



July 17, 2015

U.S. Securities and Exchange Commission
100 F Street, NE
Washington, DC 20549

Dear Chair White and Commissioners:

1. My name is Robert F. Conrad. I hold a PhD in Economics from the University of Wisconsin-Madison and I am an Associate Professor of Public Policy Studies and Economics at Duke University, a position I have held since 1988. My areas of expertise include natural resource economics and public finance. I have advised the governments of more than forty countries on fiscal policy, including some natural resource producing countries such as: China, Ecuador, Ghana, Guinea, Indonesia, Kazakhstan, The Kyrgyz Republic, Liberia, Mongolia, Mozambique, Myanmar, Niger, Nigeria, the Russian Federation, Timor-Leste, Ukraine, and Zambia. I have also advised international organizations such as the World Bank and the International Monetary Fund. In addition, I was one of the original eight authors of the Natural Resource Charter, which Paul Collier, the organizer of the group, has called a set of principles for the “governments of the willing” about how to address a variety of economic issues arising from natural resource development.¹ I currently serve on the Board of Advisers to the Natural Resource Governance Institute, which is an organization created by the merger of the Revenue Watch Institute (an organization on which I also served on the advisory board) and the Natural Resource Charter. Some of my publications and research are analyses of natural resources, including modeling the risk sharing characteristics of various contractual relationships in oil and gas (Alexeev and Conrad 2009)², and a variety of fiscal issues in natural resources.³ Most recently I have been working on a critique of so-called natural resource rent taxes (Conrad, Hool and Nekipelov 2015).⁴
2. In this letter I express my professional opinion about three matters related to project level reporting under Section 1504 of Dodd Frank by resource producers that are issuers:⁵
 - First, project level reporting is necessary for resource owners, whom I define as the citizens of most natural resource producing countries, in order to evaluate the net benefits of resource development, both in total and at the margin, in their countries.
 - Second, what I understand to be confidential information of SEC issuers will not be disclosed by project level reporting.

¹ <http://www.naturalresourcecharter.org/>

² “The Russian Oil Tax Regime: A Comparative Perspective,” *Eurasian Geography and Economics* 50(1): 93-114, 2009.

³ A complete resume is available upon request.

⁴ “The Role of Royalties in Resource Extraction Contracts,” (2015 in process).

⁵ I refer to the entities defined as resource extraction issuers in Section 1504 as resource producers.

- Third, no competitive disadvantages will result from project level reporting by issuers relative to either owners of natural resources or to competitive resource producers, including state enterprises, who would be otherwise unencumbered by such reporting requirements.⁶

Information for Natural Resource Owners

3. To provide some context for my comments, I understand that one justification for project level reporting is to supply information to the citizens of resource-rich countries so that they, as the resource owners, can evaluate their own government's performance.⁷
4. It is my view that project level data, **which for discussion purposes I take to be on a contract basis**,⁸ and published on an annual basis, are necessary inputs for resource owners in determining whether a contract is a good deal and to hold their governments accountable.⁹ A mineral contract may include several stipulated financial terms, also included in the required reporting for Section 1504. These financial terms include, but perhaps are not limited to:
 - i. taxes;
 - ii. royalties;
 - iii. fees;
 - iv. production entitlements;
 - v. bonuses;

⁶ As an aside, I believe that even if the claims made by these commenters are valid, then any cost-benefit analysis should include, among other factors, the informational gains resulting from disclosure. Such gains include the ability of natural resource owners to evaluate the ex post risk and returns from allowing their resources to be developed under particular regimes, and the ability of stockholders of listed companies to have more information to make more informed decisions about the risks and returns from various corporate strategies. In addition, the elimination of informational asymmetries can increase the overall efficiency of natural resource markets, which in my view means that the ex ante present value of the reserves plus the value of the corporate assets can increase. Given competition in the markets, such increased wealth can benefit both the citizens of resource-rich countries and the shareholders of the listed companies.

