REFINITIV EXPERT TALK

DRILLING DOWN: OIL AND GAS SUPPLY CHAIN RISKS REVEALED

By Renata Galvao

The oil and gas sector operates in a global supply chain formed by a complex web of international relationships. Suppliers and service providers are sometimes located in jurisdictions characterized by political instability, high levels of corruption and environmental crime. Consequently, organizations must always remain cognizant of heightened risk when entering specific markets and establishing relationships in new territories.

Despite that, Refinitiv research[1] shows that 57% of companies working in the energy sector felt that third-party business decisions often disregard important risks. As companies from the oil and gas sector are among the industries who have received the most significant fines, due diligence and compliance management are essential to the successful navigation of increasing regulation, environmental concerns and ethical business practices.

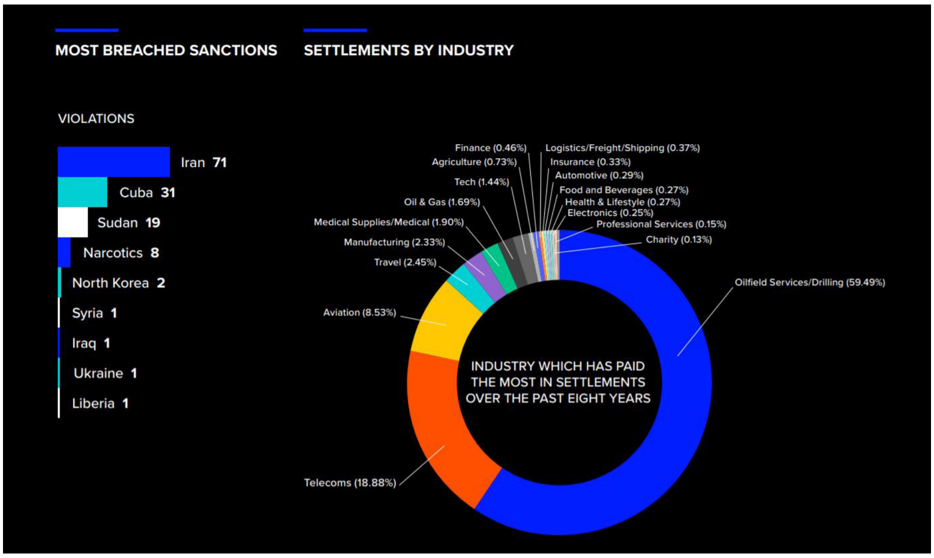
Key business decisions include the need to consider the potential hidden risks behind the operational context. Depending on the company's position within the oil and gas supply chain, financial crime, sanction orders and environmental crime could leave the organization exposed to enforcement actions and reputational damage.

Upstream industry

The exploration and production of crude oil and natural gas are arguably the most complex activities of the sector. Not only is the upstream industry highly regulated, but it also operates in a dynamic and somewhat unpredictable ecosystem.

Refinitiv research into fines imposed on institutions for breaching U.S. Office of Foreign Assets Control (OFAC) sanctions from 2011-2019 has revealed that the Oilfield Services/Drilling industry has paid by far the most in settlements over this period: a massive 59.49% of the total.

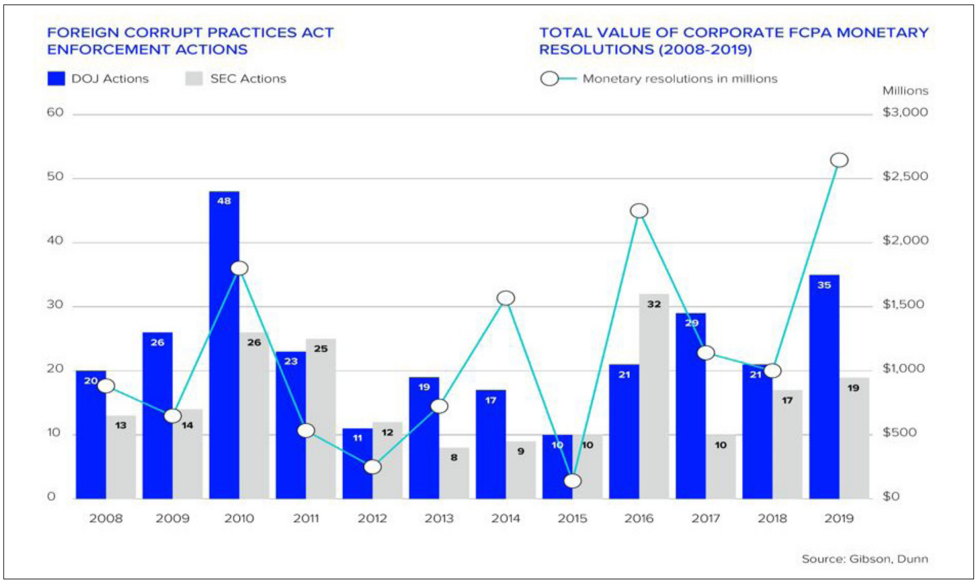
1 refinitiv.com/perspectives/regulation-risk-compliance/risk-survey-exposes-supplier-third-party-failures/



Fines across the non-banking sector for U.S. OFAC sanction breaches 2011-2019.

