December 7, 2011

Ms. Elizabeth M. Murphy
Secretary
U.S. Securities and Exchange Commission
100 F Street, N.E.
Washington, D.C.: 20449-1090

Re: File Number 57-42-10, Proposed Rules for Disclosure

Dear Ms. Murphy:

I am a third-year student at Columbia Law School. I wish to add my comments to the thoughtful submissions made over the last sixteen months on this important issue. The following is the abstract of a note being published in the forthcoming issue of the Columbia Business Law Review:

> Section 1504 of the Dodd-Frank Wall Street Reform and Consumer Protection Act seeks to bring greater transparency to extractive-related payments made to governments by resource extraction issuers required to report to the Securities and Exchange Commission. It does so by requiring resource extraction issuers to disclose non-de minimus payments made to foreign governments to further the commercial development of oil, natural gas, or minerals. There is substantial concern among industry participants that companies subject to Section 1504 may be placed at a competitive disadvantage vis-à-vis companies not subject to the reporting requirements. This Note, focusing on the oil and gas industry, identifies the major companies that will be subject to the regulation, the potential competitive disadvantages that they may face, and whether these companies can credibly threaten to leave U.S. equity markets in response to the regulation. This Note argues that the failure of Section 1504 to achieve broad coverage of oil and gas companies will place regulated companies at a competitive disadvantage with respect to their unregulated competitors. This Note analyzes the international stock exchange participation of the top fifty oil and gas companies and finds that, in response to these competitive disadvantages, certain companies may delist from U.S. exchanges.

I have attached the full text of the forthcoming note for your consideration. Thank you for the opportunity to comment on the Commission's implementation of Section 1504 of the Dodd-Frank Act.

Sincerely yours,

Branden Carl Berns
[redacted]

# WILL OIL AND GAS ISSUERS LEAVE U.S. EQUITY MARKETS IN RESPONSE TO SECTION 1504 OF THE DODD-FRANK ACT? CAN THEY AFFORD NOT TO?

Branden Carl Berns*

*Section 1504 of the Dodd-Frank Wall Street Reform and Consumer Protection Act seeks to bring greater transparency to extractive-related payments made to governments by resource extraction issuers required to report to the Securities and Exchange Commission. It does so by requiring resource extraction issuers to disclose non-*de minimus *payments made to foreign governments to further the commercial development of oil, natural gas, or minerals. There is substantial concern among industry participants that companies subject to Section 1504 may be placed at a competitive disadvantage vis-à-vis companies not subject to the reporting requirements. This Note, focusing on the oil and gas industry, identifies the major companies that will be subject to the regulation, the potential competitive disadvantages that they may face, and whether these companies can credibly threaten to leave U.S. equity markets in response to the regulation. This Note argues that the failure of Section 1504 to achieve broad coverage of oil and gas companies will place regulated companies at a competitive disadvantage with respect to their unregulated competitors. This Note analyzes the international stock exchange participation of the top fifty oil and gas companies and finds that, in response to these competitive disadvantages, certain companies may delist from U.S. exchanges.*

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## I. INTRODUCTION

Oil, according to Venezuelan Oil Minister and OPEC co-founder Juan Pablo Perez Alfonzo, is "the devil's excrement."[1] In the 1970's, Mr. Alfonzo prophetically foretold that Venezuela's oil wealth would bring it to ruin rather than deliver prosperity. The phenomenon in which natural resources, such as oil or mineral deposits, lead a country to become less developed and achieve lower economic growth relative to countries with fewer natural resources is known as the "resource curse."[2] One effect of the "resource curse" is that local communities, despite possessing valuable natural resources, fail to realize the financial benefit of those resources and remain in poverty.[3]

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[1] Jerry Useem, *The Devil's Excrement*, FORTUNE, Feb. 2, 2003, at 96; *see also* Moisés Naím, *The Devil's Excrement*, FOREIGN POL'Y, Sept.–Oct. 2009, at 159–60.

[2] Richard M. Auty first proposed the concept of the "resource curse." *See* RICHARD M. AUTY, SUSTAINING DEVELOPMENT IN MINERAL ECONOMIES: THE RESOURCE CURSE THESIS 1 (1993). Several publications have since supported his path-breaking thesis. *See, e.g.*, Jeffrey D. Sachs & Andrew M. Warner, *Natural Resource Abundance and Economic Growth* (Nat'l Bureau of Econ. Research, Working Paper No. 5398, 1995), *available at* http://www.nber.org/papers/w5398; TERRY LYNN CARL, THE PARADOX OF PLENTY: OIL BOOMS AND PETRO-STATES xv–xvii (1997); Paul Collier, *Laws and Codes for the Resource Curse*, 11 YALE HUM. RTS. & DEV. L.J. 9 (2008).

The "resource curse" was also the subject of a 2008 minority staff report directed by Senator Richard G. Lugar, then ranking minority member of the Senate Committee on Foreign Relations. *See* STAFF OF S. COMM. ON FOREIGN RELATIONS, 100TH CONG., THE PETROLEUM AND POVERTY PARADOX: ASSESSING U.S. AND INTERNATIONAL COMMUNITY EFFORTS TO FIGHT THE RESOURCE CURSE 1 (Comm. Print 2008), *available at* http://www.access.gpo.gov/congress/senate/senate11cp110.html.

[3] Letter from the Extractive Indus. Working Grp. to the SEC 1 (Dec. 13, 2010), *available at* http://www.sec.gov/comments/df-title-xv/specialized-disclosures/specializeddisclosures-103.pdf.

Numerous non-governmental organizations ("NGOs"), participants in the natural resource extraction industry, government leaders, and commentators favor increased transparency as a means to end the "resource curse."[4] Transparency, through the disclosure of royalty payments and concession fees associated with natural-resource-extraction projects, is intended to limit corrupt officials' ability to misappropriate their nations' oil or mineral wealth.[5] In the words of U2 lead singer and humanitarian Bono, transparency can help ensure that "the [African] continent's vast riches end up in service of its people, not lining the pocket of some kleptocrat."[6]

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If managed properly, some observers feel that natural resource wealth can yet be "a pathway to poverty reduction, stable economic growth and development in resource-rich countries." *See* Letter from Isabel Munilla, Dir., Publish What You Pay U.S., to Meredith Cross, Dir. Div. of Corporate Fin., SEC 5 (Nov. 22, 2010), *available at* http://www.sec.gov/comments/df-title-xv/specialized-disclosures/specialized disclosures-82.pdf.

[4] *See, e.g.*, TRANSPARENCY INT'L, PROMOTING REVENUE TRANSPARENCY: 2008 REPORT ON REVENUE TRANSPARENCY OF OIL AND GAS COMPANIES 10 (2008), *available at* http://www.transparency.org/content/download/31529 /481007; *Transparency*, EXXONMOBIL, http://www.exxonmobil.com/Corpora te/about_issues_transparency.aspx (last visited Dec. 1, 2011); President Barack Obama, Remarks at the Millennium Development Goals Summit (Sept. 22, 2010), *available at* http://www.whitehouse.gov/the-press-office/2010/09/22/remarks-president-millennium-development-goals-summ it-new-york-new-york; Matthew Genasci & Sarah Pray, *Extracting Accountability: The Implications of the Resource Curse for CSR Theory and Practice*, 11 YALE HUM. RTS. & DEV. L.J. 37, 50 (2008); Andreanna M. Truelove, Note, *Oil, Diamonds, and Sunlight: Fostering Human Rights Through Transparency in Revenues from Natural Resources*, 35 GEO. J. INT'L L. 207 (2003).

[5] Daniel M. Firger, *Transparency and the Natural Resource Curse: Examining the New Extraterritorial Information Forcing Rules in the Dodd-Frank Wall Street Reform Act of 2010*, 41 GEO. J. INT'L L. 1043, 1048 (2010). As Firger points out, however, the efficacy of this strategy is uncertain because "such a disclosure-based approach, taken alone, suffers from misaligned incentives and policing problems that make it less likely to achieve its objectives." *Id.* at 1049.

[6] Kara Scannell, *Oil Industry Gets Disclosure Jolt*, WALL ST. J., Aug. 11, 2010, at B1. Transparency may also accomplish additional goals such

The eventual enactment of section 1504 ("Section 1504") of the Dodd-Frank Wall Street Reform and Consumer Protection Act (the "Act") was largely based on several years of sustained congressional attention to the problems posed by the "resource curse," coupled with vigorous support from NGOs and international networks.[7] The stated purpose of Section 1504 is "to bring greater transparency to extractive-related payments made to governments by resource extraction issuers" required to report to the Securities and Exchange Commission ("SEC").[8] Section 1504 facilitates transparency by requiring resource extraction issuers to disclose non-*de minimus* payments[9] made to a foreign government[10] to further the commercial development of oil, natural gas, or minerals.[11] According to Senator Benjamin L. Cardin, co-author of the legislation, Section 1504 will provide important information both to investors and citizens seeking

as strengthening "domestic institutions by arming citizens with information that can enable them to hold their leaders accountable." Firger, *supra* note 5, at 1048.

[7] *See* Firger, *supra* note 5, at 1060 n.71.

[8] Letter from Benjamin L. Cardin, Senator, U.S. Senate, to Mary Shapiro, Chairman, SEC 1 (Dec. 1, 2010), *available at* http://www.sec.gov/comments/df-title-xv/specialized-disclosures/specialized disclosures-94.pdf.

[9] The definition of "payment":

> (i) means a payment that is (I) made to further the commercial development of oil, natural gas, or minerals; and (II) not de minimis; and (ii) includes taxes, royalties, fees (including license fees), production entitlements, bonuses, and other material benefits, that the Commission, consistent with the guidelines of the Extractive Industries Transparency Initiative (to the extent practicable), determines are part of the commonly recognized revenue stream for the commercial development of oil, natural gas, or minerals.

15 U.S.C. § 78m(q)(1)(C) (2010).

[10] The definition of "government" includes "those of a subsidiary or entity controlled by the issuer." *Id.* § 78m(q)(2)(A).

[11] *See* Disclosure of Payments by Resource Extraction Issuers, 75 Fed. Reg. 246 (proposed Dec. 23, 2010) (to be codified at 17 C.F.R. pt. 229, 249) [hereinafter *Proposed Rules Under Section 13(q)*].

to hold their governments accountable for extractive revenues.[12]

Among industry participants, there is substantial concern that companies subject to Section 1504 (i.e. issuers required to file annual reports with the SEC) may face a competitive disadvantage vis-à-vis companies that are not subject to the new regulation.[13] Such a disadvantage could arise if foreign governments, to avoid the public scrutiny, prohibit payment disclosure or intentionally award bids and contracts to companies not required to file annual reports with the SEC.[14] Many industry participants also believe that requirements to report detailed, proprietary information will enable competitors to use information against them when competing for future contracts.[15]

Both supporters and opponents of the legislation generally agree that implementation of the rules should maintain a neutral competitive environment and not unduly burden companies subject to the new disclosure rules.[16] To maintain neutrality and avoid creating competitive

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[12] Letter from Benjamin L. Cardin to Mary Shapiro, *supra* note 8, at 1.

[13] ARNOLD & PORTER LLP, NEW CORPORATE SOCIAL RESPONSIBILITY REQUIREMENTS: DODD-FRANK ACT MANDATES DISCLOSURE TO SEC OF PAYMENTS TO FOREIGN GOVERNMENTS AND USE OF MINERALS FROM THE DEMOCRATIC REPUBLIC OF THE CONGO 4 (2010), *available at* http://www.arnoldporter.com/public_document.cfm?u=DoddFrankCSRProvisionsMandateDisclosureofOverseasPaymentsandUseofConflictMaterials&id=16406&key=10G2.

[14] *See id.*

[15] Melissa Klein Aguilar, *Dodd-Frank Causes New Oil & Gas Pains*, COMPLIANCE WK. (Aug. 24, 2010), http://www.complianceweek.com/pages/login.aspx?returl=/dodd-frank-causes-new-oil-gas-pains/article/186923/&pagetypeid=28&articleid=186923&accesslevel=2&expireddays=0&accessAndPrice=0.

[16] *See, e.g.*, Karin Lissakers, Letter to the Editor, *More Disclosure Will Help Investors and Oil Companies*, WALL ST. J., Aug. 16, 2010, at A14; Letter from Isabel Munilla to Meredith Cross, *supra* note 3, at 3; Letter from Kyle Isakower, Vice President of Regulatory & Econ. Policy, and Patrick T. Mulva, Chairman of Corporate Fin. Comm., Am. Petroleum Inst., to the SEC 6 (Oct. 12, 2010), *available at* http://www.sec.gov/comments/df-title-xv/specialized-disclosures/specialized disclosures-27.pdf.

disadvantages, the legislation must treat companies equally. Although U.S. securities regulation cannot reach Nationally Owned Companies ("NOCs") with complete state ownership such as Saudi Aramco,[17] it is important that Section 1504 achieve broad coverage of both NOCs and Internationally Owned Companies ("IOCs") whose securities reach the U.S. market.

Supporters of Section 1504 maintain that the legislation will in fact achieve broad coverage of IOCs; with one supporter claiming the legislation will cover 90% of the major IOCs.[18] As a result, Senators Cardin and Richard G. Lugar are confident that "[c]ontrary to oil-industry assertions, the new transparency requirements for payments to governments . . . [are] unlikely to hurt the competitiveness of U.S. oil companies."[19] On the other hand, many industry participants are more pessimistic and anticipate that the legislation will create disadvantages for companies covered by the legislation. One company forecasts: "if the Commission were to adopt rules that resulted in our business operations being prohibited in certain foreign countries, we believe Shell and other Foreign Private Issuers might be forced to consider withdrawing from the U.S. market in order to protect our shareholders investments."[20]

This Note considers whether the concerns of many industry participants are justified and whether the

[17] Many NOCs do not have publicly-traded securities. As a result, they cannot be subject to U.S. securities regulation as foreign private issuers.