⁷ This conclusion is based on a statement by Senator Richard Lugar, one of the sponsors of Section 1504 ("Adoption of the Cardin-Lugar amendment would bring a major step in favor of increased transparency at home and abroad. . . . More importantly, it would help empower citizens to hold their governments to account for the decisions made by their governments in the management of valuable oil, gas, and mineral resources and revenues. . . . The essential issue at stake is a citizen's right to hold its government to account. Americans would not tolerate the Congress denying them access to revenues our Treasury collects. We cannot force foreign governments to treat their citizens as we would hope, but this amendment would make it much more difficult to hide the truth."), 156 CONG. REC. S3816 (May 17, 2010).

⁸ It has been my experience that a contract is equivalent to a project. A mining or oil and gas contract typically contains one or, perhaps, more leases for particular deposits. Specific terms, negotiated or stipulated, in the contract apply, typically, to a well-defined geographical area, again stipulated in the contract. The resource producer's decision to invest will depend, at least in part, on contract terms, evaluations will be conducted for the contract area, and financial reporting typically will be by contract area. Finally, it is common to "ring-fence" a contract area for fiscal purposes, which in effect imposes a requirement for separate accounting by contract area. For these reasons, it is natural for me to think of a project in the context of a contract area.

⁹ See Rosenblum, Peter and Susan Maples, (2009), "Contract Confidential: Ending Secret Deals in the Extractive Industries," Revenue Watch Institute. See also the website <http://www.resourcecontracts.org/about/about.html>, supported by the Natural Resource Governance Institute, among others, where contracts are published.

- vi. dividends; and
- vii. payments for infrastructure improvements.¹⁰

5. This mix of payments has arisen, in part, because resource contracts with host governments have evolved from simple bonus-royalty regimes (within the context of the generally applicable tax system, as is the practice in the United States) to complex agreements with multiple payment types. It is the combination of payments given the reserves that determines the ex ante risk-adjusted net present value and ex post net present value to a resource project, as well as the distribution of these returns to investors and to the resource owners (the citizens of the jurisdiction given the legal environment).¹¹ Economic incentives are also created in part as a result of the design, both individually and combined, of the various payment elements.
6. As noted, contracts around the world have evolved from simple bonus-royalty agreements to risk sharing, production sharing, and other complex systems. Holding the present value of revenue to the resource owners constant, these contracts have shifted risk, at least incrementally and other things equal, from the resource producer to the resource owner. For instance, price risk is shared in proportion to the royalty rate with a standard ad valorem royalty. That is, if the royalty rate is 5%, then the resource owner bears 5% of the price risk, relative to some measure of the price, while the resource producers bear 95% of the price risk, as well as all of the downside risks in the net present value. A shift from a simple royalty to a profit-sharing arrangement (such as production sharing contracts, service contracts with profit-sharing elements, and other income-based regimes), other things equal, will increase the share of project risks borne by the resource owners. Thus, resource owners need to know who is making the payments, the amounts, the general timing, and the type of payment by project in order to learn from experience about both the size of the returns and the variation in returns resulting from various contractual regimes.
7. Mineral reserves are part of a country's wealth, which, if extracted, is reduced in exchange for financial and other economic benefits as determined by each contract. Knowledge of the payment streams by a particular company and by project are then necessary for resource owners to determine whether the present value of the benefits are at least as great as the capital losses resulting from resource depletion. Some commenters have claimed that "the public's need for information can be met with aggregated data."¹² I disagree for two reasons. First, each project is only one contributor to the overall portfolio for natural assets; and total assets, held by the citizens of a host country, when combined with other natural, physical, intangible and human assets, form the overall returns to the economy as a whole. Second, there will be marginal projects and some projects that will reduce the country's net worth, either because of contract design or the simple fact that it is not in the resource owners' interest to extract reserves, even if resource producers would willingly develop the deposits. Without project level data, such incremental, or marginal, evaluations are not possible.

¹⁰ As I understand them, the rules do not cover domestic employment requirements, domestic training and local content requirements, or other terms that may affect the financial returns to both the investor and the host country.

¹¹ Property rights are vested in the national government in some countries while other countries, such as Canada, vest the mineral rights with the subnational governments (provinces).

¹² American Petroleum Institute Letter to SEC, November 7, 2013, Page 2.

