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Griffiths Energy International: The Board’s Dilemma (A)

Dawn Oosterhoff wrote this case under the supervision of Professor Gerard Seijts solely to provide material for class discussion. The authors do not intend to illustrate either effective or ineffective handling of a managerial situation. The authors may have disguised certain names and other identifying information to protect confidentiality.

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The Republic of Chad—landlocked, poor, and politically fragile—was one of the oil-rich countries of Africa. Companies had been exploring for oil in the country for some time, but because it was not easy to extract and export the oil, production began only in 2003. However, once production began, investor interest grew. Griffiths Energy International Inc. (GEI), a Canadian company based in Calgary, Alberta, wanted to join those companies drilling for oil and, in 2008, began meeting with officials in Chad in an effort to secure production-sharing contracts. At last, in 2011, with land leases in place, a team ready to work in Chad, and significant private investor backing secured, GEI was ready for an initial public offering (IPO) that would be the largest the Canadian market had seen for some time.

Investment bankers and lawyers began drafting the prospectus with plans to go public by the end of the year, and the company set about recruiting its board of directors. Robert Hodgins, an experienced director in the resources sector, was one of those invited to join the board. Hodgins accepted the appointment only to be confronted within weeks with one of the most difficult decisions he had needed to make as a business leader: when GEI’s lawyers were conducting the due diligence for the IPO, they uncovered contracts that suggested bribery had been involved in securing the land leases.

At that time, bribing officials was not uncommon in Chad or in many other parts of the world, especially where economies were less developed. However, it was an offence in Canada for Canadians and Canadian-based businesses to engage in bribery or corruption of foreign public officials. With GEI poised to go public, the original private investors anxious to realize their investment through the IPO, and the company ready to begin production, Hodgins and his board colleagues needed to decide what to do about the lawyers’ discovery.

Black Gold in Chad

GEI was founded in 2009 by investment banker Brad Griffiths and two partners.[[1]](#endnote-1) Griffiths did not have experience in the oil and gas business, but he was a brilliant investment banker, successful, and well known. He was also notable for his role in changing how investments were financed in Canada by developing what became known as “bought deals.”[[2]](#endnote-2) Most importantly, Griffiths had a reputation for identifying good investments.[[3]](#endnote-3)

In the late 1990s, Chad began to surface as a good investment country for oil. A consortium led by ExxonMobil Corporation (Exxon) began explorations in 1996; in 2003, it was finally successful getting oil from the drilling fields in the Doba basin in Chad to the seaport in Cameroon, using a 1,070-kilometre pipeline. Although the consortium was successful, it had relinquished other exploration rights.[[4]](#endnote-4) Production lands were up for bid, the price of oil was increasing, and Griffiths saw the opportunities.

Griffiths engaged numerous people to help him secure the opportunities in Chad. In 2008, he and his advisors spent six months investigating the oil and gas opportunities in Chad and establishing contacts, both with Chad’s president and his associates in the oil ministry and with Chad’s ambassador to Canada and the United States, who was based in Washington, D.C.[[5]](#endnote-5) By 2011, after years of negotiation, Griffiths had successfully secured his production-sharing contracts and the needed leases.[[6]](#endnote-6)

Changing Leadership at GEI

Success in obtaining the contracts came with a commitment to commence operations in Chad within a certain period of time; the company had also provided the Government of Chad with a work commitment worth US$115 million. So Griffiths was prompt in hiring the needed consultants and management team. To prepare GEI for its switch from prospecting to production, Griffiths hired a new chief executive officer, Gary Guidry, effective July 1, 2011. And to prepare the company to go public, Griffiths and Guidry began seeking directors for the board.[[7]](#endnote-7)

Hodgins was known in the resource sector. He was a chartered accountant, investor, and director with 30 years of experience in oil and gas. While Griffiths and Hodgins were not acquainted, Guidry had worked with Hodgins before and recommended him for the board. Guidry extended the invitation to Hodgins himself and arranged for Hodgins to meet with the management team on Monday, July 18, 2011—a fateful day, as it happened. Hodgins recalled:

I was sitting in my car, waiting in the parking lot before going in to meet the team. I pulled out my phone—at that time, a BlackBerry—and the headline read, “Prominent investment banker missing.” When I looked, I realized it was Brad Griffiths.

