



**ROYAL COMMISSION  
INTO PROCESSES AND PROCEDURES FOLLOWED BY THE  
GOVERNMENT OF PAPUA NEW GUINEA  
INTO OBTAINING THE OFF-SHORE LOAN FROM THE UNION BANK OF  
SWITZERLAND AND RELATED TRANSACTIONS**

**OPENING BY COUNSEL ASSISTING**

**2 December 2021**

*(check against delivery)*

**A. Introduction**

1. May it please the Commission.
2. On 18 August 2021, the final day of hearing of the last phase, I made a submission concerning extended Terms of Reference. Commissioners, you also made comments in that regard.
3. The foreshadowed amended Terms of Reference have now been gazetted and put on the Commission's website.
4. They effectively extend the Commission by 6 months with the new reporting date of no later than 31 March 2022.
5. The Commission has set aside the following days for sitting: December 3, 9, 10, 14 and 15 and February 7-11. Other hearings, including hearings in private, may be necessary.

**B. Amended Terms of Reference**

6. We arrive at the amended Terms of Reference, and the consequent extension of the reporting date of the Commission to 31 March 2022, as a result of a number of matters that I mentioned on the previous occasion; primarily—
  - (a) Despite the efforts and the cooperation and assistance provided by many witnesses, up to the end of the August hearings, there remained matters which seemed to warrant further consideration.

- (b) That situation arose, unfortunately, due to a number of factors outside of the control of the Commission, in particular, delays occasioned by the late and incomplete production of important documents by a number of relevant persons and entities.
  - (c) The need to consider documents produced at a very late stage (and since then, even more has been produced).
  - (d) A desire to provide one further and final opportunity to hear from key witnesses who had not yet provided evidence, including those in jurisdictions outside of Papua New Guinea.
  - (e) Continued complications caused by the Covid 19 Pandemic.
7. The amended Terms of Reference now include an inquiry into, among other things:
- (a) the Orogen Minerals merger with Oil Search [TOR a-d];
  - (b) the role of legal and financial advisors engaged, and the legal and administrative processes followed to engage them [TOR g, h, m(ii), and
  - (c) the PRL-15 resource [TOR q-v].
8. The Commission has already received some evidence in relation to these matters.
9. These hearings have been convened for the purpose of obtaining further evidence, responsive to the Terms of Reference.
10. Counsel Assisting have been assisted by evidence given to date by witnesses, as well as by further information obtained from other sources, including evidence from confidential sources, which may become critical to the Commission's understanding of the relevant transactions.

### **C. Current Issues**

11. I will say something about the potential issues the Commission may wish to consider shortly. Some of those issues already involve, or are likely to come to involve, conflicts of both recollection and what should have been done.
12. However, there are a number of areas which do not involve such conflict. Notably, the expert evidence of the Brattle Group is largely unchallenged, as are factual matters essential to their conclusions.
13. Let me recall some key matters to set the scene.

### ***IPIC Exchangeable Bond***

14. The overall objective of the IPIC exchangeable bond transaction was to allow the State to take advantage of its back-in rights in relation to the PNG LNG Project.

There does not appear to have been much opposition to this objective, at the time or since, given the revenue that the Project was anticipated to generate.