8. An example will be illustrative. Suppose the evaluation group within a government, such as the Office of Management and Budget or the Government Accountability Office in the United States, is asked to evaluate decisions, either prospectively or retrospectively, about public investments in ten infrastructure projects in Y-Land organized as public-private partnerships. The evaluators are provided with the contractual structures, but have only the overall cash flow by contractual term paid to Y-Land for the ten projects implemented at different times. No evaluation is possible because the evaluators cannot gain any understanding of either the contribution of any one project to the overall returns or the variation in benefits created by a contractual structure. Thus, if evaluators are acting in the interests of the stakeholders, who would be the public in this case, then the evaluators will require project-specific data because such data is the only means that the evaluators can use to measure the contribution of the Y-land projects, individually and collectively, to either the overall ex post present value of the country's assets or the incremental effects on the variation of returns.¹³

No Disclosure of Proprietary or Commercially Sensitive Information

9. The resource owners' need for information at the project level does not require disclosure of what I understand to be commercially sensitive data or data that would place a resource producer subject to Section 1504 at a competitive disadvantage. Furthermore, I am not aware of any requirement for disclosure of such information under Section 1504 of Dodd-Frank. No contractual relationships with downstream processors are disclosed, the contribution of the project to the overall profitability of the reporting issuer is not disclosed, trade secrets are not disclosed, and techniques related to intellectual property are not disclosed. In addition, there is no requirement that the reporting issuer disclose geological data about any particular deposit. Specifically, the data necessary for the resource owners to evaluate whether they are making a risk-adjusted competitive return on their assets (the natural resource deposits) does not depend on knowing the real economic returns to the investor from that specific project. That is, if a resource producer (issuer) enters a contract with a resource owner, then all the resource owner knows is that the ex ante risk-adjusted present value is sufficient to cover the stockholders' ex ante economic opportunity cost. The resource owners need to know their cash flow by project in order to determine if that cash flow is sufficient to cover the reduction in wealth resulting from extraction. That is, only by looking at the project can the country's citizens evaluate the value of incremental (marginal) investments.
10. I believe it is important to explain my views about the implications of the previous paragraph because some commenters claim that listed entities will be placed at a competitive

¹³ It is known that the contribution of a new asset to the risk-adjusted returns to an overall asset portfolio generally depend on the composition of the preexisting portfolio, unless the returns to the new asset are uncorrelated, or more strongly stated, statistically independent, of the return variation of the preexisting portfolio. See Brealy, Richard A., Stewart C. Myers and Franklin Allen. (2006) Principles of Corporate Finance. New York, McGraw-Hill. This dependence is another justification for project-level reporting because without such information the nature of the interdependencies amongst assets within a portfolio cannot be measured or approximated. For natural resource producing countries, such dependence implies that the risks borne by the citizens depend on both the contractual structure and the existing portfolio of assets. For example, it is common for resource discoveries to result in an appreciation of the currency (at least for some time period), reducing the profitability of traditional exported goods. Such results have been labeled "Dutch Disease."

disadvantage by project-level reporting.¹⁴ Some analysis of major payment streams may help to illustrate my point.

11. **Royalties:** Reporting total amounts of royalties per annum is required by Section 1504. Royalties are often computed on an ad valorem basis, or $\beta P_t Q_t$, where β is the royalty rate, P_t is a price in some time period “t,” and Q_t is some measure of production or sales in time period “t.”¹⁵ The royalty rate, if it is a flat rate, might be known to all parties and so any analyst can derive an estimate of total revenue attributable to the project for royalty purposes. Further disaggregation of the royalty into its two basic elements, however, is impossible without additional information. The price, while related to some observed price such as the Brent spot market (in the case of crude oil) or the LME price (in the case of certain metals), cannot be inferred from the reported total value.¹⁶ Even a posted price¹⁷ is insufficient to determine a further decomposition.
12. In order to determine the price attributable to a specific project, either the entire methodology for determining the price is necessary, or the quality-adjusted quantities must be measured. This is not possible for annual data unless prices are fixed contractually, and are known, or qualities do not vary during the time interval, or both. Prices may be based on contracts, perhaps between related parties, and how that price is derived cannot be inferred from annual totals without additional information.
13. In addition, oil and mineral quality may, or may not, be uniform over the reporting period. If uniform, then it is possible to derive the average annual price per unit of quantity, but that value is only the price attributable to that project. Even if known, I do not believe that knowledge of the average annual price is commercially sensitive. That price is not an indicator of the project’s profitability measured relative to the consolidated entity. The reason for this conclusion is that the average annual price is only the price attributable to the project. It does not represent the economic value of the output adjusted for risk to the integrated company. The equivalence of the information content between the economic value and the observed price might be inferred, but only for competitive transactions, among other options, a standard more restrictive than the arm’s-length standard and is relevant at the margin, not the average.¹⁸ Economic prices,

