**POCKET MONEY**

**By David W Berry**

Offset agreements are a minefield. They are commonly attached to major supply agreements where there are a limited number of substantial buyers, often sovereign nations, and few qualified sellers. Major trading nations frown on these mechanisms as anti-competitive, which is exactly why they use them.

The buyer will approach a short list of sellers seeking "sweeteners" to the similarly priced offers on the table for equipment which is difficult to differentiate. A discount is the simplest way, but the losing suppliers will complain to their national governments about unfair competition and subsidies given by the winner's national government. This leads to reprisals, the imposing of trade tariffs, and damage to international relationships.

A discount is a one-off price cut. It benefits the buyer in the short term, but it provides no prospect for additional future value. In theory, an offset agreement can offer more benefit to the buyer, but at the same cost to the seller as a straight discount.

For instance, a seller may agree to invest in a company in the buyer's country to build skills and capacity to manufacture a component of the equipment being ordered. That will be accompanied by an agreement to purchase the component for inclusion in the equipment or as a spare part. This generates new jobs and a technology transfer which has long term positive benefits to the buyer's country.

Problems arise, however, when the offset money goes directly into the hands of a person or entity related to the buyer, without any clear present or future benefit to the buyer. This is especially the case if the person or entity receiving the offset money is, or is related to:

i. a major shareholder of the buyer; or
ii. a director of the buyer; or
iii. a senior executive of the buyer; and
iv. a person who is involved in and able to influence the decision to award the purchase contract in the first place.

This kind of related party transaction is a "no go" area. In any company, and particularly public companies, good governance demands that significant related party transactions require the agreement of shareholders in a vote which excludes the related party and those affiliated with the related party. Absolute transparency is essential, along with complete disengagement from the buying decision.

The ethical bar is set at its highest point. No director, officer or major shareholder of a company should be able to benefit themselves in a way which is preferential to or disadvantages the company or its other shareholders.

Offset arrangements may not always be corrupt, as long as they are a mechanism for predetermined arrangements between a sovereign buyer and a seller which are beneficial to the buyer. However, because they are negotiated as a prerequisite to the award of the contract to the seller, they can be very fertile ground for the imaginative.

The golden rule: offsets can never be someone's pocket money!

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