether it is fair or not how do you even answer my question, what will you look at?

Right, so you look at the risks and the benefits they are getting so for instance you look at what happens if there is an upside, what happens if you have a downside right so if there is more oil than required what happens, if there is less oil than required I mean than expect it what happens okay all right so downside risk when you look at downside risks and you look at there is one exhibit 5 right it tells you that Chad and Cameroon do not really seem to bear much of the downside risk which means they are promised a certain amount of money right and that is the deal right.

Exxon Mobil will come in, they will extract the oil they will take it they will sell it right but what does the country get? The country gets some amount of money right and the amount of money that they get paid does not really I mean there is sort of a minimum that does not really get affected even if the oil reserves and the oil prices dip below certain levels right so they do not really bear the downside risks right.

The project sponsors bears some of the downside risks but they also have a potentially large upset right if there is more oil than you expected at the price per barrel you know goes up the upside that they have is it's quite large so there is a risk and reward for them yes there is a bit of a downside but there is a bit of an upside and the good thing is either way Chad and Cameroon are likely to benefit right which is what you want, I mean the project is for development, you do not want a situation where you do all of this and finally Chad on Cameroon are stuck with nothing okay.

So in that sense it seems relatively fair, Chad and Cameroon invest virtually nothing the so look at the return on investment, it is infinity right or close to infinity right, you are getting essentially free money somebody is saying sit back I will develop the system for you and I will give you money in your pocket and even if there is not enough oil or the prices plummet I will still give you a reasonable amount of money right, could be okay so there is a net present value so Chad tends to would you know tends to get something of the order of 463 million if you do the discounted cash flow calculations.

And again I mean you can argue that maybe more money should go to Chad and Cameroon but they are not putting in any money right no investment so the risk is being taken by Exxon right and therefore you cannot expect a lot of reward to Chad, so from this perspective do you think the project is fair? Yeah, looks fair to me right, it looks fair, there is nothing sort of unfair you know nobody seems to be gaining unfairly, yes Exxon could make a killing but they are also bearing the downside risks right so all of that seems fine.

(Refer Slide Time: 25:27)



Project Risks

- Construction Risks?
 - Low
- Operations Risks
 - Low
- Economic/Financial Risks
 - Low/medium
- Social/Environmental Risks
 - Medium/high
- Sovereign/Political Risks
 - Medium/High



Projects fair okay let us look at the project risks, does the project have high construction risks, yeah think they have high Construction risks, why do you think they have high construction risks, what is your logic so correct yeah but from a let us just look it from a look at it from a technology perspective, are there technological risks okay maybe that is a better way of putting this, technological risks are relatively low because these are projects that people have done time and time again and you have got one of the best in the business right, ExxonMobil knows what they are doing right.

So this is probably a relatively low, there is always a risk right but it is a relatively low risk operating the pipeline, okay in what way do you think that risk is high, so those are yes you always have a risk of leakage, etc. but how high is that risk in this case? So there is the risk right how high is the risk in this case right again you might think I mean I would say low, you guys can sort of say moderate whatever but again I feel Exxon Mobil is the expert here right.

They probably know exactly how to build it to prevent as many leaks as possible, they probably know how to fix these leaks better than anyone else in other words there are always risks right, I mean there always be a risk of an earthquake coming in and damaging the pipeline you can do nothing about that okay but when you look at manageable risks in terms of constructions and operations because they have got a really good player on board right you would expect that this is going to be constructed and operated to good quality okay.


Maintenance is always a problem right so see if there is always a challenge to any of these activities right even drilling underground is not necessarily the safest whatever activity the question is what is the risk of deviates and you already obviously have made some assumptions and prohibitions because of maintenance you have already put in a maintenance budget right all of that, the risk refers to what is the likelihood that you could end up with a scenario that is way outside what you have already predicted.

So obviously construction I have also put in some costs right and some safety costs and all of that so this is over and beyond all of this right this is how we look at the risk so one would expect that yes there are costs but the risks are probably going to be well managed I do not expect the pipeline to fail technically because I have got a really good operator that is not the risk I am worried about, what about economic risks, economic risks in this case relate to what?