¹⁴ See footnote 12 above, and letters to the SEC from American Petroleum Institute, January 28, 2011; Royal Dutch Shell, January 28, 2011; Exxon Mobil Corporation, January 31, 2011; and Chevron Corporation, January 31, 2011.

¹⁵ See Conrad, Robert F. “Fiscal Policy for Natural Resources,” in *Zambia: Building Prosperity from Resource Wealth*, C. Adam, P. Collier and M. Gonde (eds.), Oxford University Press, 2014 for an illustration based on copper mining in Zambia. See also Alexeev, Michael and Robert F. Conrad. “The Russian Oil Tax Regime: A Comparative Perspective,” *Eurasian Geography and Economics* 50(1): 93-114, 2009 for examples in the case of oil and gas.

¹⁶ An exception is Zambia where the royalty is based on the LME price without adjustments for netbacks or other methods to derive the mine price.

¹⁷ http://crudemarketing.chevron.com/crude/north_american/california.aspx

¹⁸ The observed price, even if based on the arm’s-length principle, might represent a combination of the relative bargaining power of the contracting parties and the information available at the time the contract was signed, given the relative risk preferences of the parties. Thus, the final price was one point, perhaps among many, that was potentially feasible at some time in the past. The fact that trade now takes place at that price does not imply that either party would have signed the contract given any new information made available since the time the contract was signed; only that the cost of breaking the contract is viewed as too high to warrant a change. Economic values, however, may or may not be included in the price options, particularly for integrated related party transactions. The economic value in this case would be the value of production to the overall profitability of

measured relative to a competitive standard, are signals about the relative scarcity of particular goods and services in a market. The arm's-length standard, in theory, does not contain such information because arm's-length prices are not required to satisfy the competitive standard.

14. Finally, I understand that "payments" means cash payments and not payments accrued. Thus, annual data on total payments may be of little or no value in attempting to further disaggregate data because of timing differences. Cash royalty payments may include, but may not be limited to, current production, production from the past, and adjustments made during audits.¹⁹
15. **Income-Related Charges:** For present purposes, income-related charges include, but may not be limited to, profits taxes, production sharing payments, risk sharing payments, and service contracts where there is a profit-sharing element to the contract.²⁰
16. Income-related charges are generally computed with reference to some measure of revenues less expenses, including, perhaps, loss carryforwards. Note that Section 1504 requires only total amounts of payments. In particular, the derivation of the income measure is not required. Thus, I believe that no commercially sensitive information or other confidential information can be inferred. In addition, I do not believe other competitors, in particular those not subject to Section 1504, can use the data to eliminate any competitive advantage enjoyed by the affected entities.
17. In order to understand this point, note that income is defined as gross revenue (however defined), less cost (however defined). Gross revenue for royalty purposes is not necessarily the same as gross revenue for the profits tax or other income-based charges. For instance, in Zambia the royalty is based on the LME price of copper while the revenue for profits tax is based on sales, sometimes adjusted for hedging gains and losses and other costs. Thus, knowledge of the base for royalties is not sufficient to separate costs from revenues.²¹

the integrated entity at the margin, or more generally the relative marginal value of the good or service to all market participants. Because such conditions are not required in bilateral trades or by the arm's-length principle as I understand it, even among independent parties, it is not possible to determine whether the price employed is a marginal evaluation in the sense that one, or both, parties are indifferent between trading at that price and not supplying (or buying) additional quantities.