15. There was some early consideration by the Treasury of selling the State's interest in the Project but this was rejected by the government of the day. The government did consider selling part of the State's equity interest as part of its consideration of the merits of the exchangeable bond proposal, but concluded that, as finance through IPIC was available to allow the State to take advantage of its full back-in rights, the State should do so.
16. There was debate about the terms of the IPIC transaction. In particular, the Treasury argued for other alternatives and said that more time was available to raise the necessary finance. But the Government decided to enter into the IPIC exchangeable bond transaction. Given this was shortly after the global financial crisis, this was an understandable decision, particularly because it would add momentum to the PNG LNG Project itself and the State was seen to be the weak link in obtaining finance for the Project.
17. In addition to the Treasury's attempts to seek alternative sources of finance, you will recall that the Brattle Group's expert evidence report considered whether sovereign debt might have provided a solution. They concluded that the State, which to that point had never issued a sovereign bond, would have been unable to raise the necessary finance in that way, at least then.
18. As the powerpoints show, the transaction itself can perhaps best be explained as a deferred sale of the State's shareholding in Oil Search. The sale price was fixed at AU\$8.55 a share and the State took the risk as to whether, by the time of the deferred sale (that is, when the bond matured), the share price would reach that figure. If not, it would have to make up the shortfall. The State also took the risk that if the share price exceeded AU\$8.55, IPIC would take the upside above that figure as profit. There was a further risk that IPIC might seek to take the shares at an earlier date if the Oil Search share price rose significantly.
19. As the Oil Search share price at the time of the deal was relatively low, about \$4.20, selling the shares outright at that point would not have generated sufficient funds to allow the State to take advantage of its full back-in rights. It was thought at the time that the share price would rise as the PNG LNG Project progressed because of Oil Search's own participation in the Project. The "deferred sale" was therefore considered by some as the best way available of extracting as much value as possible from the State's shareholding in Oil Search.
20. Another way of viewing the transaction is that it was an exchange of the State's then 17.6% interest as a shareholder in Oil Search for a 19.4% direct interest in the PNG LNG Project. The latter would be likely to generate significantly more revenue, but came with obligations, in particular to participate in further rounds of funding for the Project.
21. Brattle were asked to consider whether the pricing of the IPIC transaction was fair. Their assessment depended upon whether IPIC considered that there was a risk that IPBC might be unable to pay any shortfall necessary at the maturity of the bonds. Brattle concluded that if IPIC regarded this risk as being more than negligible, then the pricing of the bonds was fair.

22. The UBS transaction, as previously mentioned, was very complex, as the powerpoints show. We do not need to go over that material again now.

***The Novation and December 2014 Collar Loan***

23. Moving then to the novation and the December 2014 collar loan, through the novation, KPHL took the place of the State in the March 2014 transactions. It therefore became the borrower under the Bridge Loan and Collar Loan. KPHL repaid the Bridge Loan and entered into a new collar loan using as collateral the 12 million shares that had secured the Bridge Loan.
24. The December 2014 collar loan had different terms to the March 2014 collar loan. Brattle describe the differences between the March 2014 and December 2014 collar loans as follows:
- (a) the average of the put strike prices in the new collar loan was \$7.02 rather than \$7.38;
  - (b) the average of the call<sup>1</sup> strike prices was different; and
  - (c) the share price on the relevant date in December 2014 was \$7.80 rather than the \$8.20 in March of that year.
25. The principal amount of the new collar loan was again equal to the number of shares which secured the loan multiplied by the put strike prices. The interest was once again pre-paid, meaning UBS was again not exposed to the State's/NPCP's credit risk.
26. Brattle assessed that the December 2014 transaction was *not fairly priced* and that it transferred \$7.1 million of value from KPHL to UBS. KPHL realised \$77.8 million from the transaction which it used to repay part of the Bridge Loan. Had the transaction been fairly priced, KPHL would have realised an additional 7.1 million, and thus KPHL would have needed to use AUD 263 million (rather than AUD 270 million) from its Letter of Credit to repay the balance of the Bridge Loan.
27. The Commission has heard evidence that Kumul Petroleum Holdings (**KPHL**), the State-Owned Enterprise tasked with holding the Oil Search shares, sought to dispose of those shares from the outset. The Managing Director, Mr Wapu Sonk, has given evidence in his statement that the dividends received from the Oil Search shares were minimal and were far outweighed by the cost of the prepaid interest on the loan and the other transaction costs.

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<sup>1</sup> Calls give the buyer the right, but not the obligation, to buy the underlying asset at the strike price specified in the option contract. Investors buy calls when they believe the price of the underlying asset will increase and sell calls if they believe it will decrease. Puts give the buyer the right, but not the obligation, to sell the underlying asset at the strike price specified in the contract. The writer (seller) of the put option is obligated to buy the asset if the put buyer exercises their option. Investors buy puts when they believe the price of the underlying asset will decrease and sell puts if they believe it will increase.