Relate to people buying the oil okay again you would think that you know it's low or low to medium I mean there is always price fluctuations in the market but we are still an oil guzzling international economy right so there is no question of oh I have produced oil and I do not know where to sell it right so economically this is again, so it is unlikely that your finances would not really work out, socially, environmentally what would you say the risks are?


Right so here is where you know there are lots of environmental groups, social groups, etc. that could create quite a bit of problem it could be medium, it could be high, but it is certainly that end of the spectrum, sovereign or political risks right could be very high here right, so these are the keys so these are the key risks that we really want to mitigate right.

(Refer Slide Time: 28:19)



Why should the WB endorse and fund the project?


- Chad desperately needs development
 - Most of the population living on less than \$1
 - Resource starved government
 - High infant mortality etc
- Apart from oil, Chad has few development alternatives
- Project is commercially viable
- Project structure is reasonably fair



So what are they doing to mitigate this risk why should the World Bank endorse and fund this project we have talked about this so I will just go through this, Chad is desperately poor, most of the population living on less than one dollar, resource starved government, high infant mortality, they need the money, there is no other development alternative and the project is fair and viable right so that is another kicker.


We are not developing it because you know despite knowing that it is a bad project we know, we think that this is a good project right and the project structure is reasonably fair right.

(Refer Slide Time: 28:46)



More reasons

- Social and Environmental Risks are addressed
 - 19 volume document
 - Several consultative meetings
- Capacity building plan by the WB
- RMP - future lending is tied to this
- Deby has shown signs of reform



And when we looked at those two risks the social risks right how would they address the social environmental risks right what do they do right so they did not extensive (())(28:55) stakeholder engagement right how much do they do, there is there some sort of data given in the case right how much so 195 NGOs, N number of consultations then they brought out a 19 volume document which almost guarantees that it will not be read right so and you know several consultative meetings etcetera so yes and they did take some action right like you pointed out Shravi on your presentation as the result of this they said initially the pipeline is going through some ecologically sensitive areas and then diverted the pipeline right.

Maybe it added a little bit of cost on to the project right because it maybe it became a little bit longer but they did that okay, so they really took some pains to minimize these ecological risks, these social risks, etc. right and then for you know and they have this capacity-building plan that the World Bank put together, they had the revenue management plan which was again looking at mitigating some of the political risks say you cannot use the revenue for guns, you have to use it for development and interest Deby be the dictator seem to be showing signs of reform right, seemed to be sort of saying look I mean I am initially a dictator just because I have got to bring some order to the country but once that happens maybe democracy is the way to go, every dictator says that by the way okay.

(Reform Slide Time: 30:07)



Reasons not to invest - Players

- Exxon
 - Exxon Valdez oil spill + President's Speech; How environmentally committed are they?
- WB
 - What kind of a track record do they have?
- Chad
 - Despotic ruler, misuse of funds and expropriation risks, very risky investment destination
- Cameroon
 - Several political risks here also



So that, so it seems like there is a reason to invest for all of these reasons but when you look at it of the other side of the coin as some of you talked about against Shrivya likely pointed out yes we keep saying Exxon, Exxon, what is their track record really right we are all familiar with the Exxon Valdez oil spill and you know these images today of all kinds of aquatic and bird life that people dragged out from the water just completely swamped in oil and all of that.

So how environmentally committed are they right yeah they say all of these things but you know will they really take the interests of Chad and Cameroon at heart right, what kind of track record does the World Bank have and this has been questioned right there is a part of the case which says look have you always funded the most responsible projects, you know have not you funded a number of other pipelines that have not led to any real economic development in those countries right, somebody even says show me one project in Africa where this has worked right, so there is that sort of concern it's not as if the World Bank is a saint and as soon as your World Bank touches your project you are absorbed okay.

We know all about Chad despotic ruler, misuse of funds, expropriate, very risky investment destination right definitely do not take your next vacation in Chad okay and Cameroon, same thing right to a slightly lesser order okay.