¹⁹ I do not believe there is a provision for a segregation of payments based on audit adjustments under Section 1504. However, it is worth noting that audit adjustments might be either positive or negative. The investor may make mistakes and pay too much, in which case a refund (or reduction in future payments) is apparent.

²⁰ Two preliminary points are necessary. First, the derivation of production sharing payments, excess profits tax payments, and various versions of resource rent taxes (including rate of return charges) may be computed under different rules from those used in the generally applicable profits tax. A profits tax is generally based on accrual accounts and may include the aggregate of activities (or projects) of the taxpayer's net income attributable to a particular jurisdiction. Such income taxes may also include income and expenses unrelated to any particular property, such as bank interest income. Production sharing and resource rent taxes are based on cash flow attributable to a specific project (or perhaps contract). Second, the generally applicable income or profits tax may be modified by contract. That is, the derivation of income may not be the same as the standards employed for other industries or even other investors in the same line of business. Such differences are one reason, among others, why investors sometimes seek to have contracts ratified by local legislatures to ensure that the contract is legally binding and, perhaps, supersedes domestic tax law. Mongolia and Guinea are examples.

²¹ There may be theoretical conditions where revenues can be used to infer costs; for instance, the standard textbook example of a competitive single product firm where long-term economic profit is zero with perfect

18. Even assuming that the revenue attributable to the project could be derived from a combination of sources, such information is not sufficient to determine any confidential information about the nature of the investor's actions. First, revenue cannot be used to infer confidential information for reasons cited above, including the need for project cost information. Second, knowledge of total cost cannot be used to accurately infer information without a finer degree of detail. Even if information regarding the costs of individual projects is available in the financial statements, costs attributable to a project are based on attributions and allocations relative to a set of accounting rules for which there are options, even when all producers use the same accounting standards.²²
19. In effect, Section 1504 requires reporting only for total payments of each income-related charge on an annual basis. All that is divulged is a time series of total income-related payments by project. This information is also obtained years, sometimes many years, after contracts were signed and even modified, making inferences based on such data unreasonable. Such information cannot be useful in bidding because new bids may be based on revised contract terms and will be determined by reference to different geological information. Finally, it may not be possible to determine the particular time period to which the payment is attributed because I understand the reporting requires only cash payments as opposed to charges accrued for a particular time period.
20. **Dividends:** Dividends are an income-related payment to the extent that dividend distributions are measured by after-tax profits attributable to a particular entity. Given a government's equity participation, anyone can infer the basis upon which the dividend is based. Once again, however, given the definition of a dividend relative to a country's financial laws, tax law, or accounting standards, it might not be possible to determine the timing of the profits or even if profits exist in any economically meaningful sense. For instance, dividends might be defined under the laws of some countries to be any distribution from a legal entity to shareholders in proportion to the shareholders' interest, except in cases of a complete liquidation.²³ This definition will result in a different dividend flow given a particular stream of cash distributions relative to a definition such as distributions from Earnings and Profits as used in the United States. That is, what might be a partial liquidation under the definition employed in the United States would be a dividend under the former definition.
21. Thus, no confidential information of commercial value is revealed, in my opinion, by reporting a total amount of dividends per time period. More importantly, profits measured for a subsidiary, sometimes a lower-tier subsidiary, cannot be an indicator of a project's profitability to the investor given any flexibility to finance the project with parent debt, parent debt guarantees, as

certainty and with constant average cost. Such conditions are not reflected in any actual ex post reporting based on accounting data.

²² For instance, to infer any competitive advantage, one would have to know: the treatment of head office expenses, transfer pricing rules (even using OECD standards), service fees, lease payments to related parties operating in a tax-exempt fashion in the jurisdiction, depreciation methods, debt service rules (both related party and independent), cost sharing agreements, and many other computations. None of that information can be inferred from the data published at the project level.

²³ See Basic World Tax Code and the law in the Dominican Republic.

well as the attributions and allocations noted above. Thus, measures of overall profitability are not known and thus no competitive harm results.