Griffiths had last been seen midday near his boat in the middle of Lake Joseph, north of Toronto. His death was confirmed at the end of the week when diving teams recovered his body from the lake.[[8]](#endnote-8)

With the company’s founder gone, Guidry was temporarily appointed chairman,[[9]](#endnote-9) and the management team finished populating the board. Hodgins confirmed his commitment as a company director, and another director was chosen to act as the new permanent chairman. Employees were hired to get the operations up and running in Chad, and investment bankers and lawyers were retained to take GEI public. The company had raised CA$165 million with private investors who were expecting a return on their investment when the company went public,[[10]](#endnote-10) and the company was slated to begin drilling early in 2012.

Plans were made to go public by the end of 2011. Earlier that fall, lawyers for the company began preparing the prospectus. Then, while conducting the due diligence, just weeks before the IPO, which had been scheduled for December, the lawyers located certain contracts that raised concerns. Seemingly straightforward contracts for consulting services appeared on closer examination to be a conduit to pay money to the wife of Chad’s ambassador to Canada and the United States. The contracts may have, directly or indirectly, benefited the ambassador himself in exchange for his help to secure the land leases in Chad.

Bribing government officials in exchange for influence or assistance to obtain favourable contracts had previously been a routine, if distasteful, business for decades, and in Chad, the practice had been widespread. But the world, specifically those countries belonging to the Organisation for Economic Co-Operation and Development (OECD), was thinking differently about bribes for business advantages, and Canada had enacted legislation making it a criminal offence.

Corruption in Chad

The government of the Republic of Chad had been relatively stable since the 1990s when President Idriss Déby Itno took control of the government. However, political unrest in neighbouring regions flowed over into Chad, rebellions became common in the border regions, and refugees attempted to avoid conflict by moving back and forth between countries. Déby added internal political unrest when he changed the country’s constitution to allow him to run for president for another term.[[11]](#endnote-11)

Although Chad was the fifth-largest country in Africa, the country was poor. It was landlocked and much of the northern portion of the country lay in the Sahara Desert. Most of the sparse population (8 persons per square kilometre) lived by agriculture—cotton in the south and cattle in the middle regions where the tsetse fly did not decimate the herds. Foreign assistance accounted for one-quarter of the country’s gross national product. Life expectancy was only 51.5 years for women and 49 years for men, and almost half of the population was under the age of 15.[[12]](#endnote-12)

Exxon’s success in producing oil in 2003 had raised hopes that oil revenues could improve Chad’s economy. The government was abiding by an oil revenue management law that controlled the investment and allocation of the royalties, and in 2000, the government had enacted a law that provided penalties for corrupt practices. The government had even established the Ministry of Good Governance, dedicated to combating corruption. But civil servants, judicial employees, and law enforcement officials were underpaid (and sometimes not paid for stretches of time), increasing the allure of profits from bribery and weakening the state system for enforcement of anti-corruption efforts.[[13]](#endnote-13)

This rent-seeking culture was business as usual in Chad. In terms of the ease of doing business, the World Bank ranked Chad near the bottom of the list (180 out of 190).[[14]](#endnote-14) Transparency International ranked Chad as among the 10 most corrupt countries in the world.[[15]](#endnote-15) Nonetheless, the promise of oil and significant returns on investment attracted companies such as GEI that were willing to accept the risks of doing business in the country in exchange for what Hodgins described as “the big prize.”

Global Anti-Corruption Efforts

The OECD estimated that the cost of corruption globally was more than 5 per cent of the world’s gross domestic product (GDP)—valued at US$2.6 trillion, with US$1 trillion paid in bribes each year. The World Economic Forum estimated that corruption increased the cost of doing business by an average of 10 per cent.[[16]](#endnote-16)

In 1997, in an effort to combat corruption and contain its harms, the OECD passed the *Convention on Combating Bribery of Foreign Public Officials in International Business Transactions* (the Anti-Bribery Convention).[[17]](#endnote-17) Canada was a signatory to the convention, so in 1998, to meet its commitments under the convention, Canada enacted the *Corruption of Foreign Public Officials Act* (CFPOA), establishing bribing a foreign public official as a criminal offence. The offence applied to bribes paid to an official of any foreign country if carried out by a Canadian citizen or permanent resident, or by a corporation or organization formed under the laws of Canada. The legislation initially provided exemptions for facilitation payments or “grease payments”—money paid to foreign government officials to speed up or facilitate routine transactions.[[18]](#endnote-18)

The United States had similar legislation—the *Foreign Corrupt Practices Act* (FCPA)—but its exemption for facilitation payments was narrower than Canada’s legislation and its reach was broader. The U.S. legislation applied not only to American citizens, residents, and organizations but also to anyone pursuing bribery within the jurisdiction of the United States and to anyone using U.S. interstate commerce, such as wire transfers, to further an act of bribery. Thus, a Canadian citizen who engaged in bribery in the United States could be found guilty under both Canadian and American law.[[19]](#endnote-19)

