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Managing Localisation Programs - Is it time for a Chief Localisation Officer?

LEGAL BRIEFING (13 Dec 2018)

*Petroleum Development Oman ("**PDO**"), the Abu Dhabi National Oil Company ("**ADNOC**") and Saudi Aramco have implemented localisation programs (PDO and ADNOC: In Country Value or "**ICV**" and Saudi Aramco: In-Kingdom Total Value Add Program or "**IKTVA**"). ICV and IKTVA require that suppliers will familiarize themselves with its conditions and commercial, legal and tax related effects. This legal briefing gives an overview of the compliance related aspects of such localisation programs and whether it is necessary to implement a Chief Localisation Officer (CLO).*

1. *What do localisation programs require?*

The national oil companies ("**NOC**") of Oman, the Emirate of Abu Dhabi and the Kingdom of Saudi Arabia have all launched localisation programs:

- Petroleum Development Oman's "*In Country Value*" (ICV) in 2012;
- Saudi Aramco "*In-Kingdom Total Value Add*" (IKTVA) in 2015; and
- ADNOC's "*In Country Value*" (ICV) in 2018.

These localisation programs focus on

- Local supplier selection;
- Development of nationals; and
- Localisation of critical functionalities in the oil and gas industry.

2. *Why should one consider deploying human resources for managing localisation programs?*

Localisation programs undergo constant changes as can be seen when looking at ADNOC's ICV program. Having started off in April 2018, significant changes have been adopted taking effect on 1 November 2018. These changes have made it necessary for companies to re-assess their respective ICV score, renew their ICV certificate and submit an ICV Improvement Plan.

Since there is no mutual recognition of the various localisation programs, investors need to understand the effects of the different calculation methods in each country. In addition, corporations with various group companies face the challenge that there is no consolidated score for group companies, making it necessary to actively structure business in a way to have the best possible localisation score for the respective corporate vehicle. Restructuring measures may, however, also have tax consequences, as intercompany related transactions are generally subjected to the arm's length principle. In corporate income tax jurisdictions such as KSA and Oman the cost-plus method would generally need to be applied, which in turn can have an impact on the pricing level.

While NOCs typically release information on the localisation programs, not all relevant details may be publicly available. Experience shows that NOCs will hold workshops and conferences on these topics in which detailed information is passed on to the suppliers. Not engaging in such events and monitoring changes can lead to loss of business opportunities with the NOCs.

Finally, other processes within a company, in particular mergers & acquisitions, may have an impact on the respective entity's localisation score. While a transaction may make sense from a purely commercial perspective (e.g. adding a certain service to the portfolio), such a transaction may not be beneficial from a localisation point of view.

3. Who should implement a Chief Localisation Officer? What are the ideal reporting lines?

Depending on a company's or group of companies' businesses with the aforementioned NOCs and the ratio of such business against business with other customers, it may make sense to create the position of a Chief Localisation Officer ("**CLO**" – also referred to as localisation manager, officer, coordinator or engineer). As a rule, should more than 50% of the business be related to the aforementioned NOCs, it would make sense to allocate a full position towards looking after localisation programs.

Given the significance of localisation programs, it should be noted that a CLO should effectively report to the Chief Executive Officer (CEO). Internally, CLOs would need to liaise with other stakeholders, in particular with supply chain managers and general counsel. CLOs may also need to consult with external lawyers, tax and other advisors on optimizing the corporate set-up and localisation scores.

In case the size of the business does not allow to have a designated CLO, outsourcing these processes to local counsel and other advisors is an alternative.

4. What does the job description include?

Typically, CLOs would be responsible for the following tasks:

- Monitor compliance with respective commitments (e.g. ICV Improvement Plan, IKTVA Action Plan, etc.);
- Develop supply landscape and develop a roadmap to achieve ICV/IKTVA goals;
- Analyse and identify localisation opportunities;
- Increase the company's overall localisation score;
- Update and advise the company's management about the status of localisation programs and adjacent initiatives;
- Coordinate with NOCs to ensure that the company is up-to-date on all localisation program related matters and to resolve any matters in this respect; and
- Manage the audits and ensure that the correct supporting information is available to ensure compliance.

In addition, CLOs would need to optimize the supply chain:

- Identify suppliers capable of increasing the localisation score;
- Execute and monitor sourcing strategies to meet respective commitments (e.g. ICV Improvement Plan, IKTVA Action Plan, etc.); and
- Develop and execute supply agreements (that pass on localisation program associated risks).

5. Conclusion

Localisation programs are not a trend. They are made to stay and add value to the respective economies. ADNOC and Saudi Aramco have announced they will spend significant amounts to renew their facilities. Suppliers who wish to engage (directly and/or indirectly) with these NOCs will need to assess whether their business requires implementing a CLO. While this assessment needs to be taken on a case-by-case basis, it is safe to say that in order to comply with localisation programs, investors will need to allocate a significant amount of time towards implementation and management of such programs. Furthermore, the UAE and other countries may decide to apply localisation programs in other areas of business not limited to the NOCs.

Experience shows that

- In lack of mutual recognition of the programs between the relevant NOCs, set-up options and supplying strategies need to be formulated and executed;
- Companies need to monitor their program specific commitments in order to prevent negative legal consequences (e.g. early termination); and
- Localisation programs tend to undergo frequent changes, requiring constant monitoring and proactive handling of such changes.

SCHLÜTER GRAF
The Citadel Tower, Offices 2001-2005 Business Bay, P.O. Box 29337
Dubai / United Arab Emirates
Tel: +971 / 4 / 431 3060
Fax: +971 / 4 / 431 3050
Dr. Constantin Frank-Fahle, LL.M. (frank-fahle@schlueter-graf.com)
Andrés Ring (andres.ring@schlueter-graf.com)