22. **Payments for Infrastructure:** Reporting infrastructure values similarly will not put issuers at any competitive disadvantage given the fact that valuing infrastructure contributions or other social contributions is difficult at best. All that can be implied from the most transparent investors at the project level is a good faith estimate of the value of such expenditures, which might be more related to cost than true economic value.
23. As a tax analyst, I am an advocate of taxpayer confidentiality and believe that taxpayers' commercial secrets and related information should be protected. Accordingly, I would be reticent to support a proposal where income tax returns and supporting documentation are published.²⁴ I believe that a requirement for companies to report total values by country and by project in a public forum is consistent with the need to preserve confidential taxpayer information, and thus I support such publication at the project level.

No Lost Competitive Advantage

24. Some commenters have claimed that host governments may be able to use the data published from other projects to reduce the potential returns for the investing company. For instance, the American Petroleum Institute offered the following example:

Country A invites investors to develop its natural resources. Officials from Country A use Section 13(q) disclosures for projects in Country B to determine the rates of return that SEC filers are willing to accept. Country A uses this information to negotiate more favorable terms. The shareholders of SEC filers participating in Country A's projects receive a lower investment return than would otherwise be the case.²⁵

25. The officials in host countries and their advisers have better, and more accurate, means to measure the minimum returns required by different resource producers. The most reliable source of such information is the risk-adjusted returns based on market data, such as the time path of stock prices, information from financial disclosures such as 10-K reports, annual corporate reports, and other data. Country officials and their advisers can compute various measures of the risk-adjusted cost of capital for listed firms using finance methods such as the Capital Asset Pricing Model and Arbitrage Pricing Theory,²⁶ to name two methods. In addition, the divisional cost of capital might be inferred from the use of similar data, by comparing the returns of specialized firms and other methods. In short, host country officials and their advisers do not need reported total annual payments to make such inferences.²⁷

²⁴ I may take a different position on reporting for derivations of production shares and other natural resource related payments because these are revenues derived from the sale of public assets and the public may have a right to know how those payments are derived.

²⁵ See API letter to SEC, January 28, 2011, P.2.

²⁶ See Brealy, Myers and Allen (2006).

²⁷ It might be the case that information can be used by resource owners to get a better deal for the country, perhaps at the expense of shareholders of listed companies. If such transfers are indeed economic rents, then no competitive harm is imposed on listed companies because they still receive competitive returns. It could be the

26. Of course, information can be a valuable commodity in markets with uncertainty as well as situations in which there is asymmetric information that arises because of principal-agent problems, such as those found between corporate management (the agent) and the stockholders (the principals). Thus, there is an active market for such information in the natural resource sector. Some information is publicly available, such as comparative contract publications like Ernst and Young (2014).²⁸ Some information can be proprietary and held by investigators and investment analysts, who then sell it to banks, hedge funds, and others. Such information may include the advisory services offered by firms such as the Research and Advisory group of Petroleum Intelligence. Investment banks and lending institutions have their own methods for evaluating investor and government claims – efforts that are necessary in order to perform due diligence. Finally, the companies themselves are a source for project-specific data. For instance, see the information supplied for the Green Creek Mine owned by Hecla Mining, an entity listed on the New York Stock Exchange.²⁹
27. Finally, once an investment is made, and extraction begins, resource producers have a strong incentive to keep operating as long as short-run marginal (or average) costs are covered. The entire project could have a significant negative ex post net present value, but the present value of continuing to operate is positive because much of the investment costs might be treated as sunk costs. Thus, even what might be considered large payments to host governments are not indicators that the resource producer would have made the investment if the actual time path of prices and costs had been known.³⁰
28. Some commenters have claimed that reporting at the project level may create incentives for host governments to forsake listed entities subject to disclosure in favor of entities unencumbered by disclosure.³¹ Such claims have been made with respect to “state oil companies.” Three points should be made about these claims. First, some large state enterprises will have to disclose because they are listed on the New York Stock Exchange or EU-regulated capital markets, including: Statoil, Rosneft, Vale, Sinopec, CNOOC, Petrochina, and Petrobras. Some commenters claim that there will be an incentive for such entities to de-list in order to avoid reporting. Such a decision is not straightforward because the citizens of the country that owns the entities, as well as existing shareholders who are private parties, must trade transparency for reduced access to international capital markets as well as the reputational effects of being unwilling to supply information that is helpful in making better decisions for both citizens of resource-producing countries and shareholders. Such effects might increase the risk-adjusted cost of capital for these firms, making them less competitive.

case, however, that such information could increase the overall efficiency of markets, reducing asymmetries for instance. In this case, it is possible for total project returns, ex ante, to increase without reducing returns to listed companies.