[18] PUBLISH WHAT YOU PAY U.S., QUESTIONS AND ANSWERS: EXTRACTIVE INDUSTRY PAYMENT DISCLOSURE PROVISION IN THE DODD-FRANK WALL STREET REFORM AND CONSUMER PROTECTION ACT 1 (2010), http://pwypusa.org/resource-center/resources/q-disclosure-provision-dodd-frank-wsr-cpa [hereinafter PUBLISH WHAT YOU PAY Q&A].

[19] Richard G. Lugar & Benjamin L. Cardin, Letter to the Editor, *More Disclosures Will Help Investors and Oil Companies*, WALL ST. J., Aug. 16, 2010, at A14.

[20] Letter from Martin J. ten Brink, Exec. Vice President Controller, Royal Dutch Shell PLC, to Meredith Cross, Dir. Div. of Corp. Fin., SEC 3 (Oct. 25, 2010), *available at* http://www.sec.gov/comments/df-title-xv/specialized-disclosures/specializeddisclosures-33.pdf.

regulations promulgated under Section 1504 will incentivize companies covered by the legislation to leave U.S. equity markets. The scope of the question is narrowed by focusing on oil and natural gas companies[21] and the equity segment of capital markets.[22] To answer the question, this Note will address the following issues: First, how broad is the scope of coverage that Section 1504 achieves with respect to IOCs? Second, what are the potential costs and competitive disadvantages companies covered by Section 1504 will face? Third, can IOCs credibly threaten to leave U.S. equity markets?

## II. BACKGROUND

### A. The Competitive Structure of the Oil and Gas Industry

#### 1. Nationally Owned Companies

Major IOCs, such as ExxonMobil, BP, Chevron, ConocoPhillips, and Royal Dutch Shell ("Shell"), control very little of the world's supply of crude oil. As of 2006, these five firms held only 3.8% of the world's liquid oil reserves.[23] In contrast, NOCs hold the majority of the world's petroleum reserves and produce the majority of the world's supply of crude oil.[24] The dominance of NOCs with respect to oil reserves is also demonstrated by their reserve-to-production

[21] The vast scope of the extractive industry necessitated narrowing the focus of this Note. Therefore, an analysis of other extractive industries such as mining has been omitted.

[22] Many companies analyzed in this Note are foreign. The data used in this Note are available primarily as a result of U.S. and foreign stock exchange disclosure requirements. Reliable data could only be obtained with respect to companies' equity securities. Therefore, this Note does not contain analysis of debt and other instruments.

[23] ROBERT PIROG, CONG. RESEARCH SERV., RL 34137, THE ROLE OF NATIONAL OIL COMPANIES IN THE INTERNATIONAL OIL MARKET 3 (2007).

[24] *Id.* at 3–4.

ratios.[25] In 2008, the Iraqi National Oil Company had a ratio of fifty-four years.[26] By contrast, as of 2008, the five major IOCs cited above possessed an average ratio of only 5 years.[27] The vast reserves of NOCs translate into production and pricing power, suggesting the continued rise of NOCs in world oil markets. Table 1, below, illustrates the reserves and production of the top twenty oil and gas companies as of 2008.

TABLE 1: TOP TWENTY OIL AND GAS COMPANIES BY RESERVES[28]

| Rank | Company | Reserves[29] | Production[30] |
|---|---|---|---|
| 1 | Nat'l Iranian Oil Co. | 311,883 | 6,202 |
| 2 | Saudi Aramco | 308,650 | 12,106 |
| 3 | Iraqi Nat'l Oil Co. | 133,650 | 2,454 |
| 4 | Petroleos de Venezuela | 128,713 | 3,042 |
| 5 | Qatar Petroleum | 118,216 | 1,879 |
| 6 | Gazprom | 116,613 | 9,695 |
| 7 | Kuwait Petroleum Corp. | 111,983 | 2,991 |
| 8 | Abu Dhabi Nat'l Oil Co. | 73,050 | 2,007 |
| 9 | Turkmengas | 46,833 | 907 |
| 10 | Nigerian Nat'l Petroleum Corp. | 40,020 | 1,640 |
| 11 | Libya NOC | 39,073 | 1,547 |
| 12 | PetroChina[31] | 37,691 | 3,847 |

[25] Reserve-to-production ratios calculate the amount of oil remaining, expressed in terms of years. The numerator of the ratio is the total known amount of oil. The denominator of the ratio is the yearly amount of oil produced.

[26] Letter from Kyle Isakower & Patrick T. Mulva to the SEC, *supra* note 16, at Attachment B.

[27] *Id.*

[28] *Id.*

[29] Millions of BOE (barrel of oil equivalent)

[30] Letter from Kyle Isakower & Patrick T. Mulva to the SEC, *supra* note 16, at Attachment B.

[31] PetroChina is a subsidiary of CNPC. CNPC owns approximately 86.29% of PetroChina's share capital. PetroChina Co. Ltd., Annual Report (Form 20-F) 13 (May 10, 2011).

| Rank | Company | Reserves[29] | Production[30] |
|---|---|---|---|
| 13 | Sonatrach Petroleum Corp. | 35,661 | 3,106 |
| 14 | Petronas | 27,020 | 1,796 |
| 15 | Exxon Mobil | 22,986 | 3,921 |
| 16 | Rosneft | 22,309 | 2,320 |
| 17 | BP | 17,888 | 3,790 |
| 18 | Lukoil | 15,467 | 1,787 |
| 19 | Pemex | 13,982 | 3,849 |
| 20 | Royal Dutch Shell | 11,663 | 3,199 |

Due to their state ownership, NOCs generally hold exclusive rights to exploration and development within their local jurisdiction.[32] Through partnership agreements, NOCs determine the level at which IOCs participate in these activities.[33] As NOCs become more sophisticated, they will be better positioned to exploit new domestic opportunities for development without the support of IOCs.[34] NOCs have traditionally operated solely within their home jurisdictions, but they are increasingly expanding their international presence.[35] As such, a "national oil company" can no longer be defined as a company operating exclusively within its own national borders.[36] For example, in 1997, Petrobas, Brazil's majority-state-owned company, operated in eleven countries, while today it has operations in twenty-nine countries.[37]

[32] *See* PIROG, *supra* note 23, at Summary.

[33] *Id.*

[34] *See* VALÉRIE MARCEL, CHATHAM HOUSE, INVESTMENT IN MIDDLE EAST OIL: WHO NEEDS WHOM? 11–12 (2006), *available at* http://www.chathamhouse.org/sites/default/files/public/Research/Energy,%20Environment%20and%20Development/vmfeb06.pdf.

[35] *Id.* Increasingly, NOCs wish to compete with IOCs and demonstrate their equal competence. They also wish to be seen as international companies rather than solely local institutions.

[36] *Id.* at 6; *see also* Letter from Grant D. Aldonas, Principal Managing Dir., Split Rock Int'l Inc., to Meredith Cross, Dir. Div. of Corp. Fin., SEC 13 (Mar. 1, 2011), *available at* http://www.sec.gov/comments/s7-42-10/s74210-36.pdf.

[37] Letter from Marcos Menezes, Chief Accounting Officer, Petrobras, to Elizabeth Murphy, Sec'y, SEC 5 (Feb. 21, 2011), *available at* http://www.sec.gov/comments/s7-42-10/s74210-25.pdf; Nina Nikolayevna

NOCs generally have two types of equity ownership structure, but this distinction is becoming increasingly blurred.[38] The first structure is pure government ownership with no publicly held shares.[39] Of the top fifty oil and gas companies by reserves, nineteen NOCs fit this description.[40] The second structure is partial government ownership with the remaining shares held by private shareholders in local and international equity markets.[41] Of the top fifty oil and gas companies by reserves, eleven NOCs have partial direct or indirect government ownership, and the government is the majority owner in all but two of such companies.[42] Complete or partial privatization of NOCs has occurred steadily over the last thirty years,[43] and as NOCs expand internationally, privatization may increase in order to supply the necessary capital for new projects.[44]

### 2. Internationally Owned Companies

In contrast to NOCs, IOCs will likely play an increasingly minor role in international oil and gas markets. A 2009 ranking showed that the top IOCs, as a group, accounted for a smaller portion of the operational criteria rankings than

Pusenkova, *The Hungry, Impoverished and Rich: The Strategies of National Oil Companies Largely Determined by the State of Their Countries' Resources*, NEZAVISIMAYA GAZETA (Apr. 8, 2008), http://en.ng.ru/energy/2008-04-08/4_strayegy.html.

[38] *See* THE WORLD BANK GROUP & THE CENTER FOR ENERGY ECONOMICS/BUREAU OF ECONOMIC GEOLOGY, A CITIZEN'S GUIDE TO NATIONAL OIL COMPANIES, PART A, TECHNICAL REPORT 13 (2008), *available at* http://www.beg.utexas.edu/energyecon/nocs/WB_CEE_NOC_Guide_A _Technical_Report_October_2008_final.pdf.

[39] *See id.*

[40] *See infra* Appendix 1.

[41] WORLD BANK GROUP, *supra* note 38, at 13.

[42] *See infra* Appendix 1.

[43] *See* Christian Wolf & Michael Pollitt, *Privatising National Oil Companies: Assessing the Impact on Firm Performance* 9 (Cambridge Judge Bus. Sch., Working Paper No. 02, 2008), *available at* http://papers.ssrn.com/sol3/papers.cfm?abstract_id=1088327.

[44] *See* PIROG, *supra* note 23, at 13.

they did prior to the mega-mergers that created them.[45] Despite their decline, IOCs still offer superior access to capital, expertise, management skills, and state-of-the-art technologies.[46] Moreover, IOCs possess several advantages including: (1) the ability to offer NOCs access to western markets; (2) mitigation of project and regional risk through global portfolio diversification; (3) branding that reflects the core values of the firm, allowing them to be perceived as independent and politically neutral; (4) a culture of risk-taking and profit-maximization that naturally results from shareholder ownership; and (5) superior access to financial markets, allowing IOCs to obtain relatively cheaper capital.[47] These advantages motivate NOCs to enter production-sharing and joint venture agreements with IOCs, particularly for ventures involving the expansion of NOCs beyond their own jurisdictions.[48]

Unlike NOCs, IOCs are owned by private shareholders and frequently list or trade on multiple international exchanges. One example is Shell. Shell securities are primarily listed on the London Stock Exchange[49] with shares or American Depository Receipts ("ADRs") also listed on the Euronext and the New York Stock Exchange ("NYSE"). Shell is registered with the SEC as a "foreign private

[45] The operational criteria rankings are based on six operational criteria comparing internationally-owned and state-owned oil companies. ENERGY INTELLIGENCE GROUP, NATIONAL OIL COMPANIES STRENGTHEN THEIR HOLD IN ANNUAL SURVEY, PETROLEUM INTELLIGENCE WEEKLY RANKS WORLD'S TOP 50 OIL COMPANIES (2009), *available at* http://www.energyintel.com/documentdetail.asp?document_id=245527.

[46] *See* DELOITTE, SEIZING OPPORTUNITIES: A NEW ERA FOR NATIONAL OIL COMPANIES 4 (2008), *available at* http://www.deloitte.com/assets/Dcom-Global/Local%20Assets/Documents/SeizingOpportunities.pdf.

[47] GERSON LEHRMAN GROUP, THE IOC RESPONSE TO THE GOVERNMENT/NOC COMPETITIVE THREAT 1–2 (2008), *available at* http://www.glgroup.com/NewsWatchPrefs/Print.aspx?pid=21307.

[48] *See id.*; *see also* MARCEL, *supra* note 34, at 11.

[49] Letter from Martin J. ten Brink to Meredith Cross, *supra* note 20, at 1.

issuer"[50] and currently has over 500 million ADRs outstanding.[51]

## B. Pre-Section 1504 Transparency Initiatives

### 1. The Extraction Industry Transparency Initiative

The Extractive Industry Transparency Initiatiave ("EITI") is a voluntary coalition of governments, corporations, civil groups, investors, and international organizations whose stated purpose is to "strengthen governance by improving transparency and accountability in the extractives sector."[52] Within the EITI, participating governments agree to publish revenues received from extractive industries and companies agree to disclose payments made to governments.[53] An independent auditor then reconciles the payments and revenues and publishes an opinion regarding the reconciliation.[54] Generally, the EITI only requires countries to report payments on an aggregated, countrywide basis rather than disaggregated payments by individual companies.[55] Currently, thirty-six countries have implemented or are committed to implementing the EITI.[56] In addition, fifty oil and gas companies support the EITI.[57]

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[50] *Id.*

[51] Royal Dutch Shell plc, Annual Report (Form 20-F) 88 (Mar. 15, 2011).

[52] *What is the EITI?*, EITI, http://eiti.org/eiti (last visited Dec. 1, 2011).

[53] Mara V.J. Senn & Rachel L. Frankel, *Wall Street Reform Law Creates Foreign-Payment Legal Hazards*, 108 OIL & GAS J. 24, 24 (2010).

[54] *Id*.

[55] Letter from Kyle Isakower & Patrick T. Mulva to the SEC, *supra* note 16, at 4.

[56] *See EITI Countries*, EITI, http://eiti.org/countries (last visited Dec. 1, 2011). Under the Energy Security Through Transparency Act ("ESTT"), a forerunner to Section 1504, Senators Lugar and Cardin called for the United States to become a candidate country of the EITI. *See* Energy Security Through Transparency Act of 2009, S. 9897, 111th Cong. (2009).

[57] *See Supporting Companies*, EITI, http://eiti.org/supporters/companies (last visited Dec. 1, 2011).