28. Mr Sonk gave evidence that it was never in KPHL's mandate to hold investments in private companies such as Oil Search. According to Mr Sonk, the burden of the Oil Search shareholding posed the further problem of potentially limiting KPHL's ability to take advantage of other opportunities which actually fell within its founding objectives and which were coming on stream. These included the Papua LNG and P'nyang LNG projects.
29. Mr Sonk explained that the Oil Search shares came with significant liabilities and expenses which were of concern to the KPHL Board and which significantly outweighed the benefits of receiving dividends from the Oil Search shares. Mr Sonk's evidence was that, by 11 August 2017, KPHL had spent USD\$299.4 million, inclusive of dividends received, on the bridge and collar loans. Had KPHL sought to refinance the loans in order to maintain the shareholding, Mr Sonk contends that this would have required additional financing of an estimated \$71 million in early 2018 and another \$71 million in 2020.
30. The Commission notes evidence from Mr Sonk indicating that a low Oil Search share price provided positive intrinsic value to KPHL arising from the structure of the collar loans, and that the opposite also held true – that a higher Oil Search share price provided negative intrinsic value to KPHL.
31. The Commission has been presented with evidence that the decision by KPHL on when to sell the Oil Search shares was dictated, at least in part, by the alignment of factors such as share price and political climate. Mr Sonk has provided both oral and written evidence that, in his view, the primary consideration of then Prime Minister and KPHL Trustee Peter O'Neill in selling the Oil Search shares was in having a politically acceptable narrative to support the sale.

### ***The February 2016 Transactions***

32. Further transactions followed. Again, it would have cost KPHL nothing to allow the March 2014 and December 2014 collar loans to expire in accordance with their terms. As Brattle noted:
 

*If the loans had been allowed to mature according to their terms, KPHL would from that point forward have had no further exposure to the Oil Search share price, KPHL would not have needed to make any further payments to UBS, and KPHL would have received up to AUD 390 million between 9 March 2016 and 13 July 2016 as the collars expired. The actual amount received would have been zero if the Oil Search share price was AUD 6.24 or less on all of the expiry dates of the options making up the collar component of the loans, but would have been a positive amount if the share price was above AUD 6.54 on any of the expiry dates. The maximum amount would have been AUD 390 million if the share price was AUD 11.64 (or more) on all of the expiry dates.*
33. Brattle also concluded that, taking the Oil Search share price used by UBS on that day of \$6.75, there was value for KPHL in the loans that were being unwound:
 

*KPHL's rights under the collar loan agreements were valuable because of the possibility that UBS would be obliged to make a payment to KPHL as the collars*

*matured. In order to realise this value, the Government could have looked for a third-party to take on KPHL's rights under the loan agreements. That third party would have been willing to pay to take on these rights, because KPHL had no further obligation to pay UBS and had the right to receive payment from UBS if the Oil Search share price was above any of the put strike prices on any of the final exchange dates. In other words, the loans had a market value. Equivalently, UBS should have been willing to pay this amount to KPHL to terminate the loans.*

34. Brattle concluded that, on 22 February 2016, the value of the March 2014 collar loan was \$119.3 million and the value of the December 2014 collar loan was \$8.7 million.
35. Instead of allowing the two collar loans to mature or seeking to extract their value by seeking to transfer them to a third party, KPHL decided to replace the two loans with a new, single collar loan with a longer term. The structure of the new collar loan was similar to the previous collar loans but with a lower interest rate and a further important difference: KPHL had the right to terminate the loan at any time.
36. We note that:
  - (a) the inclusion of this termination right is consistent with KPHL's desire to terminate the loans, and
  - (b) the fact that KPHL did not allow the loans to mature and terminate according to their terms is consistent with the suggestion that Prime Minister O'Neill did not want the Oil Search shares to be sold until there was an acceptable political narrative.
37. Brattle also considered that the February 2016 transactions were **not** fairly priced. The result of this was that, in their opinion, the February 2016 transactions transferred \$38.8 million from KPHL to UBS.