(Refer Slide Time: 31:22)



More Reasons - problems with the RMP

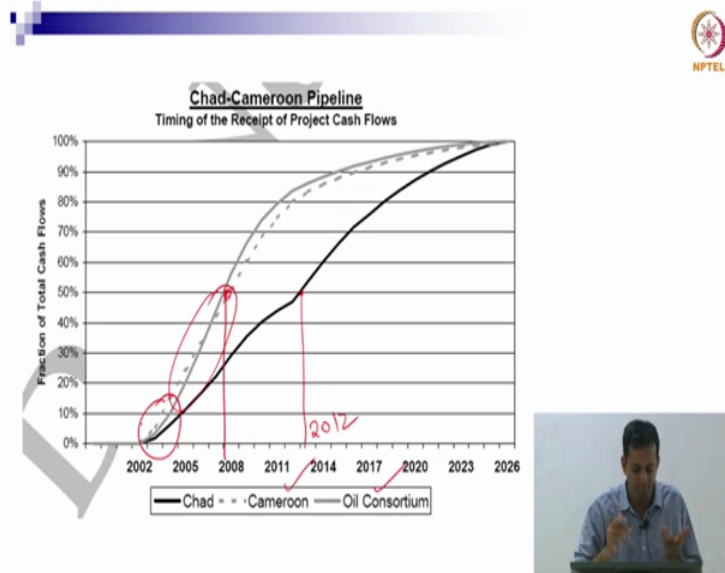
- Lacks specificity on how the money will be spent, how much in each sector, region etc
- Oversight committee has a majority of government members
 - Potential biases?
- Enforcement mechanisms
 - These are poorly defined
- Invasion of sovereign rights



So right and we have talked about the problems with the RMP lack specificity on how the money will be sent, how much restructure, etc. Oversight Committee we know seven of them are government, is that biased, the enforcement mechanisms (31:34) right so what happens if I do not implement the revenue management plan what happens right, what is the enforcement mechanism okay it is very unclear right what the enforcement mechanism.

So I can always agree right to anything that you are saying right like you guys always agree that you will do the readings in ahead of the class right but what is the guarantee right that you can do it okay and will people if I start enforcing will people actually say that is an invasion of sovereign rights right, will they say look I am Chad this is my money right, I have a government elected in whatsoever manner should not I be concerned with my business right, who do you is living in India or China or the US or whatever what right do you have to tell me how to live my life right, how different is this from you know bombing Afghanistan for or Iraq or whatever it is right for feeling that you know they do not align with your principles, so that is another sort of argument is it an invasion of sovereign rights okay.

(Refer Slide Time: 32:32)




You look at this graph you know it is a little bit interesting it tells you that Chad's, this is actually quite interesting because it says the cash flows right, this is a percentage of cash flows from zero to hundred and who gets what okay, Chad as you can see has the least steep of all the curves, what does that mean that means of all the money that is going to people right Chad gets its money the latest or the slowest whichever way you want to think about it right, so these guys here which is essentially Cameroon and the oil consortium and get their money fast so by 2008 these guys are at 50 percent of whatever is promised to them is already there right whereas for Chad to hit the 50 percent you are really looking at 2012 okay.

So this is interesting because what does this tell you so that is one thing right it gets his money slower so it may know it may not be able to kick Exxon Mobil out, it is also getting its money later which means it's incentive to use money to sort of buy arms reduces because let us say I get my first tranche of money somewhere here and I start buying guns right away you know project might just stop right so you have more incentive to behave well because your returns are coming later on in the project all right.

If I had front loaded your returns you might have had more intent to say I have got my money now let me do whatever I want right so again when you look at the finances it seems quite well thought-out right see the people have said okay to keep Chad in check, let us sort of give them


small amounts of money over a period of time as opposed to give you a really good deal upfront right so seems interesting okay.

(Refer Slide Time: 34:07)




Other Reasons

- Chad's returns occur later on in the project
- Some commercial risks
- There is a potential for large economic and social risks to actually occur
- Why did Shell and Elf exit? Do they know something we don't?