Canadian and American legislation also differed in how they were enforced. Acts subject to the CFPOA were investigated by Canada’s national police service, the Royal Canadian Mounted Police (RCMP), and were prosecuted only under criminal law. In contrast, the American legislation imposed both criminal and civil penalties, and both the U.S. Department of Justice and the Securities and Exchange Commission (SEC) were responsible for enforcing the FCPA. The SEC was responsible for civil enforcement of the Act over companies the SEC regulated, and the Department of Justice was responsible for all other enforcement.[[20]](#endnote-20)

The United Nations also made efforts to curb international bribery and corruption, adopting the *United Nations Convention against Corruption* in 2003.[[21]](#endnote-21) When introducing the convention to the General Assembly of the United Nations, Kofi Annan, then secretary-general, described corruption as:

An insidious plague that has a wide range of corrosive effects on societies. It undermines democracy and the rule of law, leads to violations of human rights, distorts markets, erodes the quality of life and allows organized crime, terrorism and other threats to human security to flourish.[[22]](#endnote-22)

Canada was a signatory to the OECD and United Nations conventions, and it had federal legislation dealing with bribery of foreign officials. Still, Transparency International had assessed Canada as being far behind other developed countries in dealing with transnational bribery, and the OECD harshly criticized Canada in 2011 for its weaker legislation, an insufficient number of investigations, and weak penalties for conviction. By 2011, the RCMP had managed to advance only two investigations in a decade, one resulting in a guilty plea and a negotiated fine of CA$9.5 million, and the other just then heading to trial.[[23]](#endnote-23) At that time, while financial penalties levied against companies could be unlimited in size, individuals convicted of foreign bribery could be sentenced to a maximum of five years in prison, and no individual had ever been convicted. In comparison, the U.S. legislation imposed a complex range of criminal and civil penalties that could amount to millions of dollars, a maximum of five years in prison, or both,[[24]](#endnote-24) although in most cases actions had been taken against companies rather than individuals.

the Board’s Dilemma

GEI had new management and a new board that had been in place just a few months, and Brad Griffiths was dead. The company had raised tens of millions of dollars privately, and the early stage investors wanted their exit through an IPO, scheduled to take place in a month. And then the lawyers uncovered the contracts. According to Hodgins:

The contracts were questionable. We didn’t know what we were dealing with. You had to wonder, if you were going to engage in bribery, why would you have a contract? The first contract was with the wife of the ambassador to Chad. You can’t have a contract with the ambassador because he’ll try to influence the outcome, and that’s offside under the legislation.

Now we see that there’s a big chasm between us and going public. Now we have to decide, what do we do?

Hodgins’s gut instinct was to “come clean,” and contact the RCMP to report the facts. While some of his colleagues felt the same, the risks were high, and not all immediately agreed on this course of action. Given the circumstances, some felt that the likelihood of the contracts coming to light was “slim to nil.” If the matter did surface at some point later, the issues could be dealt with then, once the company was stable and producing oil. The business of conducting oil and gas operations in Chad involved a high degree of risk, which was well known to investors, so uncovering bribery at some future point would not be surprising. But if revealed later, how long would it take to bring the matter to trial, and could the company survive in the meantime?

Immediate public disclosure of these events could slow or even cancel the IPO: Could it survive a foreign corruption investigation and possible prosecution? Canada had no history of self-disclosure for bribery offences, so if the contracts were revealed to the authorities right away, the process and penalties were unknown. Employees could be out of work, investors would have put their money down for nothing, and the company could go bankrupt. To compound the problem even further, it appeared the bribery could be linked to Chad’s ambassador to Canada and the United States, who was located in Washington.[[25]](#endnote-25) Voluntary disclosure would thus involve Canadian and American enforcement agencies; if they were going to report the problem, to whom should they report it?

The board was small—just six directors—and all were experienced professionals with public business profiles. Some were concerned about their reputations, which could be tainted by the company’s actions even though the contracts had been negotiated under the previous management. All had exercised their options to purchase company shares, collectively worth $1.65 million.

The newly appointed chair of the board resigned, and Hodgins was appointed to take over. He described his role as “creating an environment that was positive for everyone to contribute. I needed to herd these cats, use the strengths of the individuals, and have a logical discussion so we could reach the best decision, collectively.” In hindsight, Hodgins thought the whole experience was “something like the valley of death,” adding,

Not many things wake me up at night and have me staying awake, but I was wondering, “Should I quit this board or should I continue to try to lead them to do the right thing and have confidence that, collectively, we will do the right thing? What *was* the right thing?”

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Endnotes

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