### ***The September 2017 Transaction***

38. Finally, in September 2017, KPHL took advantage of its early termination rights to sell the Oil Search shares and close out the February 2016 collar loan.
39. Brattle considered whether there was a financial benefit to KPHL in exercising the early termination right. The inclusion of the termination right meant that the transaction documents also needed to specify the amount to be paid to KPHL on early termination. Brattle reported that there were two elements to the amount to be repaid:
  - (a) A partial refund of prepaid interest. The refund was only partial because it was calculated using an interest rate of 2.05%, instead of the rate at which prepaid interest had in fact been paid, of 3%.
  - (b) A payment called the "Optional Early Termination Amount". This was to be determined by UBS in its discretion and was said to be "*subject to such factors as [UBS] deems relevant including, without limitation, the*

*prevailing market circumstances and the price per Share which [UBS] would have achieved in terminating or liquidating its applicable Hedge Positions in connection with the Optional Early Termination, as determined by [UBS] in good faith and a commercially reasonable manner.”*

40. The Optional Early Termination Amount was therefore an indeterminate amount which could have been zero. It depended in part on the outcome of UBS' hedging strategy which might, of course, have been negatively disrupted by the request for early termination. Brattle noted that the payment that UBS made to KPHL for the Optional Early Termination Amount was less than Brattle's estimate of the market value of the loan at the time. Brattle also considered the value of the February 2016 collar loan at its termination in September 2017. In Brattle's view, the loan was worth some \$17.6 million more than KPHL received from UBS for its termination. In other words, the termination transferred \$17.6 million of value from KPHL to UBS.
41. This suggests that the value of UBS' hedge positions was significantly less than the market value of the collar component of the loan. It follows from this that as KPHL did not receive the market value of the loan when it terminated it early, there was a financial disadvantage to it, in terms of the loan itself, in seeking early termination.
42. Notwithstanding this, Mr Sonk gave evidence that the early termination of the collar loan would allow KPHL to invest in other projects with better returns and that he saw this as a benefit of the early termination. The Commission has not received any evidence about whether KPHL in fact did this.
43. Had KPHL decided to allow the loan to mature according to its terms, Brattle note that it would not have had to pay any further sums to UBS but it would have remained exposed to movements in Oil Search's share price.

### ***Dividends***

44. As the State/KPHL's shares in Oil Search were pledged as security for the collar loans, the loan agreements needed to address the question of what should happen to the dividends paid on the Oil Search shares during the period of the loan.
45. This is a complex issue with collar loans because the bank making the loan will want to hedge its exposure to the put options in the collar. Generally, it will do this by short selling borrowed stock in the same company, Oil Search in this case. The lenders of that stock miss out on the dividends that they would have received on the shares which they have lent to the bank and the bank has then sold. The lender of the stock therefore requires the bank to compensate it for the lost dividends. The bank then seeks to recover the compensatory sum from its borrower, here the State/KPHL. It is part of the price to be paid for the loan.
46. So, the treatment of the dividends as between UBS and the State/KPHL also needed to take account of UBS' likely obligations to the lenders of the stock to be short sold. This required a prediction of future dividend flows and an allocation

of the risk that the dividend policy of the company in question, here Oil Search, could change.