The EITI receives strong support from industry participants, governments, and NGOs. However, critics point to several flaws. First, the voluntary nature of the EITI allows the governments of those countries who could benefit most from revenue transparency to avoid liability simply by declining membership in the coalition. Second, aggregated revenue data are often too general to be useful for country-by-country comparisons. Third, countries face no real sanctions for violating commitments other than expulsion from the EITI.[58] Recent data do not reveal any visible, positive effect on transparency in the countries that signed the EITI.[59]

### 2. Disclosure Rules in Non-U.S. Capital Markets

Some foreign governments have also begun implementing disclosure regimes, though none as comprehensive as Section 1504. In 2010, the Hong Kong Stock Exchange adopted limited country-level disclosure requirements (similar to the EITI) that require mineral companies applying to the exchange to furnish country-by-country data on tax, royalty, and other payments to host governments.[60] Similarly, extractive companies applying for initial listing on the London Stock Exchange's Alternative Investment Market must "disclose any payments aggregating over £10,000 made to any government or regulatory authority or similar body made by the applicant or on behalf of it, with regard to the

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[58] *See* Firger, *supra* note 5, at 1067.

[59] *See* Dilan Ölcer, *Extracting the Maximum from the EITI* 10 (OECD Dev. Ctr., Working Paper No. 276, 2009), *available at* http://www.oecd.org/dataoecd/56/60/42342311.pdf.

[60] The disclosure requirements apply to a listed issuer that becomes a Mineral Company by undertaking a Relevant Notifiable Transaction involving the acquisition of Mineral or Petroleum Assets. HONG KONG STOCK EXCHANGE, AMENDMENTS TO THE GEM LISTING RULES OF THE HONG KONG STOCK EXCHANGE Ch. 18A.05(6)(c) (2010), *available at* http://www.hkex.com.hk/eng/rulesreg/listrules/gemrulesup/Documents/gem34_miner.pdf; *see also* REVENUE WATCH INSTITUTE, HONG KONG: STOCK EXCHANGE TO REQUIRE GREATER TRANSPARENCY 1 (2010), *available at* http://www.revenuewatch.org/print/1192.

acquisition of, or maintenance of, its assets."[61] E.U. and U.K. officials will likely wait until the U.S. rules are finalized before making decisions with respect to further payment disclosure requirements.[62] Finally, the International Accounting Standards Board ("IASB"), whose reporting standards are required or permitted in nearly 120 countries, is considering mandatory financial reporting on a country-by-country basis.[63] This mandate would likely replicate aspects of the disclosures required by the EITI and Section 1504.

## III. HOW BROAD IS THE SCOPE OF COVERAGE THAT SECTION 1504 ACHIEVES WITH RESPECT TO IOCS?

### A. Background of the Bill

On July 21, 2010, President Obama signed the Dodd-Frank Wall Street Reform and Consumer Protection Act, an unprecedented overhaul of the U.S. financial regulatory

[61] LONDON STOCK EXCHANGE, NOTE FOR MINING AND OIL & GAS COMPANIES 4 (2009), *available at* http://www.londonstockexchange.com/companies-and-advisors/aim/advisers/rules/guidance-note.pdf.

[62] *See, e.g.*, Letter from Karin Lissakers, Exec. Dir., Revenue Watch Inst., to Meredith Cross, Dir. Div. of Corp. Fin., SEC 5 (Dec. 6, 2010), *available at* http://www.sec.gov/comments/df-title-xv/specialized-disclosures/specializeddisclosures-98.pdf.

[63] IFRS FOUNDATION, INTERNATIONAL ACCOUNTING STANDARDS BOARD (IASB), WHO WE ARE AND WHAT WE DO (2011), *available at* http://www.ifrs.org/NR/rdonlyres/1D35BB5F-6E59-446F-9861-A84F9288CBB4/0/Who_we_areJuly11.pdf.

For a general overview of the IASB's most recent views, see INTERNATIONAL ACCOUNTING STANDARDS BOARD, DISCUSSION PAPER: EXTRACTIVE ACTIVITIES (2010), *available at* http://www.ifrs.org/NR/rdonlyres/735F0CFC-2F50-43D3-B5A1-0D62EB5DDB99/0/DPExtractiveActivitiesApr10.pdf. *See also* Karin Lissakers, *Wall Street Reform Includes Big Steps on Oil and Mining Transparency*, THE HUFFINGTON POST (July 15, 2010, 5:40 PM), http://www.huffingtonpost.com/karin-lissakers/wall-street-reform-includ_b_643399.html.

system.[64] In addition to overhauling the financial system, the Act contained Section 1504, "Disclosure of Payments by Resource Extraction Issuers,"[65] which is based on the proposed Energy Security Through Transparency Act ("ESTT") originally introduced in Congress in September 2009.[66] Senators Lugar and Cardin inserted Section 1504 into the Dodd-Frank Act during the late stages of conference negotiations.[67]

## B. Requirements of the Bill

Enactment of Section 1504 added Section 13(q) to the Securities Exchange Act of 1934 (the "Exchange Act").[68] Section 13(q) requires the SEC to issue rules, not later than

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[64] Dodd-Frank Wall Street Reform and Consumer Protection Act, H.R. 4173, 111th Cong. (2010).

[65] *Id.* § 1504.

[66] The ESTT intended that the U.S. be an "implementing" country of the EITI. *See* 155 Cong. Rec. S9746 (daily ed. Sept. 23, 2009) (statement of Sen. Richard Lugar); *see also* SHEARMAN & STERLING LLP, THE DODD-FRANK ACT: NEW DISCLOSURE REQUIREMENTS FOR REPORTING ISSUERS ENGAGED IN EXTRACTIVE ENTERPRISES OR USING CONFLICT MINERALS 5 (2010), *available at* http://www.shearman.com/files/Publication/1304d12f-1229-46be-963b-c45db1ae9c16/Presentation/PublicationAttachment/883bc9a2-3934-4633-9c38-7537baa09984/CM-072910-New-Disclosure-Requirements-for-Reporting-Issuers-Engaged-in-Extractive-Ente.pdf.

[67] The inclusion of Section 1504 in the Dodd-Frank Act took many by surprise. Its late insertion can be observed in the language of Senator Dodd during conference negotiations:

> Because we have not yet been able to hold hearings on this measure this year . . . I am not sure we have all the precise details and the language exactly right, but the thrust is exactly right and, therefore, in my view, the amendment by Senators Cardin and Lugar ought to be adopted. We can work on the details, if we have to, later on, but we should not miss this opportunity provided by this legislation to make this historic contribution to something that not only benefits investors here at home but might make a huge difference in the wealth and opportunity in these countries.

156 Cong. Rec. S3817 (daily ed. May 17, 2010) (statement of Sen. Dodd).

[68] 15 U.S.C. § 78m(q) (2010).

270 days after the date of enactment of the Act,[69] that compel resource extraction issuers to include in an annual report information relating to any payment made by the issuer, a subsidiary, or a controlled entity to the Federal or a foreign government for the purpose of the commercial development of oil, natural gas, or minerals.[70] Section 13(q) also requires resource extraction issuers "to provide information about the type and total amount of payments made for each project related to the commercial development of oil, natural gas, or minerals, and the type and total amount of payments made to each government."[71] In addition, the Act provides definitions for the following terms: (1) resource extraction issuer; (2) commercial development of oil, natural gas, or minerals; (3) foreign government; (4) payment; (5) interactive data format; and (6) interactive data standard.[72]

Section 13(q) specifies, "[t]o the extent practicable, the rules issued under [the section] shall support the commitment of the Federal Government to international transparency promotion efforts relating to the commercial development of oil, natural gas, or minerals."[73] In its proposed rules, the Commission has determined that "[a]lthough the provision regarding international transparency efforts does not explicitly mention the EITI, the legislative history indicates that the EITI was considered in connection with the new statutory provision."[74] Further, the Commission must give significant consideration to both the protection of investors and the promotion of efficiency, competition, and capital formation, as required by Section 3(f) and Section 23(a)(2) of the Exchange Act.[75]

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[69] The rule-issuing deadline was April 15, 2011.

[70] 15 U.S.C. § 78m(q)(2)(A).

[71] *Id.* The information must be provided "in an interactive data format," as specified by the SEC. *Id.* § 78m(q)(2)(C).

[72] *See id.* § 78m(q).

[73] *Id.* § 78m(q)(2)(E).

[74] *See Proposed Rules Under Section 13(q)*, *supra* note 11, at 80979.

[75] In a letter to the SEC, several prominent law firms opined that the Act did not repeal or amend sections 3(f) and 23(a)(2) of the Exchange Act and that Section 1504 of the Dodd-Frank Act is not irreconcilable with

Section 13(q) provides that the final rules "shall take effect on the date on which the resource extraction issuer is required to submit an annual report relating to the fiscal year . . . that ends not earlier than 1 year after the date on which the Commission issues final rules . . . ."[76] To implement Section 13(q), the Commission has issued a proposal containing new rules and form amendments.[77] Although Section 1504 requires the Commission to issue final rules prior to April 15, 2011, this deadline was not met.[78] As of the publication of this note, the Commission has yet to issue final rules.

## C. Scope of Issuer Coverage

Section 13(q) defines "resource extraction issuer" as "an issuer that . . . is required to file an annual report with the Commission and . . . engages in the commercial development of oil, natural gas, or minerals . . . ."[79] The filing of an annual report is significant because payment disclosures are to be made via additional disclosures on Forms 10-K, 20-F, and 40-F.[80] Under the securities laws, not only domestic

sections 3(f) and 23(a)(2). The firms therefore concluded that the directive contained in these sections should be given consideration in connection with the rulemaking process. *See* Letter from Cravath, Swaine & Moore LLP, Cleary Gottlieb Steen & Hamilton LLP, Davis Polk & Wardwell LLP, Shearman & Sterling LLP, Simpson Thacher & Bartlett LLP, Skadden, Arps, Slate, Meagher & Flom LLP, Sullivan & Cromwell LLP, and Wilmer Cutler Pickering Hale and Dorr LLP to Meredith Cross, Dir. Div. of Corporate Fin., SEC 1, 5 (Nov. 5, 2010), *available at* http://www.sec.gov/comments/df-title-xv/specialized-disclosures/specialized disclosures-45.pdf [hereinafter Letter from Cravath to Meredith Cross].

[76] 15 U.S.C. § 78m(q)(2)(F).

[77] *See Proposed Rules Under Section 13(q)*, *supra* note 11, at 80978.

[78] Letter from Benjamin L. Cardin & Richard G. Lugar, Senators, U.S. Senate, to Mary Shapiro, Chairman, SEC 1 (Apr. 15, 2011) (on file with author).

[79] 15 U.S.C. § 78m(q)(1)(D).

[80] Added are proposed items 4(c) of Form 10-K, proposed items 601(b)(97) and (98) of Regulation S-K, proposed item 16I of Form 20-F, and proposed paragraph (17) to General Instruction B of Form 40-F. *Proposed Rules Under Section 13(q)*, *supra* note 11, at 80980.

companies but also foreign companies may be required to file an annual report with the Commission. Under the Exchange Act, a domestic company becomes an issuer required to file a Form 10-K annual report by: (1) listing securities for trading on a national securities exchange;[81] or (2) having a class of equity securities owned of record by 500 or more persons and having total assets exceeding $10 million.[82]

A foreign company, other than a foreign government, is a foreign private issuer *unless* it has more than fifty percent of its outstanding voting securities directly or indirectly held of record by residents of the United States; and if either (1) the majority of the executive officers or directors are U.S. citizens or residents; (2) more than fifty percent of its assets are located in the United States; or (3) the business of the issuer is administered principally in the United States.[83] A foreign company designated as a foreign private issuer is subject to the reporting requirements of filing a Form 20-F or 40-F annual report if: (1) it registers with the Commission the public offer and sale of its securities under the Securities Act; (2) it lists a class of its securities on a U.S. national securities exchange; or (3) a class of the foreign private issuer's securities is held of record by 500 or more persons in the United States.[84]

Based on this analysis, which companies qualify as domestic and foreign private issuers and are required to file annual reports with the Commission? Of the top fifty oil and gas companies, nineteen companies are NOCs with complete state-ownership.[85] Because NOCs with complete state-ownership do not have publicly-listed securities, they cannot be subject to the reporting requirements of Section 1504. Of the top fifty oil and gas companies, twenty-eight companies have some portion of publicly-listed shares.[86] Of these

[81] 15 U.S.C. § 78l(b).

[82] *Id.* § 78l(g).

[83] 17 C.F.R. § 240.3b-4(c) (2010).

[84] *See* 15 U.S.C. § 78l(g).

[85] *See infra* Appendix 1.

[86] *See infra* Table 2. The term "publicly-listed shares" is meant to include shares listed in both foreign and U.S. markets.

twenty-eight companies, eighteen qualify as domestic issuers or foreign private issuers required to file annual reports with the Commission.[87] Several companies avoid the filing requirement by failing to have any securities listed or sufficiently held in the United States.[88] Others, such as Lukoil, Surgutneftegas OJSC, and BG Group, have Level 1 over-the-counter ADRs ("OTC ADRs") listed on an over-the-counter exchange.[89] These securities are not deemed to be listed on an exchange as defined by the Exchange Act and are exempted from filing pursuant to Exchange Act Rule 12g3-2(b).[90] Finally, three companies of the top fifty are partially or wholly owned by IOCs who qualify as issuers.[91] These companies are likely to be deemed an "entity under the control of the issuer" and would also be required to comply with Section 1504.[92] In summary, Section 1504, as proposed, would cover twenty-one of the top fifty oil and gas companies in the world (eighteen foreign and domestic issuers and three controlled entities).

The following table illustrates the coverage achieved by §13(q) under the proposed rules.

[87] *See id*.