²⁸ Ernst and Young (2014) published comparative fiscal laws of major producing countries along with major tax rules and accounting standards.

²⁹ http://www.hecla-mining.com/investors/documents/MorganStanley06-03-2014_final_web.pdf

³⁰ Investors might shut down operations and incur fixed costs in the hope that future short-term net-of-tax and payments cash flows are positive and if they can get permission from host governments, who are concerned about funding current expenditures in many cases.

³¹ See API letter to SEC, November 7, 2013, P. 2.

29. Second, state enterprises, and state oil companies in particular, are not a uniform group. Some companies are merely holding companies. For instance, the Liberian state oil company is largely a passive holding company, as are Mongolia's state mining company and Zambia's ZCCM-IH. Other entities, such as Indonesia's PERTAMINA, might engage in joint ventures, have their own operations, and may raise debt. Such enterprises, however, may have limited sources of capital absent listing on some formal capital market.
30. The lack of technology and expertise in some state oil companies is a third point. The recent joint venture between Exxon and Rosneft designed to develop Arctic reserves may be one example. The Russian government limited access to Arctic reserves to state companies, but Rosneft found it in its interest to form joint ventures with international entities such as Exxon and Statoil,³² in part because of their technical knowhow and experience. Thus, informed financial self-interest may provide an effective incentive to retain such relationships.
31. Two other scenarios have been offered by API³³ to illustrate the supposed competitive harm resulting from company-by-company, project-level disclosure. As I understand one example, Company Alpha is awarded Block A for exploration and production. Alpha has found a commercial deposit and is producing. Under 1504, Company Alpha would have to report all of its bonus payments, royalty payments, and income charges for Block A. Suppose now that additional blocks located near Block A come up for bid. Company Alpha wants to bid on them, but competing companies can see all of the payments Company Alpha made for Block A, and use that information in ways that put Company Alpha at a competitive disadvantage. Essentially, API argues, company-by-company reporting, by project, puts "first-movers" at a disadvantage when they seek to expand their operations nearby.
32. I infer that, because Company Alpha was a first mover, it is assumed in the example that this entity is making super-marginal profit, perhaps adjusted for risk. That is, Company Alpha did not pay the maximum it was willing to pay for the rights adjusted for risk, so there is a surplus accruing to Company Alpha. It is important to note that such an assumption might not be empirically the case. For instance, Company Alpha may have paid too much for the initial block, but others will not know this information, even if payments are published. I also infer from the example that it is assumed that publication of information will force Company Alpha to pay more for the adjacent licenses than it would have if the information were not public. Publication of such information is neither necessary nor sufficient, however, for the first mover's advantage to be lost. Self-interest of the resource-owning government, combined with the public information that the first mover was successful, will naturally lead to an increase in the value of adjacent properties. The resource owner should be able to accrue larger payments, either through larger bid values or contract terms more favorable to the country, and Company Alpha's super-marginal returns may be reduced for subsequent investments, but not eliminated for the initial investment.³⁴

³² See Rosneft Annual Report 2013.

³³ See API Letter to SEC, January 28, 2011, Pages 2-3.

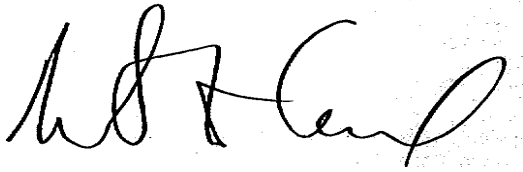
³⁴ The value of the first move may also be protected by the host government. It has been my experience that exploration licenses for particular areas are granted on an exclusive basis. Thus, the first mover can be protected by the exclusive nature of the license.