47. Brattle analysed the treatment of dividends in the collar loans. Brattle concluded that:
  - (a) in the case of the March and December 2014 collar loans, the State or KPHL received from UBS a pre-agreed fixed amount per share on some of the shares (called the "Delta Quantity") and the actual dividends on the rest of the shares, and
  - (b) in the case of the February 2016 Collar Loan, the pre-agreed amount to be paid in relation to the Delta Quantity was zero.
48. The structure of this arrangement was not in itself unfair (in the sense that it would not transfer value between the parties) if the pre-agreed fixed amount to be paid in relation to the Delta Quantity was equal to the expected dividend payments on those shares.
49. This was essentially the case for the December 2014 collar loan but not for the March 2014 or February 2016 collar loans.
50. With the March 2014 collar loan, UBS received \$40 million of dividends whilst the State/KPHL only received \$19 million. This may have been the result of a change in dividend policy announced by Oil Search in October 2014 which may not have been anticipated when the loan was agreed but worked to the benefit of UBS. It was a risk of the transaction, a windfall and does not of itself indicate that the March 2014 dividend agreement was unfair at the time that it was made.
51. With the February 2016 collar loan, the agreement that the pre-agreed fixed payment on the Delta Quantity was zero cannot reasonably be seen as a proper estimate of future dividend flows on those shares. In Brattle's view, it did therefore represent a transfer of value from KPHL to UBS. By considering a dividend forecast for Oil Search issued at about the time that this loan was made, Brattle estimate that by agreeing to a pre-agreed payment of zero, KPHL transferred about \$20.2 million of value to UBS.
52. In addition, had the dividend agreement of the February 2016 collar loan been the same as the prior loans, the market value of the loan when it was unwound in September 2017 would itself have been increased. This is because the dividend expectations for Oil Search in February 2016 were higher than they were in September 2017 because the dividend rights under the loan would have been more attractive than could have been obtained in the market at that time. Brattle estimate that this would have increased the market value of the loan and hence its fair unwind amount by \$7.8 million.
53. The dividend arrangements of the February 2016 loan therefore transferred a total of \$28.3 million from KPHL to UBS.

### ***The Financial Outcome***

54. So what is the outcome in financial terms of the aforementioned transactions between March 2014 and September 2017? In their third report Brattle considered their overall financial impact.
55. From information provided by UBS, Brattle have calculated that the State incurred costs of AU\$336.3 million to hold Oil Search shares between March 2014 and September 2017.
56. This is made up as follows, with numbers in brackets showing payments to the State:

<b>Item</b>	<b>AUS Mil</b>
Bridge Loan interest payments	22.0
Dividends	(23.2)
March 2014 Bridge Loan extension fee	5.0
Funds from Letter of Credit	270.3
Front Collar Additional Consideration Amount	97.4
Unwind payment from February 2016 Collar Loan	(35.1)
<b>Total</b>	<b>336.3</b>

57. This amount includes the net impact on the State of purchasing the shares (at \$8.20) and the ultimate sale of the shares at a price of \$6.70. It also includes fees paid to UBS, and to other advisers via UBS. It does not include fees paid directly to other advisers, for example the \$4 million that Mr Sonk has said KPHL paid directly to external advisers. It also does not include the cost to the State or KPHL of the Letter of Credit used to refinance the Bridge Loan which is not known.
58. Brattle have also considered what it would have cost the State to hold the Oil Search shares if the transactions with UBS had been fairly priced. In their opinion, the State actually paid a net \$80.9 million to UBS, but if the transactions had been fairly priced the State would have received AUD 94.0 million from UBS. Thus the transactions in aggregate transferred \$174.8 million of value from the State to UBS. None of these figures includes fees paid to UBS or others.

59. This enables the loss in the table above to be shown in a different way as follows:

Item	AU\$ Mil
Purchase Oil Search shares at \$8.20	1,225
Fair value of the UBS transactions	(94.0)
Value transferred to UBS	174.8
UBS Bridge Loan fee	11.7
UBS advisory fees	16.5
Other fees	3.1
Sell Oil Search shares at \$6.70	(1,000.9)
<b>Total</b>	<b>336.3</b>

60. Of course, this is not a final view of these transactions or the calculation of loss. Indeed, it is expected that the Brattle Group will return after they have been given an opportunity to consider the further material received.