[88] For example, Rosneft, KazMunaiGas, and Tatneft. *See id.*

[89] *Id.*

[90] Subject to the requirement that the company's equity securities are held of record by less than 300 residents in the United States. 17 C.F.R. § 240.12g3-2(e) (2010).

[91] The three companies are TNK-BP (partially owned by BP), Petrodar (partially owned by CNPC), and SPC (wholly owned by SPC).

[92] 15 U.S.C. § 78m(q)(2)(A) (2010). At a minimum, the SEC-regulated partner in a joint venture may have to disclose its pro-rata share of payments made. *See Proposed Rules Under Section 13(q)*, *supra* note 11, at 80986–87.

## TABLE 2: ISSUER STATUS OF THE TOP FIFTY OIL AND GAS COMPANIES[93]

| **Rank**[94] | **Company** | **Central Index Key (“CIK”)** | **Issuer Status**[95] |
|---|---|---|---|
| 1 | Nat’l Iranian Oil Co. | - | - |
| 2 | Saudi Aramco | - | - |
| 3 | Iraqi Nat’l Oil Co. | - | - |
| 4 | Petroleos de Venezuela | - | - |
| 5 | Qatar Petroleum | - | - |
| 6 | Gazprom | 0001358581 | Not Issuer |
| 7 | Kuwait Petroleum Corp. | - | - |
| 8 | Abu Dhabi Nat’l Oil Co. | - | - |
| 9 | Turkmengas | - | - |
| 10 | Nigerian Nat’l Petroleum Corp. | - | - |
| 11 | Libya Nat’l Oil Co. | - | - |
| 12 | PetroChina[96] | 0001108329 | Foreign |
| 13 | Sonatrach Petroleum Corp. | 0001054835 | Not Issuer |
| 14 | Petronas | - | - |
| 15 | Exxon Mobil | 0000034088 | Domestic |
| 16 | Rosneft | 0001040970 | Not Issuer |
| 17 | BP | 0000313807 | Foreign |
| 18 | Lukoil | 0000940173 | Not Issuer |
| 19 | Pemex | 0000932785 | Not Issuer |
| 20 | Royal Dutch Shell | 0001306965 | Foreign |

[93] Data were taken from the SEC’s EDGAR database. The database can be accessed by entering the company’s Central Index Key (“CIK”) number in the search engine located at http://www.sec.gov/edgar/searchedgar/companysearch.html.

[94] Letter from Kyle Isakower & Patrick T. Mulva to the SEC, *supra* note 16, at Attachment B.

[95] Issuer status was determined by examining the companies’ recent filings. Companies currently filing 10-K annual reports were classified as domestic issuers (“Domestic”). Companies currently filing 20-F or 40-F reports were classified as foreign private issuers (“Foreign”). Some companies have a CIK as a result of a previous SEC filing yet do not currently file annual reports with the Commission. With the exception of BG Group, no previous filings included annual reports.

[96] *See supra* note 31.

| **Rank**[94] | **Company** | **Central Index Key ("CIK")** | **Issuer Status**[95] |
|---|---|---|---|
| 21 | Chevron | 0000093410 | Domestic |
| 22 | Petrobras | 0001119639 | Foreign |
| 23 | Surgutneftegas OJSC | 0001021122 | Not Issuer |
| 24 | ConocoPhillips | 0001163165 | Domestic |
| 25 | Total S.A. | 0000879764 | Foreign |
| 26 | Uzbekneftegaz | - | - |
| 27 | Egyptian Gen. Petroleum Co. | - | - |
| 28 | Eni | 0001002242 | Foreign |
| 29 | Petrodar | - | Joint Venture[97] |
| 30 | ONGC | - | - |
| 31 | State Oil Co. of Azerbaijan Rep. | - | - |
| 32 | Tatneft | 0001058255 | Not Issuer |
| 33 | KazMunaiGas | - | - |
| 34 | StatoilASA | 0001140625 | Foreign |
| 35 | Pertamina | - | - |
| 36 | OAO Novatek | - | - |
| 37 | Sonangol | - | - |
| 38 | SPC | - | Owned by PetroChina[98] |
| 39 | TNK-BP | - | Joint Venture[99] |
| 40 | Sinopec | 0001123658 | Foreign |
| 41 | Canadian Natural Resources | 0001017413 | Foreign |
| 42 | EnCana | 0001157806 | Foreign |
| 43 | Occidental | 0000797468 | Domestic |
| 44 | YPFB | - | - |
| 45 | Suncor | 0000311337 | Foreign |

[97] *Shareholders,* PETRODAR OPERATING COMPANY, http://www.petrodar.com/content.php?GL=1&PL=5 (last visited Dec. 1, 2011).

[98] Judith Wang, *PetroChina owns 96.18% of SPC after closing mandatory offer*, ICIS NEWS (Sept. 7, 2009, 4:50 AM), http://www.icis.com/Articles/2009/09/07/9245403/petrochina-owns-96.18-of-spc-after-closing-mandatory.html.

[99] *TNK-BP*, BP, http://www.bp.com/sectiongenericarticle.do?categoryId=9009631&contentId=7018796 (last visited Dec. 1, 2011).

| **Rank**[94] | **Company** | **Central Index Key (“CIK”)** | **Issuer Status**[95] |
|---|---|---|---|
| 46 | CNOOC | 0001095595 | Foreign |
| 47 | BG | 0000805260 | Not Issuer |
| 48 | Devon Energy | 0001090012 | Domestic |
| 49 | Bashneft | - | - |
| 50 | Apache | 0000006769 | Domestic |

## D. Consequences of the Limited Scope of Issuer Coverage

Both supporters and opponents of Section 1504 agree that broad coverage of oil and gas companies is necessary to ensure that the law does not unduly disadvantage the companies subject to the regulation.[100] Section 1504 supporters Senator Cardin and Publish What You Pay U.S. (“PWYP U.S.”), an NGO committed to increased revenue transparency in the extractive sector, each expected that the legislation would achieve broad coverage.[101] Furthermore,

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[100] *See, e.g.*, Lissakers, *supra* note 16, at A14; Letter from Isabel Munilla to Meredith Cross, *supra* note 3, at 3; Letter from Kyle Isakower & Patrick T. Mulva to the SEC, *supra* note 16, at 6; Cohen, *infra* note 147.

[101] In May 2010, during the formulation of the Dodd-Frank Act (then known as the “Restoring American Financial Stability Act of 2010”), Senator Cardin unsuccessfully attempted to pass Amendment No. 3072. The amendment was substantially similar to Section 1504. With respect to the amendment, Senator Cardin stated:

> The provisions of this amendment would apply to all oil, gas, and mining companies required to file periodic reports with the SEC; namely, 90 percent of the major internationally operating oil companies . . . . Of the top 50 oil and gas companies by proven oil reserves, 20 are national oil companies that do not usually operate internationally . . . . Of the remaining 30 companies that do operate internationally, 27 would be covered by this legislation—27 of the 30. These include Canadian, European, Russian, Chinese, Brazilian, and other international companies.

156 Cong. Rec. S3315–16 (daily ed. May 6, 2010) (statement of Sen. Cardin). Similarly, following the enactment of the Dodd-Frank Act, PWYP

the Commission, in implementing Section 1504, anticipates that the disclosure requirements will "apply equally to companies that fall within this definition whether or not they are owned or controlled by governments."[102] The Commission anticipates that the proposed rule and form amendments will "affect in substantially the same way both U.S. companies and foreign companies that meet Section 13(q)'s definition of 'resource extraction issuer.'"[103] Regrettably, by amending the reporting requirements for only forms 10-K, 20-F, and 40-F, the Commission has considerably narrowed the coverage of foreign issuers.

What accounts for the discrepancy between expected and actual results? One factor appears to be differences in data. In its memorandum, PWYP U.S. cites the 2007 worldwide oil equivalent reserves as reported in the *Oil & Gas Journal*.[104] These statistics are over four years old and do not take into account the recent emergence of powerful state and international companies, particularly those located in Russia and the former Soviet republics.[105] Furthermore, the data are based on crude oil reserves and fails to include natural gas reserves.[106] Finally, the PWYP U.S. analysis includes Lukoil and BG Group, but did not seem to anticipate that Section 1504 would fail to cover companies with OTC ADRs that can be exempted from filing pursuant to Exchange Act Rule 12g3-2(b).[107]

U.S. explained that the Act covered 90% of the major internationally operating oil and gas companies. PUBLISH WHAT YOU PAY Q&A, *supra* note 18, at 1.

[102] *Proposed Rules Under Section 13(q)*, *supra* note 11, at 80980.

[103] *Id.* at 80996.

[104] Marilyn Radler & Leena Koottungal, *OGJ100 Group Posts Improved 2007 Results*, 106 OIL & GAS J. 34, 34 (2008). Senator Cardin does not cite the source for his statistics, but they are likely derived from a similar source.

[105] The continued emergence of Russia is extremely important to the oil and gas industry. *See* Andrew E. Kramer, *Despite Politics, Oil Companies Are Lured by Russian Petroleum*, N.Y. TIMES, Jan. 28, 2011, at B1.

[106] Radler & Koottungal, *supra* note 104, at 34.

[107] PUBLISH WHAT YOU PAY Q&A, *supra* note 18, at 1.

The Social Investment Forum and Calvert Investments, both supporters of Section 1504, recognize the gap in coverage between the proposed and final rules. To close this gap, they advocate that disclosure should be required, not only by entities filing an annual report using forms 10-K, 20-F, or 40-F, but also by entities with OTC ADRs currently required to furnish only an annual report pursuant to Section 12g3-2(b) of the Exchange Act.[108]

The failure of Section 1504 to achieve broad coverage of all companies with shares traded in U.S. markets is exacerbated by the inherent inability of SEC regulation to reach NOCs without publicly-listed securities. Supporters of Section 1504 presume that NOCs "do not compete with internationally operating companies."[109] Unfortunately, this view is outdated and incorrect. NOCs do compete internationally with IOCs for projects and contracts, and increasingly so.[110] Their expanding international presence is illustrated by a list of the countries in which NOCs have international operations contained in Attachment C of the American Petroleum Institute's ("API") letter to the SEC.[111] By discounting the importance of NOCs in competing for international projects, supporters of Section 1504 further

[108] Letter from Bennett Freeman, Paul Bugala & Lisa N. Woll, Senior Vice President, Calvert Asset Mgmt Co., Inc., Sustainability Analyst, Calvert Asset Mgmt. Co., Inc. & CEO, Soc. Inv. Forum, to Meredith Cross, Dir. Div. of Corp. Fin., SEC 3–4 (Nov. 15, 2010), *available at* http://www.sec.gov/comments/df-title-xv/specialized-disclosures/specialized disclosures-49.pdf. The distinction in "filing" and "furnishing" an annual report is that exempted issuer only need publish, at a minimum, English translations of: (1) its annual report, including or accompanied by annual financial statements; (2) interim reports that include financial statements; (3) press releases; and (4) all other communications and documents distributed directly to security holders of each class of securities to which the exemption relates. 17 C.F.R. § 240.12g3-2(e) (2010).

[109] *See* 156 Cong. Rec. S3315-16, *supra* note 101; *see also* PUBLISH WHAT YOU PAY Q&A, *supra* note 18, at 1.

[110] *See* Letter from Kyle Isakower & Patrick T. Mulva to the SEC, *supra* note 16, at 5.

[111] *Id*. at Attachment C.

overstate the degree to which the regulation achieves universal coverage.

Changes to the proposed rules, such as those suggested by Calvert Investments and the Social Investment Forum, may increase the coverage of Section 1504. However, the inability of a U.S. disclosure regime to affect companies without publicly listed securities creates doubt about whether such a regime could ever preserve a neutral regulatory environment.

## IV. WHAT ARE THE POTENTIAL COSTS AND COMPETITIVE DISADVANTAGES FACING COMPANIES COVERED BY SECTION 1504?

As proposed, Section 1504 will potentially impose additional costs and disadvantages including: (1) increased internal compliance costs of establishing appropriate disclosure procedures; (2) external public relations costs of publicly disclosing payments made to foreign governments; (3) informational disadvantages vis-à-vis other competitors resulting from the publication of proprietary information contained in payment disclosures; (4) forced violation or costly renegotiation of existing contracts between companies and foreign governments; and (5) placement of issuers covered by Section 1504 at a competitive disadvantage vis-à-vis unregulated companies in commercial negotiations and contract bidding with foreign governments.[112] The following sections analyze the potential impact of these additional costs and disadvantages.

### A. Compliance Costs

#### 1. Requirements of Section 1504

Section 13(q) requires disclosure of payment information in an annual report, which must contain an interactive data format that complies with an interactive data standard

[112] SHEARMAN & STERLING LLP, *supra* note 66, at 6.

established by the SEC.[113] An "interactive data format" is "an electronic data format in which pieces of information are identified using an interactive data standard . . . ."[114] An "interactive data standard" is a "standardized list of electronic tags that mark information included in the annual report of a resource extraction issuer."[115] The electronic tags must identify: (1) the total amount of payments, by category; (2) the currency used to make the payments; (3) the financial period in which the payments were made; (4) the business segment of the resource extraction issuer that made the payments; (5) the government that received the payments and the country in which the government is located; and (6) the project of the resource extraction issuer to which the payments relate.[116]

### 2. SEC Proposal to Implement the Requirements

The proposed rules require that payment information be included in two additional exhibits to Forms 10-K, 20-F, and 40-F.[117] The issuer must include in the exhibits: (1) the type and total amount of payments made for each project; (2) the total amount of payments made to each government, relating to the commercial development of oil, natural gas, or minerals; and (3) other certain detailed information about the payments.[118] The Commission prefers the disclosure of payment information within the 10-K, 20-F, and 40-F annual reports to avoid imposing the additional burden of submitting a separate annual report.[119]

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113 *See* 15 U.S.C. § 78m(q) (2010).
114 *Id.* § 78m(q)(1)(E).
115 *Id.* § 78m(q)(1)(F).
116 *Id.* § 78m(q)(2)(D)(ii).
117 *Proposed Rules Under Section 13(q)*, *supra* note 11, at 80989–90.
118 *Id.* at 80998.
119 *Id.* at 80989.