So Chad's returns occur later in the project right there are some commercial risks, there is a potential for large economic and social growth to occur but here is the thing why did you know the case talks about Shell which is another big oil company and Elf and they sort of analyze this project and they exit it right and that is always something to think about right, why do they do that right do they know something that we do not know right because they are just as good I mean what is the difference between Shell and Exxon right they are both equally popular you know whatever or unpopular large you know oil companies okay one exited why not okay.

(Refer Slide Time: 34:41)



What happened next?


- The WB approves the Project
- Chevron and Petronas pays Chad \$25M as agreed
- Deby spends \$4.5M on Military expenditures
- What will you do now?
 - Go as planned
 - Amend the agreements
 - Scrap the project



So to fund or not to fund right therein lies the question, so you can see there is arguments on both sides right essentially politically and in case I know some of you might have googled to see what happened but essentially what happened is the World Bank said you know what we are going to go with the majority in this class right so you guys want us to fund the project will fund the project right we think it is the right thing to do right we think the project is fair, it is structured well, it will benefit the people of Chad, we have got safeguards in place and we will sort of strong-arm the government all of this exactly right so we will go approve the project.

So Chevron so if you remember there was sort of an initial 25 million dollar payment that was supposed to go to Chad upfront this was actually paid to Chad and immediately 4.5 million was spent on military expenditures right so everyone said what! right and they'd be pointed out that hang on these are not project revenues, the revenue management plan only talks about project revenues right this 25 million is out of that okay so I am not doing anything wrong so people looked at it and said okay maybe he is got a point and anyway it is only 4.5 million out of 25 million right so fine let us go ahead right so but what would you do go ahead as planned okay all right anyways.

(Refer Slide Time: 35:53)




What happened after that?

- WB dismisses Deby's action as an anomaly
- Institutes an International Advisory group headed by prime minister of Senegal to monitor the project and the RMP
- Deby re-elected in 2001, amidst political controversy




But the World Bank essentially said there are that is an anomaly okay let us go ahead with the project okay so they had an institutional Advisory Group so this was their response to that whole revenue management plan monitoring committee has seven people from the government except they said let us change that okay let us have an International Advisory Group headed by the Prime Minister of Senegal, so let us get out this government bias, let us get a better revenue management plan monitoring group and things will be better right, Deby gets reelected so the project goes ahead.

(Refer Slide Time: 36:22)



..the conclusion

- In late 2005 Chad modifies its Petroleum Revenue Management Law
 - Funds can be directed towards security (war) and away from poverty alleviation
- In January 2006 the WB stops assistance to Chad
- In June 2006, WB and Chad govt sign an MOU pledging 70% of revenues for poverty alleviation!



Deby gets reelected late 2005, Chad modified its petroleum revenue management law and the revenue management law now said funds that come through these projects can be directed through security right, in brackets that means towards war and away from poverty alleviation right so the World Bank said look this is ridiculous right this goes against the grain and this is where the sovereign function sort of came in where Chad said look it is my Constitution right I feel this is the best interest of the Constitution therefore I am changing the constitution right.

So 26 the Chad and World Bank signed an agreement etc. pledging 70 percent of revenues for poverty alleviation after that but in January 2006 the World Bank did have to stop assistance so you can see sort of a stop-start curve.

(Refer Slide Time: 37:08)



And then people wrote articles like this here is your chance to invest in corrupt governments and get high-yield rainforest destruction at no extra cost essentially saying look these are the kinds of projects you should not invest okay but anyway so essentially there is a political risk here right and the whole case hinges around how am I managing that political risk right, one I bring the World Bank in that sort of one lever right another lever is I put in a revenue management plan and I actually have some governance mechanism surrounding it but nothing in this world is it is so easy or so perfect right so just because the World Bank comes in your problems are not solved, just because you have a revenue management plan your problems are not solved, you can never really walk away from the fact that there will be that temptation of using money to for

further military needs and you know taking it away from social infrastructure needs and therefore the question is what can you do about alright.

So we will talk a little bit towards the end of the class about how we manage some of these political risks right but this is a case of political risk world bank went ahead and funded it some of those risks came back to bite them and there is a little bit of a dance going on okay, so now let us have group 11 talk about the second project which is the Dabhol project which has political risks of a slightly different kind.