33. It is also important to note that the benefits of being a first mover may not be eliminated completely. For instance, there could be economies of scale for Company Alpha that are not available to others, which will lead to lower average costs. For instance, Company Alpha may have constructed a pipeline with extra capacity that can be used to transport output from neighboring blocks, which means that Company Alpha might be able to outbid competitors and still make super-marginal profits. Others will not know the first-mover's cost structure and might not know the geological structure of the initial area. None of this information is required to be published under project level reporting, which may further preserve the value of being the first mover. In addition, the first mover would have gained valuable institutional knowledge about working in the local environment – an investment that can provide a significant continued competitive advantage.
34. I also understand that project reporting is claimed to harm astute, risk-taking oil companies because, at least at the exploration phase, anonymity is claimed to be essential. I understand this to mean that the supposedly astute companies do not want others to know that they are exploring in a particular area. Allegedly such knowledge could harm the returns to the risk taker, as disclosure of financial information at an early stage under Section 1504 would divulge information about activities not otherwise known. Two comments are offered in response. First, companies that explore, presumably in green fields, may not want to acknowledge failure as well as success. Second, it has been my experience that anonymity will depend on the oil and mining laws of particular countries. Again, an entity must have a license to legally explore. In my experience, the license may be obtained by auction, in which case everyone knows who is exploring, or by first-come, first-served distribution, in which case the name of the license holder may be a matter of public record. There could also be nontransparent methods of awarding licenses. Organizations such as the International Monetary Fund and the World Bank are opposed to such methods on both transparency and efficiency grounds and I support their position.³⁵ In addition, the mining laws in countries of which I am familiar generally have exploration licenses for broad areas (the production license is generally for a smaller area) and these licenses are exclusive. Through time, these countries' mining laws require the licensee to yield exclusive rights, thereby reducing the total area covered by the license. There are also minimum exploration expenditures and work programs that must be approved. Given these mining laws, confidentiality of who is exploring should be lost once the license is awarded. At a minimum, competitors will know that exploration is being undertaken when a drilling rig is placed at a location or an exploration shaft is excavated.

³⁵ Two examples are noted about the positions taken by these international institutions. "Licensing procedures should be published and should be simple, objective, and transparent, with a limited number of bid variables and an emphasis on competition when possible," Calder's summary of the IMF Recommendation from the Guide on Resource Revenue Transparency, 2007. (See also Calder, Jack. *Administering Fiscal Regimes for Extractive Industries: A Handbook*. International Monetary Fund. 2014. P. 52.) Also, the World Bank has taken a strong stance on the issue (World Bank Extractive Industries Sourcebook, 2015). The Sourcebook (Section 5.6.4) states: "Transparency is at the core of good practice when it comes to award procedures. Whether acting individually or as participants in a competitive bidding round, license applicants – on a non-discriminatory basis – should be made fully aware of the procedures to be followed. They should also be provided access to all available data, whether on a free or purchase basis, and be informed of all applicable legal and fiscal regimes (including model contracts)." http://www.eisourcebook.org/650_56TheAwardofContractsandLicenses.html

35. Finally, it might be noted that reporting under Section 1504 might trigger endogenous responses by countries and entities. That is to say, reporting might, and probably will, induce changes in contract terms and structures. For instance, if firms are reticent to explore given existing mineral contractual structures, then by mutual agreement the time period for keeping geological data confidential might change. Alternatively, provisions such as forced revocation of exploration areas could be relaxed either in terms of time or areas. In addition, blocks or areas open for exploration could be larger or smaller. The point is that listed companies and host governments will adjust to reporting because the intent of reporting is to provide a better, and I would argue more economically efficient, balance of information between the contracting parties.

Thank you for the opportunity to express my views.

A handwritten signature in black ink, appearing to read 'R. F. Conrad', written over a horizontal line.

Robert F. Conrad
Associate Professor of Public Policy Studies
and Economics*

*My Duke title and affiliation are provided for identification purposes only. Any views expressed are mine alone and do not reflect the views of Duke or its constituent institutions or any other Duke personnel.