According to the U.S. Energy Information Administration (EIA), oil supply disruptions can have a large and immediate effect on crude oil prices[2], which exposes companies to financial instability. Such disruptions are normally related to sociopolitical volatility, natural disasters and sanction orders.

This is because oil-rich territories are usually situated in jurisdictions characterized by political uncertainty or even taken by active armed conflict. This exposes organizations to high risks of bribery and corruption, especially in the context of a global operation which relies on third-party consultants and service providers.



The Brazilian Car Wash investigation uncovered exactly that: kickbacks allegedly paid in return for contracts at the state-run oil company. The bribery scheme, one of the biggest ever registered in Latin America, resulted in the second-largest fine imposed by the U.S. Foreign Corrupt Practices Act (FCPA): US$1.78 billion against Petroleo Brasileiro S.A.

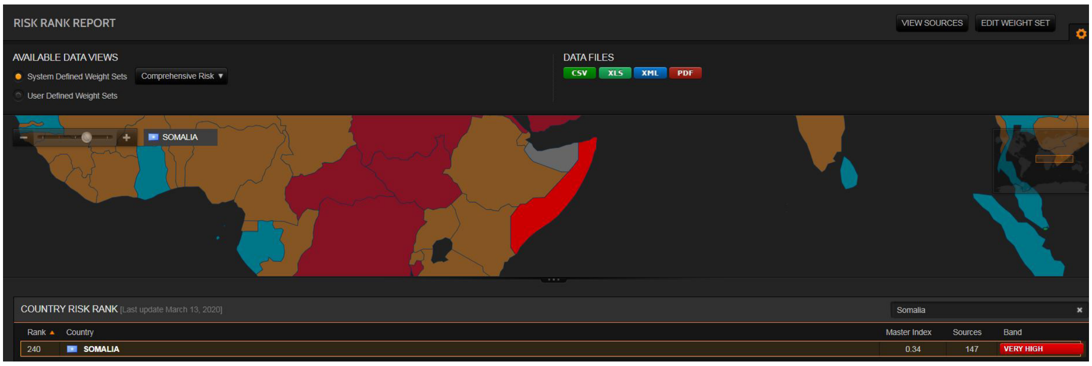
2 eia.gov/todayinenergy/detail.php?id=42675

The Car Wash case is an illustration of an ongoing risk when it comes to this industry and a growing concern with corrupt practices. Regulated countries with big oil reserves tend to operate via contractual agreements with the government, as the foreign or private ownership of natural resources are usually not constitutionally permitted. In the context of local geopolitical instabilities, business relationships could be disrupted and exposed to different levels of financial crime.

Unregulated territories are also vulnerable to hidden risks, specifically related to terrorism financing and engagement with armed rebel groups. Somalia, for example, is a resource-rich territory with a big potential in the oil industry[3]. Security issues, degraded infrastructure and the lack of legal and governance frameworks impede its development.

However, the absence of regulation has made the exploitation of different types of natural resources, including crude oil, an attractive business for criminal groups. Key actors operating in this space include terrorist groups, clan militias and transnational corporations, knowingly or unknowingly.

The exploitation of oil has been utilized as a mode of conflict financing in several territories. In fact, oil interests are possibly behind the growing hostilities between the Federal Government of Somalia and other Federal Member States[4]. The unregulated nature of such context also provides for further environmental concerns.



Location risk rating report for Somalia from Refinitiv Country Risk Ranking.

There is a huge focus on environmental policies in the regulated upstream industry. The 2010 Deepwater Horizon oil spill caused devastating environmental effects that trigged more stringent offshore drilling policies around the globe. In total, the organization paid an estimated US$1.7 billion in claims and penalties for the 2010 disaster[5].

Midstream industry

Oil spills and overall concerns of environmental impact are also a reality for transporting services. Via railroad, truck, pipeline or vessel, any material loss could lead to financial downtime, regulatory fines or even reputational risks. Midstream companies are subjected to different environmental regulations due to possible explosions and leaks.

The U.S. Act to Prevent Pollution from Ships (APPS), for instance, provides authorities the ability to bring criminal charges against vessel owners, operators and crew members. Punishment can vary to up to six years imprisonment and a fine of about US$500,000 for an entity[6].

Located in the middle of the supply chain, this industry is exposed to both supplier and customer risk. Any irregularities in either the extraction company or the purchaser of crude oil could leave the transporting service vulnerable to fines and even sanctions.

3 IMF Country Report No. 19/256
4 UNSC S/2013/413
5 reuters.com/article/us-bp-deepwaterhorizon/bp-deepwater-horizon-costs-balloon-to-65-billion-idUSKBN1F50NL
6 unodc.org/documents/organized-crime/GPTOC/Issue_Paper_-_TOC_at_Sea.pdf

In 2019, the U.S. Department of the Treasury's Office of Foreign Assets Control (OFAC) issued a global advisory alert for parties involved in the shipment of petroleum and petroleum products from Iran. In 2018, OFAC sanctioned individuals and entities from several jurisdictions involved in the shipment of Iranian oil to Syria, which directly financed U.S. Treasury designated terrorist groups.