### 3. Impact of the Requirements and Proposal

The SEC estimates that the proposed rules will increase the marginal burden of submitting the amended forms by approximately 52,932 hours of company personnel time and $11,857,200 in services paid to outside professionals.[120] This includes the cost of collecting information, preparing and reviewing disclosure, filing documents, and retaining records.[121] The SEC acknowledges that these costs may vary depending on the required degree of modification to existing systems and the extent to which issuers already voluntarily provide payment information under the EITI.[122] At a minimum, issuers will incur some costs because the EITI requires disclosure of payment information on a per-country basis, rather than the per-project basis required by Section 1504.[123] Also, issuers will be required to provide the additional disclosures without receiving a deadline extension, which may further increase compliance costs.[124]

The SEC's estimates of increased marginal costs address only the proposed rules over which the SEC exercises discretion, rather than the entire Section 1504 regime.[125] Opponents of Section 1504 voice objection to the increased costs of the entire regime because companies must track additional data to comply with Section 1504's disclosure rules.[126] They believe this will increase compliance costs for companies that already have extensive Foreign Corrupt Practices Act ("FCPA") compliance policies and procedures by requiring further disclosure of legal and legitimate payments to foreign governments.[127] According to one

[120] *Id.* at 80994.

[121] *Id.*

[122] *Id.* at 80996–97.

[123] *Id.*

[124] *Id.*

[125] *Id.*

[126] *Id.*

[127] Letter from Mike Koehler, Assistant Professor of Bus. Law, Butler Univ., to the SEC 1 (Sept. 3, 2010), *available at* http://www.sec.gov/comments/df-title-xv/specialized-disclosures/specialized

market observer, "[t]he burden of disclosure could be pretty heavy" and some companies may have to "disclose thousands of payments annually."[128] ExxonMobil Vice President and Controller Patrick T. Mulva estimates that the cost to ExxonMobil of implementing the Proposed Rules will exceed $50 million and the industry-wide cost will reach into the hundreds of millions.[129] The burden of disclosure is likely to be heaviest on large, diversified companies because they would face this data-gathering obligation in almost every country in which they are conducting business.[130] For example, Shell operates in over ninety countries and designs its financial systems to provide information on an entity, rather than project, basis.[131] As a result, integrating detailed project reporting requirements could cost Shell hundreds of millions of dollars.[132]

An additional concern facing large foreign issuers is the potential need to provide multiple payment disclosures in Form 20-F to satisfy the different requirements of the United States, United Kingdom, and European Union.[133] Shell

disclosures-7.htm; *see also* MCDERMOTT WILL & EMERY, UNITED STATES: DODD-FRANK ACT IMPOSES NEW DISCLOSURE REQUIREMENTS ON ENERGY AND MINING COMPANIES 2 (2010), *available at* http://www.mwe.com/index.cfm/fuseaction/publications .nldetail/object_id/5fe36c64-ba99-48ee-bacf-f7683b09f9ce.cfm.

[128] *See* Aguilar, *supra* note 15, at 2.

[129] Letter from Patrick T. Mulva, Vice President & Controller, ExxonMobil Corp., to the SEC 1 (Oct. 25, 2011), *available at* http://www.sec.gov/comments/s7-42-10/s74210-112.pdf.

[130] *See id; see also* PRICEWATERHOUSECOOPERS, TOTAL TAX CONTRIBUTION: GLOBAL STUDY FOR THE MINING SECTOR 5 (2009), *available at* http://www.pwc.com/gx/en/energy-utilities-mining/pdf/total-tax-contribu tion-mining-sector.pdf (noting that "[f]or most of the participating companies, this was the first time such data has been put together to show a picture of their real tax footprint" and that "not all of the participants were able to provide all of the data requested . . . each participant covered only some, not all, of their countries of operation").

[131] Letter from Martin J. ten Brink to Meredith Cross, *supra* note 20, at 5.

[132] *Id.*

[133] *See id.*

requested that the Commission provide an exemption to allow "foreign private issuers to follow their home country rules and disclose in their Form 20-F the required home country disclosure."[134] The Commission rejected this request because it felt the statutory language did not allow standards to vary in response to special circumstances or burdens facing an individual issuer.[135]

Finally, industry participants object to the requirement that they file additional disclosures according to the same deadline as annual reports. To ease the burden, they request an extension to make such disclosures after filing the annual reports.[136] According to the National Mining Association, including disclosures in the registrant's filed annual report would create unrealistic time pressure.[137] The Commission has resisted this suggestion because it believes that "it could be less burdensome for resource extraction issuers, as well as more useful to investors, to provide the disclosure in a form that issuers are already required to file rather than requiring them to furnish a separate report."[138]

Despite these objections, some analysts remain optimistic that the additional cost burden will be minimal. According to PWYP U.S., "[s]everal securities law experts have considered the potential ramifications of this new regulation for U.S. markets" and "have concluded . . . this is a low-cost regulation that does not directly impact corporate behavior."[139] Other commentators believe the burden will be minimal because: (1) companies already conduct internal audits and have the revenue information available; (2)

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[134] *Id.*

[135] *Proposed Rules Under Section 13(q)*, *supra* note 11, at 80987.

[136] *See* Letter from Kyle Isakower & Patrick T. Mulva to the SEC, *supra* note 16, at 10. The annual report is normally prepared in January and February and approved by its board of directors in the mid-February timeframe (for domestic issuers whose fiscal year is on a calendar basis).

[137] Letter from the Nat'l Mining Ass'n to the SEC 5 (Nov. 16, 2010), *available at* http://www.sec.gov/comments/df-title-xv/specialized-disclosures/specializeddisclosures-52.pdf.

[138] *Proposed Rules Under Section 13(q)*, *supra* note 11, at 80989.

[139] PUBLISH WHAT YOU PAY Q&A, *supra* note 18, at 3.

thirty-seven companies are supporters of the EITI and already have a head start on compliance; and (3) companies operating in the United States already must make equivalent payment disclosures to taxation authorities, such as the Minerals Management Service.[140]

## B. Public Relations Costs

Section 13(q) requires, to the extent possible, that the SEC make a compilation of the information it receives from resource extraction issuers publicly available online.[141] Some companies have expressed concern regarding the public disclosure of bids submitted confidentially to protect sensitive information, such as the terms of a contract with a foreign government.[142] Public disclosure of these bids and payments could have public relations ramifications for companies regularly conducting business with foreign governments.[143]

Supporters of Section 1504 claim that disclosures protect companies from reputational risk by shifting the target for social, environmental, and distribution concerns from the company to the government.[144] For example, Newmont Mining Corporation, the second largest gold mining company in the world, stated: "[B]y publishing their payment information, the focus of citizens and local communities

[140] *See id.* at 4; Letter from Isabel Munilla to Meredith Cross, *supra* note 3, at 16–17; *see also* Letter from Karin Lissakers, Exec. Dir., Revenue Watch Inst., to Meredith Cross, Dir., Div. of Corp. Fin., SEC 7–8 (Feb. 17, 2011), *available at* http://www.sec.gov/comments/s7-42-10/s74210-23.pdf.

[141] 15 U.S.C. § 78m(q)(3) (2010).

[142] ARNOLD & PORTER LLP, NEW CORPORATE SOCIAL RESPONSIBILITY REQUIREMENTS: DODD-FRANK ACT MANDATES DISCLOSURE TO SEC OF PAYMENTS TO FOREIGN GOVERNMENTS AND USE OF MINERALS FROM THE DEMOCRATIC REPUBLIC OF THE CONGO 4 (2010), *available at* http://www.aporter.net/resources/documents/Advisory-New_Corporate_Social_Responsibility_Requirements_081310.pdf.

[143] An entity's reputation could be harmed if it is perceived to be associated with, or complicit in, corrupt government practices that have adverse social or environmental consequences.

[144] PUBLISH WHAT YOU PAY Q&A, *supra* note 18, at 3.

shifts from them to the government. This is because once citizens know how much has been received, they can demand accountability from their government."[145]

## C. Proprietary Information Costs

The public disclosure of confidential information by companies subject to Section 1504 may create the additional disadvantage that competitors will understand their costs, investments, and lease payments without having to disclose their own proprietary information.[146] Ken Cohen, CEO of ExxonMobil, expressed his fear that Section 1504 requires ExxonMobil to "turn over the competitively negotiated terms of their proprietary contracts to all foreign competitors who don't have U.S. SEC reporting requirements—providing no protection for confidential information."[147] The API, a lobbying group that includes many major U.S. oil and gas companies, is troubled that non-U.S. companies such as Russia's Gazprom are not required to disclose information under the proposed rules of Section 1504 and could use the data to outmaneuver U.S. companies in contract negotiations.[148]

Supporters of Section 1504, a group that includes some companies affected by the legislation, contend that these concerns are overstated. In 2009, Revenue Watch Institute and Columbia Law School conducted a joint study of over 100 oil and mining contracts between local governments and extractive companies.[149] The study found that "many companies maintain confidentiality rules around contract terms chiefly as a matter of habit" and "most deals include

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[145] *Id.*

[146] *See* Aguilar, *supra* note 15.

[147] Ken Cohen, *A Less Than Transparent Approach to Transparency in Congress,* EXXONMOBILPERSPECTIVES (July 14, 2010), http://www.exxon mobilperspectives.com/2010/07/.

[148] *See* Scannell, *supra* note 6, at B1.

[149] PETER ROSENBLUM & SUSAN MAPLES, CONTRACTS CONFIDENTIAL: ENDING SECRET DEALS IN THE EXTRACTIVE INDUSTRIES 17 (2009).

few matters of genuine commercial sensitivity."[150] Chris Anderson, Director of Corporate Affairs for Newmont Mining, remarked during a panel discussion on negotiated fiscal terms in the oil sector that he "cannot see one reason why investment agreements are kept confidential" and called the commercial sensitivity argument "an anachronism."[151] The 2009 study also confirmed that most information would likely already be in the public domain or would be of such minimal competitive value that, with the exception of references to future transactions and trade secrets (for which Section 1504 does not require disclosure), they would not cause substantial harm to an issuer's competitive position.[152] This is because the information most sensitive within the extractive industries, specifically geological data, costs, and profits, is not covered by Section 1504.[153]

## D. Violation and Renegotiation of Current Contracts

A compliance expert recently observed that confidentiality agreements may prevent oil and gas companies from disclosing information to third parties concerning their arrangements to purchase oil or gas from host countries.[154] Oil and gas companies may be in breach of these confidentiality agreements if they make disclosures to the SEC.[155] The SEC has resisted requests to provide an exemption for companies that are contractually prevented from disclosing payments made to host governments.[156] A spokesman for Shell, in a letter to the SEC, noted that some

[150] PUBLISH WHAT YOU PAY U.S., COMMENTS OF PUBLISH WHAT YOU PAY ON SECTION 1504 OF THE DODD-FRANK WALL STREET REFORM AND CONSUMER PROTECTION ACT 16 (2010), *available at* http://www.earthrights.org/sites/default/files/documents/PWYP-Comment-SEC-Rulemaking-Section-1504-11-22-10.pdf.

[151] *Id.*

[152] ROSENBLUM & MAPLES, *supra* note 149, at 37.

[153] Letter from Karin Lissakers to Meredith Cross, *supra* note 62, at 5.

[154] Senn & Frankel, *supra* note 53, at 24.

[155] *Id.*

[156] *See Proposed Rules Under Section 13(q)*, *supra* note 11, at 80987.

of their existing contracts prohibit disclosure of such payments and would require costly renegotiation.[157]

This compliance risk may be exaggerated. The 2009 joint study of extractive industry contracts conducted by Revenue Watch Institute and Columbia Law School recognized that contracts often include confidentiality clauses; however, the study pointed out that the clauses are not an impermeable shield.[158] Compliance with the law, including stock market disclosure requirements, is generally considered under judicial or arbitral review as an exception to confidentiality obligations.[159] Additionally, many confidentiality clauses include explicit exceptions for securities regulation, stock exchanges, and compliance with home country laws.[160] On the other hand, the API notes that while many contracts contain such exceptions, some contracts only permit the contracting party, not affiliates or parents, to make such disclosures.[161] Further research may be required to verify that a general exception for compliance with the law exists in the respective statutes of host countries and whether it applies to affiliates, parents, and subsidiaries. If so, U.S. companies may be able to use such an exception to avoid violating local law by making public disclosures of payments, despite contractual obligations to the contrary.

### E. Competitive Disadvantages

The greatest concern expressed by industry participants is that local governments will enact laws preventing disclosure of payments. Shell, in a letter to the SEC,

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[157] Letter from Martin J. ten Brink to Meredith Cross, *supra* note 20, at 3.

[158] ROSENBLUM & MAPLES, *supra* note 149, at 26–28.

[159] *Id. See also* Letter from Isabel Munilla, Dir., Publish What You Pay U.S., to Elizabeth Murphy, Sec'y, SEC 5 (Feb. 25, 2011), *available at* http://www.sec.gov/comments/s7-42-10/s74210-29.pdf.