#### **D. Issues To Be Considered**

61. Arising out of the amended Terms of Reference, as well as from the material that has been received by the Commission to date, in our submission, further evidence is required to assist the Commissioners to form a final view in relation to the relevant transactions.
62. A number of other issues arise for consideration by the Commissioners, including, without limitation:
- (a) the circumstances of the merger of Orogen Minerals with Oil Search;
  - (b) the origin of the IPIC exchangeable bond transaction;
  - (c) the question of professional fees paid to legal and financial advisors;
  - (d) the dominant purpose of the UBS transaction, including whether that purpose was to fund the purchase of an interest in PRL-15 from Interoil;
  - (e) the pricing of, and movement of funds from, the PRL-15 transaction;
  - (f) the choice of UBS as financier, including any due diligence undertaken in relation to the collar loan structure;
  - (g) the complexity of the UBS transaction;

- (h) the role of the trustee, ie then Prime Minister O’Neill in respect of decision making of Kumul Petroleum Holdings Ltd in 2014;
  - (i) the decision to acquire the Oil Search shares in 2014, then sell them in 2017; and
  - (j) the timing of the sale of shares in 2017.
63. The Commission has also received evidence and submissions in relation to section 209 of the Constitution, more particularly, the nature of the authorisation and control by the Parliament required by the section, as well as the nature of the regulation by an Act of Parliament for the purposes of the section.
64. One contention is that in order to raise and expend loan finance, a general authority regulated by an Act of Parliament is sufficient. This appears to be the view taken in relation to the UBS loan in 2014 where reliance was placed upon the provisions of the *Loans (Overseas Borrowings) (No. 2) Act 1976*, in particular section 2 thereof.
65. Alternatively, it might be thought that the section requires each individual loan raised by the Government to be authorised and controlled by the Parliament, and to be regulated by a specific Act of Parliament. That appears to have been the view taken in relation to the IPIC loan in 2009 with the enactment of the *PNG Liquefied Natural Gas (State Participation) Act 2008*, in particular section 7.
66. There are also policy issues arising for consideration and recommendation, eg:
- (a) the role of a properly functioning Sovereign Wealth Fund;
  - (b) the role of an Independent Commission Against Corruption, including whether such a role could be more conveniently added to the function of the Ombudsman Commission, and
  - (c) whether the corporations legislation in the Independent State should permit a company and the State to demand details of the ultimate beneficial ownership of shares in a company incorporated in or operating in Papua New Guinea.

## **E. Conclusions**

67. As mentioned at the outset, the December hearings have been set down for today and tomorrow, as well as the 9<sup>th</sup>, 10<sup>th</sup>, 14<sup>th</sup> and 15<sup>th</sup> of December. Hearings from the 7<sup>th</sup> to the 11<sup>th</sup> of February 2022 have also been set down.
68. We remind all that where evidence has been given on oath or documents have been produced in answer to a summons, it is a serious matter not to tell the truth or not to produce all available documents. Such conduct does have consequences.
69. We ask everyone to reflect on their positions and come forward to correct or clarify anything they may now consider to be incomplete or inaccurate.

70. Finally, we say something about those who advised or acted for the State and its entities, especially, UBS and Norton Rose Australia.
71. We contend that former and current Norton Rose Fulbright Australia partners and employees namely Anthony Latimer, Iain Laughland, Vittorio Casamento and Steven Moe and current and former UBS employees are able to provide important evidence about various matters relevant to the Terms of Reference - their former clients having waived any confidentiality as to their work - but they choose not to as they are located outside the Independent State: although it is true that documents have been produced and we have a submission from UBS containing a number of assertions.
72. The Commission will examine, as best it can on the evidence available, matters relating to the Terms of Reference, including the role of these persons in the UBS Loan transaction. Adverse public comments, findings and recommendations may well be made, as may also a recommendation to the Government of PNG that witnesses located outside PNG who have chosen not to assist the Commission when requested to do so be excluded from future opportunities to be engaged by or on behalf of the State. It is therefore important, in fairness to the individuals involved, to give them a final opportunity to cooperate with the Commission. That opportunity must be taken up no later than next week.

May it please the Commission.

**2 December 2021**

**COUNSEL ASSISTING THE COMMISSION**

**Dr James Renwick CSC SC**

**Dr Dominic Katter Levente Jurth**