On the other hand, upstream and downstream corporations are equally susceptible to risks coming from the midstream industry. This is due to a heavy reliance on third-party on-the-ground operations. Verifying the beneficial ownership of vessels becomes essential to mitigate growing risks of migrant smuggling at sea[7].

Downstream Industry

Reliance on suppliers and service providers from different areas of the globe exposes refineries to third-party risks from both the upstream and midstream industry. Sanctions management, contraband concerns and environmental regulations are all aspects of a risk-based approach to the business of refining oil.

Understanding the source of the crude oil and the legitimacy of the product are pressing issues for the sector. In February 2020, the U.S. Department of Justice uncovered a scheme to sell sanctioned Iranian oil to a refinery[8]. Oil theft is also a growing concern. In Nigeria, thieves tap pipelines in the oil-rich Niger Delta region, which is then pumped into oil tankers for export. In a ratio as small as 10%, the stolen oil is mixed with the legitimate product and exported mainly to Asia[9].

Contraband and theft are also a reality for refined oil products. A study conducted in 2017 showed that hydrocarbons fraud cost the European Union (EU) €4 billion in lost revenues in 2012 alone. In Nigeria, 30% of all oil products are smuggled into neighboring countries. It is estimated that more than 650,000 cars in Morocco and Tunisia run on fuel smuggled from Algeria[10].

International intelligence and security cooperation are essential to tackling this issue. Maritime and cybersecurity have also been appointed as protective measures against theft and contraband. In 2019, the Nigerian Department of Petroleum Resources (DPR) started investing in satellite tech to track oil smugglers in hopes of putting an end to the criminal activity that has cost the country billions[11].

In addition to security risks, downstream companies also face increasing environmental controls due to the air pollutant emissions from the refinery processes. National regulations usually limit the amount of pollution that the refineries are allowed to emit.

Since March 2000, the U.S. Environmental Protection Agency (EPA) has entered into settlements with over 100 refineries that cover 95% of the country's petroleum capacity. The companies have agreed to invest more than US$7 billion in control technologies and pay fines of more than US$116 million. The settlements will result in a significant reduction of nitrogen oxide, sulphur dioxide and benzene emissions on an annual basis[12].

7 unodc.org/documents/organized-crime/GPTOC/Issue_Paper_-_TOC_at_Sea.pdf
8 justice.gov/opa/pr/four-texans-one-new-yorker-arrested-conspiracy-sell-sanctioned-iranian-oil-refinery-china
9 reuters.com/article/us-nigeria-oil-theft/nigeria-deploys-satellite-tech-to-track-oil-smugglers-idUSKCN1S61KG
10 atlanticcouncil.org/wp-content/uploads/2017/01/Downstream_Oil_Theft_web_0327.pdf
11 reuters.com/article/us-nigeria-oil-theft/nigeria-deploys-satellite-tech-to-track-oil-smugglers-idUSKCN1S61KG
12 epa.gov/enforcement/petroleum-refinery-national-case-results

How Refinitiv can help address risks in the oil and gas sector

The World-Check® Risk Intelligence database delivers accurate and reliable information to help you make informed decisions. It has hundreds of specialist researchers and analysts across the globe, adhering to the most stringent research guidelines as they collate information from reliable and reputable sources – such as watch lists, government records and media searches

World-Check One is an essential screening platform, created to support your due diligence needs in the fight against financial crime, bribery and corruption. Streamline your screening processes with powerful customization and control, and a range of time-saving features for single users or large teams. Our unified World-Check One platform helps to make remediation simpler and more intelligent.

Identify relevant media content with Media Check, our opt-in feature, which uses intelligent searching, a unique taxonomy and machine-learning algorithms. Also available via our API.

Optimize your workflow with UBO Check through a two-step process – first identifying the beneficial ownership of entities and then screening them all on a single platform.

The opt-in feature Vessel Check allows you to reveal any potential risks related to sanctioned or embargoed vessels by screening against IHS Maritime and World-Check data.

Enhanced Due Diligence reports gives detailed integrity and advanced background checks on any entity or individual – wherever their location, helping you to comply with your regulatory requirements and safeguard your reputation through a detailed review of new and existing customers and third parties.

About the author

Renata Galvao is currently the Research Manager for the Africa Region at Refinitiv World-Check and was recently appointed as the Manager of Content Specialists. Originally from Brazil, she has a background in journalism and previously worked as an international correspondent in Africa. She has had several investigative stories published focusing on the issue of slavery and the refugee crisis in Africa. Renata is a certified Anti-money laundering specialist (ACAMS) and is currently studying a Postgrad in Law specializing in Criminology at the University of Cape Town (UCT).

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