[160] *Id.*

[161] Letter from Kyle Isakower, Vice President of Regulatory & Econ. Policy & Patrick T. Mulva, Chairman of API Corp. Fin. Comm., Am. Petroleum Inst., to Elizabeth Murphy, Sec'y, SEC 25 (Jan. 28, 2011), *available at* http://www.sec.gov/comments/s7-42-10/s74210-10.pdf.

outlined four reasons why foreign governments will choose to enact such laws:

> 1. Payment information is likely to be viewed as competitively sensitive. For example, it is unlikely that a foreign government would want one international oil company to know the amount of a signature bonus and other remuneration elements paid by another international oil company when negotiating a similar project;
> 2. A country where security is an issue may have significant safety concerns regarding such disclosure. For example, precise project level payment disclosure could allow terrorists or insurgents to target a specific project in order to significantly affect a country's revenues and thereby destabilizing that country's economy;
> 3. Disclosure of precise payment information concerning projects where the underlying field crosses a country's borders could be viewed as a security risk or state secret; and
> 4. Some countries are unlikely to appreciate the extraterritorial effects of the US legislation.[162]

The API also argues that disaggregation at the project, payment, and payee levels (as opposed to the country-level reporting of the EITI) may encourage the adoption of laws prohibiting the disclosure of payments.[163] Although thirty-six host countries are committed to implementing country-level disclosure under the EITI, their participation does not imply approval of the disaggregated payment disclosures required under Section 1504.[164] According to the API, no host government has ever agreed to or suggested that project-level disclosure of payments would be appropriate.[165]

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[162] Letter from Martin J. ten Brink to Meredith Cross, *supra* note 20, at 2–3.

[163] Letter from Kyle Isakower & Patrick T. Mulva to the SEC, *supra* note 16, at 6.

[164] *Id.*

[165] *Id. See also* Letter from Martin J. ten Brink to Meredith Cross, *supra* note 20, at 1–2 ("[N]o EITI country has adopted project level

Currently, a number of resource extraction issuers operate in countries that have laws limiting or preventing the disclosure of payments to the government.[166] According to the API, the disclosure of revenue payments made to foreign governments or companies owned by foreign governments is currently prohibited in Cameroon, China, Qatar, and Angola.[167] These laws will require companies to choose between either avoiding new projects and abandoning existing projects in certain countries or terminating their SEC registrations.[168] Due to the increasing power of NOCs relative to IOCs, and the near monopoly of NOCs over worldwide oil reserves, this competitive disadvantage poses a serious threat to IOCs.[169] The threat will be much less

disclosure."). *But see* Letter from Benjamin L. Cardin to Mary Shapiro, *supra* note 8, at 2 ("[H]alf of EITI implementing countries have decided to report on a disaggregated basis, by company and payment type. Many have expanded reporting to the sub-national level, as well as to other sectors, and many are considering reporting on social payments.").

[166] *See* Letter from Cravath to Meredith Cross, *supra* note 75, at 2.

[167] Letter from Kyle Isakower & Patrick T. Mulva to Elizabeth Murphy, *supra* note 161, at 2. *See also* Letter from Patrick T. Mulva, Vice President & Controller, ExxonMobil, to Elizabeth Murphy, Sec'y, SEC 1–2 (Mar. 15, 2011), *available at* http://www.sec.gov/comments/s7-42-10/s74210-73.pdf (citing specific laws in Qatar and Angola that prohibit disclosure of payments); Letter from Martin J. ten Brink, Exec. Vice President Controller, Royal Dutch Shell PLC, to Elizabeth Murphy, Sec'y, SEC 1–2, 12–17 (May 17, 2011), *available at* http://www.sec.gov/comments/s7-42-10/s74210-90.pdf (citing specific laws in Cameroon and China which prohibit disclosure of payments). *But see* Letter from Isabel Munilla to Elizabeth Murphy, *supra* note 159, at 48–51 (noting instances in which all four countries have allowed disclosure of payments and noting their general support for payment disclosure); Letter from Jaff Napolean Bamenjo, Assoc. Coordinator, RELUFA, to Elizabeth Murphy, Sec'y, SEC 1–2 (July 11, 2011), *available at* http://www.sec.gov/comments/s7-42-10/s74210-96.pdf (disputing Mr. ten Brink's assertion that Cameroon's laws do not allow the disclosure of extractive payments).

[168] *See* Letter from Cravath to Meredith Cross, *supra* note 75, at 2; Letter from Torgrim Reitan, Exec. Vice President & Chief Fin. Officer of Statoil ASA, to Elizabeth Murphy, Sec'y, SEC 5 (Feb. 22, 2011), *available at* http://www.sec.gov/comments/s7-42-10/s74210-26.pdf.

[169] *See supra* Section I.

plausible if the final rules provide universal or near-universal coverage of IOCs and publicly-listed NOCs. Under a scenario of near-universal coverage, NOCs would be limited to a handful of partners if they wished to avoid public disclosure of payments. Conversely, if the proposed rules were to achieve significantly less than universal coverage, NOCs would have greater choice of potential partners, placing companies subject to Section 1504 at a disadvantage.[170] According to the API, host governments could select business partners on future projects that did not have similar reporting requirements or remove U.S.-listed companies as operators from existing projects.[171] The competitive disadvantage would be augmented as foreign IOCs and publicly-listed NOCs with insubstantial secondary listings in U.S. equity markets choose to delist and avoid payment disclosure regulation. This discrepancy could ignite a "race to the bottom"; however, each company's decision to delist would be constrained by its dependence on U.S. equity markets.[172]

Not all are convinced such an extreme result is imminent. PWYP U.S. believes there is little reason to be concerned that "issuers that are required to report information pursuant to Section 1504 will find themselves at a competitive disadvantage when competing with firms that are not subject to such disclosure requirements when bidding for new projects."[173] They reason that, in practice, companies compete on a variety of factors, including the fiscal terms offered, technological capacity, capital available, and others.[174] Therefore, it is unlikely that disclosure of project payments would be the sole determinant of a company's success in capturing a bid.[175] For example, successful companies, such as Statoil, Newmont Mining, and Talisman

[170] ARNOLD & PORTER LLP, *supra* note 13, at 4.

[171] Letter from Kyle Isakower & Patrick T. Mulva to the SEC, *supra* note 16, at 6.

[172] For a discussion of this possibility, see *infra* Section V.

[173] Letter from Isabel Munilla to Meredith Cross, *supra* note 3, at 16.

[174] *Id.* at 18.

[175] *Id.*

Energy, all have robust voluntary disclosure practices.[176] This suggests that disclosure practices may not weigh heavily among factors affecting competition.[177]

Other analysts believe that local laws prohibiting payments are unlikely to be enacted. Calvert Investments points out that, "investment contracts allow [disclosure of payments], EITI nations have committed to disclosure, and many countries (such as Angola and Brazil) have unilaterally disclosed information similar to that covered by [Section 1504]."[178] The organization is also confident in the long-term leverage of IOCs relative to NOCs, stating: "[t]he argument that it will be harder to compete with opaque state-owned companies is weaker than it may seem. The big groups—North American and European majors but also, for example, Brazil's Petrobras—have technology and know-how that no state-owned giant can beat."[179] Despite the potential competitive disadvantages that may result from implementing Section 1504, supporters nevertheless argue, "it is better to avoid altogether places whose despots only welcome companies that covertly help despoil the country."[180]

## F. Conclusion

The marginal compliance costs of Section 1504 could be substantial, particularly for large, complex IOCs such as Shell.[181] However, these costs are unlikely to be enough, on their own, to cause companies to consider delisting from U.S. stock exchanges. Similarly, public relations costs could become significant should companies become the target of local or international public opposition.[182] Nevertheless, companies are in the best position to deal with these costs,

[176] Letter from Karin Lissakers to Meredith Cross, *supra* note 62, at 5.

[177] *Id.*

[178] *Id.* at 4.

[179] Editorial, *U.S. Shines a Light*; *Transparency Rules Emerge from Shadows of Congress*, FIN. TIMES, June 19, 2010, at 8.

[180] *Id*.

[181] *See supra* Section IV.A.

[182] *See supra* Section IV.B.

and the magnitude of the threat, on its own, is unlikely to discourage participation in U.S. equities markets.

It is unclear whether the threat of proprietary information costs is as severe as industry insiders claim.[183] It may be true that many deals include few matters of genuine commercial sensitivity. Nonetheless, if these items are vital to the competitiveness of a company, we should expect competitors to exploit this data. The potential costs of renegotiating existing contracts violated by disclosure of payments are also unclear.[184] Even so, they are unlikely to be sizeable enough to discourage U.S. equity listings. The greatest potential competitive disadvantage is the risk that host countries will prohibit payment disclosure.[185] The inadequate issuer coverage achieved by the proposed rules exacerbates this risk and creates the possibility that companies required to file forms 10-K, 20-F, and 40-F will consider exiting U.S. equity markets.

## V. CAN IOCS CREDIBLY THREATEN TO LEAVE U.S. EQUITY MARKETS?

### A. Data

Of the top fifty oil and gas companies by reserves, thirty-one have some form of private ownership.[186] These thirty-one companies can be roughly grouped into three categories: (a) foreign companies that are not subject to the proposed rules of Section 1504; (b) domestic and foreign companies that are subject to the proposed rules of Section 1504 and also have a substantial portion of their shares listed on U.S. exchanges; and (c) foreign companies that are subject to the proposed rules of Section 1504 but have a less substantial portion of their shares listed on U.S. exchanges.

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[183] *See supra* Section IV.C.

[184] *See supra* Section IV.D.

[185] *See supra* Section IV.E.

[186] *See infra* Appendix 1.

### 1. Category (a)

Of the ten companies in category (a), three—Lukoil, Surgutneftegas OJSC, and BG Group—have Level I OTC ADRs trading in the United States.[187] Pursuant to the exemption contained in Exchange Act Rule 12g3-2(b), Level I ADRs do not give rise to a requirement for the company to file annual 20-F or 40-F forms, and are therefore not subject to the proposed rules.[188] The remaining seven companies do not have direct or indirect U.S. shareholders and therefore cannot qualify as foreign private issuers.[189]

TABLE 3: FOREIGN ISSUERS NOT COVERED BY THE PROPOSED RULES OF SECTION 1504

| **Rank** | **Company** | **Share Type** | **Percent of Shares** | **Total Market Capitalization (millions)**[190] |
|---|---|---|---|---|
| 6 | Gazprom | State held | 50.002%[191] | $145,248 |
| | | Ordinary shares[192] | 22.42% | |
| | | GDRs[193] | 27.57%[194] | |

[187] *See infra* Table 3.

[188] 17 C.F.R. § 240.12g3-2(b) (2010).

[189] *See supra* Section III.C.

[190] Unless noted otherwise, all market capitalization data are taken from the Reuters website as of November 17, 2011. *See generally Stocks,* REUTERS, http://www.reuters.com/finance/stocks (last updated Nov. 29, 2011, 8:44 PM). Some market capitalization data on the Reuters website were listed in foreign currencies. Currency conversions were made using the appropriate exchange rate on the OANDA website as of November 17, 2011. *See generally Currency Converter*, OANDA, http://www.oanda.com/ (last updated Nov. 29, 2011, 4:00 PM).

[191] OAO GAZPROM, ANNUAL REPORT 2010 103 (2011), *available at* http://www.gazprom.com/f/posts/55/477129/gazprom-annual-report-2010-en.pdf.

[192] Ordinary shares are defined as publicly-listed shares not held by the state government or held in the form of global depository receipts.

[193] For the purposes of this note, global depository receipts ("GDRs") are defined as depository receipts traded solely outside of the United

| **Rank** | **Company** | **Share Type** | **Percent of Shares** | **Total Market Capitalization (millions)**[190] |
|---|---|---|---|---|
| 16 | Rosneft | State held | 75.16%[195] | $77,801 |
| | | Ordinary shares | 13.04% | |
| | | GDRs | 11.80%[196] | |
| 18 | Lukoil | Ordinary shares | 33.69% | $48,490 |
| | | ADRs | 66.31%[197] | |
| 23 | Surgutneftegas | Ordinary shares | Unknown | $37,259 |
| | | GDRs and ADRs[198] | Unknown | |
| 30 | ONGC | State held | 74.14%[199] | $45,262 |
| | | Ordinary shares | 25.86% | |
| 32 | Tatneft | Ordinary shares | 70.10% | $11,865 |
| | | GDRs | 29.90%[200] | |

States. For the purposes of this note, ADRs consist solely of depository receipts publicly available to U.S. investors on a national stock exchange or in the over-the-counter market. *See DR Basics and Benefits*, BNY MELLON DEPOSITORY RECEIPTS, http://www.adrbnymellon.com/dr_edu_basics_and_benefits.jsp (last visited Dec. 1, 2011).

[194] OAO GAZPROM, *supra* note 191, at 103.

[195] ROSNEFT, 2010 ANNUAL REPORT 148 (2011), *available at* http://www.rosneft.com/attach/0/58/80/a_report_2010_eng.pdf.

[196] *Id.* at 150.

[197] LUKOIL, ANNUAL REPORT 2010 125 (2011), *available at* http://www.lukoil.com/materials/doc/Annual_Report_2010/LUKOIL_AR_2010_ENG.pdf.

[198] OJSC Surgutneftegas does not distinguish between depository receipts trading on the U.S. OTC Market and the London Stock Exchange. *See* OJSC SURGUTNEFTEGAS, 2010 OJSC SURGUTNEFTEGAS ANNUAL REPORT 80 (2011), *available at* http://www.surgutneftegas.ru/en/investors/reports/annual/.

[199] *Shareholding Distribution As On Quarter Ending June 30, 2011*, OIL & NATURAL GAS CORP. LTD. (July 19, 2011), http://www.ongcindia.com/financial_30_June_11.asp.

| **Rank** | **Company** | **Share Type** | **Percent of Shares** | **Total Market Capitalization (millions)**[190] |
|---|---|---|---|---|
| 33 | KazMunaiGas | State held | 57.90%[201] | $7,338 |
| | | Ordinary shares | 41.60% | |
| | | GDRs | 0.50%[202] | |
| 36 | OAO Novatek | Ordinary shares | 70.01% | $40,990 |
| | | GDRs | 29.99%[203] | |
| 47 | BG Group | Ordinary shares | 97.00% | $74,552 |
| | | ADRs | 3.00%[204] | |
| 49 | Bashneft | Ordinary shares | 100.00%[205] | $10,013 |

### 2. Category (b)

Of the thirteen companies in category (b), nine have ordinary shares listed on the NYSE and must file an annual report with the Commission.[206] In the opinion of several prominent law firms, deregistration would be practically

[200] *Equity Structure*, TATNEFT, http://www.tatneft.ru/wps/wcm/connect/tatneft/portal_eng/to_shareholders/equities_structure/ (last visited Dec. 1, 2011).

[201] *Shareholder Structure,* KAZMUNAIGAS http://www.kmgep.kz/eng/investor_relations/shareholder_structure/ (last visited Dec. 1, 2011).

[202] KAZMUNAIGAS, ANNUAL REPORT 2010 59, 103 (2011).

[203] *GDR*, NOVATEK, http://www.novatek.ru/en/investors/shares/GDR/ (last visited Dec. 1, 2011).

[204] Tom Cahill & Lars Paulsson, *BG Group Quits NYSE Because of Sarbanes-Oxley Costs (Update3)*, BLOOMBERG (July 25, 2007), http://www.bloomberg.com/apps/news?pid=newsarchive&sid=ajANRufIBObE&refer=uk.

[205] *Securities*, BASHNEFT, http://www.bashneft.com/shareholders/share_capital/information_about_the_securities/ (last visited Dec. 1, 2011).

[206] *See infra* Table 4; 17 C.F.R. § 249.310 (2010).

impossible for these companies, meaning they have no credible threat to leave U.S. equity markets.[207]

Three of the thirteen companies (BP, Shell, and Petrobras) are primarily listed on international exchanges but each of the three companies also has substantial indirect U.S. shareholder ownership through ADRs traded on U.S. exchanges.[208] This means that the market capitalization contributed by ADR holders can be very large in absolute terms. For example, BP's total capitalization of U.S. ADRs is nearly $37 billion.[209] Repurchasing the nearly $37 billion of capital contributed by ADR holders in the U.S. market and re-issuing the same amount of securities in overseas markets would be economically challenging and extremely costly. Due to substantial market capitalization in the United States, these firms are also unlikely to exit the U.S. equity markets.

Lastly, TNK-BP is not listed on a U.S. exchange but is likely subject to Section 1504 because fifty percent of its shares are owned by BP.[210] BP would have to delist from the NYSE for TNK-BP to avoid Section 1504, which is extremely unlikely for the reasons outlined above.

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[207] *See* Letter from Cravath to Meredith Cross, *supra* note 75, at 2.

[208] *See infra* Table 4. This analysis omits direct U.S. shareholder ownership because direct U.S. shareholder ownership generally constitutes only a small number of the total ownership of a foreign company and is not central to this analysis. Listing securities on U.S. exchanges, not small numbers of direct U.S. ownership, is the primary reason the companies in categories (b) and (c) are required to file reports. *See supra* note 84 and accompanying text.

[209] *See infra* Table 4.

[210] BP, in its 20-F form, would have to disclose payments made by TNK-BP to the Russian government because TNK-BP is likely an "entity under the control of the issuer." BP would need to make a factual determination as to whether it has control of an entity based on a consideration of all relevant facts and circumstances. *See Proposed Rules Under Section 13(q)*, *supra* note 11, at 80987 (citing 17 C.F.R. § 240.12b-2 and 17 C.F.R. § 210.1.02).

TABLE 4: DOMESTIC AND FOREIGN ISSUERS COVERED BY THE PROPOSED RULES OF SECTION 1504 AND DEEPLY ENTRENCHED IN THE U.S. EQUITY MARKET

| **Rank** | **Company** | **Share Type** | **Percent of Shares** | **Total Market Capitalization (millions)**[211] |
|---|---|---|---|---|
| 15 | ExxonMobil | Ordinary shares | 100.00% | $375,068 |
| 17 | BP | Ordinary shares | 73.99% | $141,851 |
| | | ADRs | 26.01%[212] | |
| 20 | Royal Dutch Shell | A shares | 79.34% | $230,419 |
| | | B shares | 87.68% | |
| | | ADRs (A) | 20.66%[213] | |
| | | ADRs (B) | 12.32%[214] | |
| 21 | Chevron | Ordinary shares | 100.00% | $201,240 |
| 22 | Petrobras | State held | 55.47%[215] | $172,782 |
| | | Ordinary shares | 23.01% | |
| | | ADRs | 21.52%[216] | |
| 24 | ConocoPhillips | Ordinary shares | 100.00% | $92,623 |

[211] *See supra* note 190.
[212] BP p.l.c., Annual Report (Form 20-F) 134 (Mar. 2, 2011).
[213] Royal Dutch Shell plc, *supra* note 51.
[214] *Id.*
[215] Petróleo Brasileiro S.A.—Petrobras, Annual Report (Form 20-F) 126 (May 25, 2011).
[216] *Id.* at 126.

| Rank | Company | Share Type | Percent of Shares | Total Market Capitalization (millions)[211] |
|---|---|---|---|---|
| 39 | TNK-BP | Controlled shares[217] | 96.50% | $41,742 |
| | | Ordinary shares | 3.50%[218] | |
| 41 | Canadian Natural Resources | Ordinary shares | 100.00% | $40,681 |
| 42 | EnCana | Ordinary shares | 100.00% | $13,843 |
| 43 | Occidental | Ordinary shares | 100.00% | $79,231 |
| 45 | Suncor | Ordinary shares | 100.00% | $49,519 |
| 48 | Devon Energy | Ordinary shares | 100.00% | $26,722 |
| 50 | Apache | Ordinary shares | 100.00% | $42,350 |

### 3. Category (c)

Only the eight companies in category (c) have the option of exiting U.S. equity markets.[219] With the exception of Total S.A., which has an NYSE capitalization of nearly $9 billion, each has an overall U.S. capitalization of less than $3 billion.[220] Additionally, the U.S.-listed ADRs of each

[217] Controlled shares are those shares controlled through a complex corporate scheme by the joint venture TNK-BP Limited. *See* TNK-BP, 2010 ANNUAL REPORT 103 (2011), *available at* http://annual-report-2010.tnk-bp.com/upload/TNK_bp_ar10_en_lo.pdf.

[218] *Stocks Information*, TNK-BP, http://www.tnk-bp.ru/en/investors/stocks/ (last visited Dec. 1, 2011).

[219] Of the nine companies, five are Chinese or controlled by Chinese companies: PetroChina, Petrodar, SPC, Sinopec, and CNOOC. The remaining three are Norwegian, French, and Italian: respectively, Statoil ASA, Total S.A., and Eni.

[220] *See infra* Table 5.

company account for less than ten percent of its total capitalization.[221] Because of low U.S. capitalizations and the relatively lower cost of repurchasing U.S.-traded shares, it would not be unreasonable to suggest that these companies could forego their current U.S. listing and list solely in foreign markets. Alternatively, they could avoid U.S. regulation and remain in the U.S. market by delisting their ADRs and restricting them to over-the-counter trading.[222]

Finally, the PetroChina-owned joint venture Petrodar and the PetroChina wholly-owned subsidiary SPC do not have ADRs listed on a U.S. exchange, but are likely subject to Section 1504 because a large percentage of Petrodar's shares and all of SPC's shares are owned by PetroChina. These companies could only avoid regulation if their parent companies choose to delist their ADRs.[223]

TABLE 5: FOREIGN ISSUERS COVERED BY THE PROPOSED RULES OF SECTION 1504 BUT NOT DEEPLY ENTRENCHED IN THE U.S. EQUITY MARKET

<table>
<tr><th>Rank</th><th>Company</th><th>Share Type</th><th>Percent of Shares</th><th>Total Market Capitalization (millions)[224]</th></tr>
<tr><td rowspan="3">12</td><td rowspan="3">PetroChina</td><td>A shares</td><td>100.00%[225]</td><td>$277,726[226]</td></tr>
<tr><td>H shares</td><td>91.48%</td><td rowspan="2">$28,449[227]</td></tr>
<tr><td>ADRs (H only)</td><td>8.52%[228]</td></tr>
</table>

221 *See infra* Table 5.

222 BG Group took this action in 2007. *See* BG Group plc, *infra* note 262 and accompanying text.

223 PetroChina, in its 20-F form, would have to disclose payments made by Petrodar to the Chinese government because Petrodar is likely an "entity under the control of the issuer." PetroChina would need to make a factual determination as to whether it has control of an entity based on a consideration of all relevant facts and circumstances. *See Proposed Rules Under Section 13(q)*, *supra* note 11, at 80987 (citing 17 C.F.R. § 240.12b-2 and 17 C.F.R. § 210.1.02).

224 *See supra* note 190.

225 PetroChina, *supra* note 31, at 81.

226 *Id.* at 81–82.

| **Rank** | **Company** | **Share Type** | **Percent of Shares** | **Total Market Capitalization (millions)**[224] |
|---|---|---|---|---|
| 25 | Total S.A. | Ordinary shares | 93.28% | $131,923 |
| | | ADRs | 6.72%[229] | |
| 28 | Eni | State held | 30.30%[230] | $94,475 |
| | | Ordinary shares | 67.70% | |
| | | ADRs | 2.00%[231] | |
| 29 | Petrodar[232] | N/A | N/A | N/A |
| 34 | Statoil ASA | State held | 67.00%[233] | $88,406 |
| | | Ordinary shares | 23.70% | |
| | | ADRs | 2.00%[234] | |
| 38 | SPC[235] | N/A | N/A | N/A |

[227] *Id.*

[228] *Id.* at 81.

[229] Total S.A., Annual Report (Form 20-F) 118 (Mar. 28, 2011).

[230] *Investor Relations*, ENI, http://www.eni.com/en_IT/investor-relation/eni-stock-markets/shareholders/relevant-partecipation/relevant-partecipation.shtml (last visited Dec. 1, 2011).

[231] Eni SpA, Annual Report (Form 20-F) 153 (Apr. 7, 2011).

[232] Petrodar is forty-one percent owned by CNPC (parent of PetroChina) and six percent owned by Sinopec. Although PetroChina does not directly own Petrodar, Petrodar may be controlled by PetroChina as an "entity under the control of the issuer." Alternatively, Petrodar could be an "entity under the control" of Sinopec and also covered by the regulation. PetroChina would also need to make a factual determination as to whether it has control of Petrodar based on a consideration of all relevant facts and circumstances. *See Proposed Rules Under Section 13(q)*, *supra* note 11, at 80987 (citing 17 C.F.R. §§ 210.1.02, 240.12b-2).

[233] *Our Shareholders*, STATOIL, http://www.statoil.com/en/investor centre/share/shareholders/pages/default.aspx (last visited Dec. 1, 2011).

[234] *Id.*

[235] Singapore Petroleum Company Limited is wholly owned by PetroChina and would likely be deemed to be controlled by PetroChina as an "entity under the control of the issuer." PetroChina would need to make a factual determination as to whether it has control of Singapore Petroleum Company Limited based on a consideration of all relevant facts

| Rank | Company | Share Type | Percent of Shares | Total Market Capitalization (millions)[224] |
|---|---|---|---|---|
| 40 | Sinopec | A shares | 100.00%[236] | $95,972 |
| | | H shares | 93.00%[237] | $17,208[238] |
| | | ADRs (H only) | 7.00%[239] | |
| 46 | CNOOC | Ordinary shares | 97.10% | $87,937 |
| | | ADRs | 2.90%[240] | |

## B. Analysis

Recently, Shell suggested: "Shell and other Foreign Private Issuers might be forced to consider withdrawing from the U.S. market in order to protect our shareholders [sic] investments."[241] Shell could not have been referring to the companies described in category (a) because they are unaffected by the proposed rules.[242] Nor is it likely Shell meant to refer to the companies described in category (b), because deregistration would not be feasible for them.[243] Unless Shell was mistaken or disagrees with the opinion of

and circumstances. *See Proposed Rules Under Section 13(q)*, *supra* note 11, at 80987 (citing 17 C.F.R. §§ 210.1.02, 240.12b-2).

[236] China Petroleum & Chem. Corp., Annual Report (Form 20-F) 60 (Apr. 11, 2011).

[237] *Id.*

[238] *Listed Company*, CHINA STOCK MKTS. WEB, http://www.hkex.com.hk/eng/csm/company.asp?LangCode=en&mkt=hk&StockCode=386 (last visited Dec. 1, 2011).

[239] China Petroleum, *supra* note 236, at 60.

[240] CNOOC Ltd., Annual Report (Form 20-F) 80 (Apr. 29, 2011).

[241] Letter from Martin J. ten Brink to Meredith Cross, *supra* note 20, at 3.

[242] *See supra* Section V.A.1.

[243] *See supra* Section V.A.2. This group includes Shell itself. The only other option for the companies described in part (b) would be to avoid opportunities and abandon projects with host governments prohibiting disclosure.

Cravath et al.[244] that diversification would be practically impossible, it is more likely that Shell meant to refer to the companies described in category (c).[245]

PWYP U.S. recently stated, "[s]everal securities law experts have considered the potential ramifications of this new regulation for U.S. markets" and "[t]hey have concluded that it is unlikely to impact currently listed companies (such as causing them to delist), or those companies considering registering in the United States."[246] The experts' reasoning is as follows:

> [F]irstly, this is a low-cost regulation that does not directly impact corporate behavior. Secondly, this regulation is the latest in a series of efforts that are leading the way to an international standard of disclosure that many companies regard as inevitable. Thirdly, most of the oil, gas and mining companies registered with the SEC are willing to disclose this information through the [EITI] and the regulation requires companies to publish data that many have already disclosed under EITI.[247]

These may be valid reasons; however, they do not address the competitive disadvantage facing regulated oil and gas companies under Section 1504. U.S. equity markets provide foreign companies vast access to capital, but U.S. equity markets may be less vital than they appear. The chairman of a leading Dutch company noted, "[g]lobal markets are now very efficient; as a result, the necessity for a U.S. listing is diminished."[248] Because of the declining importance of U.S. equity markets, foreign companies now have greater choice to not enter U.S. equity markets to raise needed capital. Even some U.S. companies are choosing to list abroad in

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[244] *See* Letter from Cravath to Meredith Cross, *supra* note 75, at 2.

[245] *See supra* Section V.A.3.

[246] PUBLISH WHAT YOU PAY Q&A, *supra* note 18, at 3.

[247] *Id.*

[248] Amy E. Wong, *SOX: Culprit Behind Increased Delisting?*, GEN. COUNSEL CONSULTING 2–3, *available at* http://www.gcconsulting.com/articles/pdf/120046.pdf (last visited Dec. 1, 2011).

countries with less-strict regulation.[249] Discussing recent regulatory changes, Joshua Ford Bonnie of Simpson Thacher & Bartlett stated: "The simple fact is that as the U.S. regulatory environment has become more restrictive, other global exchanges have become more sophisticated and liquid and therefore have gained market share . . . [.] Given the difficulties of listing in the United States, more foreign companies are choosing to list on their home exchange."[250]

There is precedent for companies with low U.S. market capitalizations delisting from U.S. exchanges. In May 2010, Frankfurt-based Daimler delisted from U.S. exchanges.[251] Daimler expected delisting would simplify financial reporting procedures and reduce fees and administration costs.[252] Although not publicly cited as a reason for delisting, Daimler may have also been trying to avoid costly U.S. regulation, such as the Foreign Corrupt Practices Act, after paying $185 million in March 2010 to settle with the SEC and the U.S. Justice Department over allegations that the company made improper payments to government officials in at least twenty-two countries in exchange for lucrative business contracts.[253] The list of other German companies who have recently exited U.S. exchanges includes Deutsche Telekom, Eon, Allianz, and Bayer.[254]

Delisting is becoming an increasingly viable option as less-regulated markets gain strength.[255] A Deloitte study

[249] *See id.*

[250] KCSA STRATEGIC COMMUNICATIONS, 2011 IPO OUTLOOK SURVEY: U.S. IS LOSING ITS SHARE OF GLOBAL IPOS (2010), *available at* http://www.prnewswire.com/news-releases/2011-ipo-outlook-survey-us-is-losing-its-share-of-global-ipos-112598284.html.

[251] *Daimler to Stop Trading on New York Stock Exchange*, THE LOCAL (May 15, 2010 7:35 AM), http://www.thelocal.de/money/20100515-27217.html [hereinafter *Daimler*].

[252] *Id.*

[253] *Id.*

[254] *Id.*

[255] *But see* Letter from Jasbeena, Managing Dir., Syena Capital Mgmt. LLC, to Meredith Cross, Dir. Div. of Corp. Fin., SEC 2 (Feb. 17, 2011), *available at* http://www.sec.gov/comments/s7-42-10/s74210-22.pdf

found that "markets are shifting as new financial centers, such as Dubai, Hong Kong, Singapore, and Shanghai, seek to attract new business away from more established centers, such as New York, London, and Frankfurt."[256] According to the results of an independent survey, seventy-one percent of securities attorneys think the U.S. is losing its share of global initial public offerings ("IPOs").[257] Further, in 2009, for the first time, Hong Kong surpassed the United States with a 23.4% market share of global IPOs.[258] The United States, with the NYSE and Nasdaq combined, held only a 20.6% share of the IPO market.[259] For IOCs wishing to avoid U.S. payment disclosure regulation, there are a growing number of realistic alternatives.

There is also precedent for companies to delist their more highly regulated Level II or Level III ADRs, while continuing to trade Level I ADRs[260] in over-the-counter markets.[261] In 2007, BG Group delisted from the NYSE and deregistered and terminated its SEC reporting obligations while maintaining its ADRs on the U.S. over-the-counter market International OTCQX.[262] At the time, BG Group Chief

(expressing view that the importance of U.S. capital markets would prevent delisting from occurring).

[256] *See* DELOITTE, *supra* note 46, at 3.

[257] KCSA STRATEGIC COMMUNICATIONS, *supra* note 250.

[258] Anita Raghavan, *Hong Kong Seeks Bigger Role in Global Finance*, N.Y. TIMES (Nov. 15, 2010, 5:10 PM), http://dealbook.nytimes.com/2010/11/15/hong-kong-seeks-bigger-role-in-global-finance/.

[259] *Id.*

[260] Companies with only Level I ADRs are exempt from filing periodic reports pursuant to Exchange Act Rule 12g3-2(b). 17 C.F.R. § 240.12g3-2(e) (2010).

[261] EarthRights International, a supporter of Section 1504, suggests this possibility. It acknowledges this would "leav[e] U.S. companies as the primary entities required to disclose their payments under Section 1504 . . . ." They propose that the Commission monitor the situation and consider extending reporting requirements to Level I ADR issuers in the future. Letter from EarthRights Int'l to Meredith Cross, Dir. Div. of Corp. Fin., SEC 7–8 (Jan. 26, 2011), *available at* http://www.sec.gov/comments/s7-42-10/s74210-8.pdf.

[262] Press Release, BG Group plc, BG Group to Delist from NYSE (July 25, 2007), *available at* http://www.energy-pedia.com/article.aspx?articleid=

Financial Officer Ashley Almanza stated: "This move will reduce costs and complexity without in any way detracting from our standards of governance and control. As less than 3% of our shares are held through the ADR program, it no longer makes sense from a cost and administrative perspective to maintain our SEC registration and NYSE listing."[263]

In summary, although foreign companies may choose to remain in U.S. capital markets to preserve an appearance of equality with their Western counterparts, delisting is a viable option for companies with low U.S. market capitalizations. Companies for whom delisting is viable may choose to delist rather than make the payment disclosures required by Section 1504. Remaining subject to Section 1504 may cause such companies to forego lucrative opportunities to do business with host governments that prohibit payment disclosure or that prefer to contract with companies that are not subject to the Section 1504 disclosure regime.

## VI. CONCLUSION AND PROPOSED SOLUTIONS

Because of the incomplete coverage of companies with Level I ADRs trading in U.S. over-the-counter markets[264] and the fundamental inability of U.S. regulation to reach NOCs without listed U.S. securities, the proposed rules of Section 1504 fail to achieve comprehensive coverage. If local governments prohibit or discourage the disclosure of payments, companies required to make Section 1504 disclosures will likely face a competitive disadvantage in competing for future projects with those companies not subject to the disclosure requirements.

Should this occur, foreign companies with modest capitalizations on U.S. exchanges may choose to delist and avoid costly regulation. As more companies delist, and as host governments disfavoring payment disclosure have a growing number of unregulated partners to select from, U.S.-

117271.

[263] *Id.*

[264] For example, Lukoil, Surgutneftegas OJSC, and BG Group

listed companies will face an increasing disadvantage. In the absence of a more comprehensive scheme, there exists a "first mover" advantage for foreign companies listed on U.S. exchanges because the proposed rules incentivize "forum shopping by extractive companies seeking the most lax reporting requirement."[265]

One solution would be for Congress to pass legislation instructing the Commission to delay its rulemaking. Such a delay would allow time for domestic regulators to establish a consensus among other international regulators.[266] The concurrent enactment of multiple international disclosure regimes similar to Section 1504 would help provide more comprehensive coverage of oil and gas companies. For example, KazMunaiGas, OAO Novatek, Rosneft, and Tatneft each have GDRs listed on the London Stock Exchange but do not have shares listed in U.S. markets.[267] Concurrent enactment of a regulatory regime in the United Kingdom would reach many of the international companies left untouched by Section 1504.

If such a delay is not feasible, the SEC should, at minimum, strongly consider rulemaking that would increase the number of companies covered by Section 1504. For example, broader coverage could be achieved by the proposal of the Social Investment Forum and Calvert Investments, both supporters of Section 1504, to require disclosure not only by entities filing an annual report using forms 10-K, 20-F, or 40-F, but also by entities with OTC ADRs exempted from disclosure pursuant to Section 12g3-2(b) of the Exchange Act.[268] This would not only provide coverage of

[265] *But see* Letter from Karin Lissakers to Meredith Cross, *supra* note 62.

[266] Such a consensus appears to be on the horizon. *See* Letter from Jane Allen, Campaign Coordinator, Publish What You Pay U.S., to Mary L. Shapiro, Chairman, SEC 1–2 (Apr. 28, 2011), *available at* http://www.sec.gov/comments/s7-42-10/s74210-88.pdf.

[267] *See supra* Table 3.

[268] Letter from Bennett Freeman, Senior Vice President, Calvert Asset Mgmt. Co., Inc., Paul Bugala, Sustainability Analyst, Calvert Asset Mgmt. Co., Inc., and Lisa N. Woll, CEO, Soc. Inv. Forum, to Meredith Cross, Dir.

those companies currently with OTC ADRs but would also eliminate the intermediate step between having shares listed on U.S. exchanges and completely exiting U.S. equity markets. Removing this intermediate step would pose a more drastic choice to foreign companies that are considering the delisting of their securities and hopefully discourage their exit.

Beyond these proposals, the SEC should consider any additional means that would increase the coverage of companies. To fail to achieve comprehensive coverage will likely create competitive disadvantages for U.S. companies and may cause enduring harm to U.S. investors.

Div. of Corp. Fin., SEC 3–4 (Nov. 15, 2010), *available at* http://www.sec.gov/comments/df-title-xv/specialized-disclosures/specialized disclosures-49.pdf. The distinction in "filing" and "furnishing" an annual report is that an exempted issuer only need to publish, at a minimum, English translations of: (1) its annual report, including or accompanied by annual financial statements; (2) interim reports that include financial statements; (3) press releases; and (4) all other communications and documents distributed directly to security holders of each class of securities to which the exemption relates. 17 C.F.R. § 240.12g3-2(e) (2010).

# VII. APPENDIX 1: CAPITAL MARKET PARTICIPATION/STATE OWNERSHIP OF TOP FIFTY OIL AND GAS COMPANIES

| **Rank** | **Company** | **Ownership** |
|---|---|---|
| 1 | Nat'l Iranian Oil Co. | 100.00% state owned[269] |
| 2 | Saudi Aramco | 100.00% state owned[270] |
| 3 | Iraqi Nat'l Oil Co. | 100.00% state owned[271] |
| 4 | Petroleos de Venezuela | 100.00% state owned[272] |
| 5 | Qatar Petroleum | 100.00% state owned[273] |
| 6 | Gazprom OAO | 50.002% state owned[274] |
| 7 | Kuwait Petroleum Corp. | 100.00% state owned[275] |
| 8 | Abu Dhabi Nat'l Oil Co. | 100.00% state owned[276] |
| 9 | Turkmengas | 100.00% state owned[277] |
| 10 | Nigerian Nat'l Petroleum Corp. | 100.00% state owned[278] |
| 11 | Libya Nat'l Oil Co. | 100.00% state owned[279] |
| 12 | PetroChina[280] | 86.29% state owned[281] |
| 13 | Sonatrach Petroleum Corporation | 100.00% state owned[282] |
| 14 | Petronas | 100.00% state owned[283] |

[269] PIROG, *supra* note 23, at 17.

[270] *Id.*

[271] *Id.*

[272] *Id.*

[273] *Id.*

[274] OAO GAZPROM, *supra* note 191, at 103.

[275] *See* KUWAIT PETROLEUM COMPANY, THE KPC STORY, http://www.kpc.com.kw/AboutKPC/TheKPCStory/default.aspx (last visited Dec. 1, 2011).

[276] PIROG, *supra* note 23, at 17.

[277] Dinakar Sethuraman & Stephen Bierman, *China Turns to Turkmen Natural Gas as Gazprom Seeks Price, Pipeline Deal*, BLOOMBERG (Mar. 4, 2011), http://www.bloomberg.com/news/2011-03-03/china-may-increase-gas-purchase-from-turkmenistan-minister-says.html.

[278] PIROG, *supra* note 23, at 17.

[279] *Id.*

[280] *See supra* note 31.

[281] PIROG, *supra* note 23, at 17.

[282] *Id.*

[283] *Id.*.

| Rank | Company | Ownership |
|---|---|---|
| 15 | Exxon Mobil | Publicly held |
| 16 | Rosneft | 75.16% state owned[284] |
| 17 | BP | Publicly held |
| 18 | Lukoil | Publicly held[285] |
| 19 | Pemex | 100.00% state owned[286] |
| 20 | Royal Dutch Shell | Publicly held |
| 21 | Chevron | Publicly held |
| 22 | Petrobras | 48.30% state owned[287] |
| 23 | Surgutneftegas | Publicly held |
| 24 | ConocoPhillips | Publicly held |
| 25 | Total | Publicly held |
| 26 | Uzbekneftegaz | 100.00% state owned[288] |
| 27 | Egyptian Gen. Petroleum Co. | 100.00% state owned[289] |
| 28 | Eni | 30.30% state owned[290] |
| 29 | Petrodar | Joint venture[291] |
| 30 | Oil and Natural Gas Co. of India | 74.14% state owned[292] |
| 31 | State Oil Co. of Azerbaijan Rep. | 100.00% state owned[293] |
| 32 | Tatneft | Publicly held |

[284] *Id.*

[285] *History of Share Capital,* LUKOIL OIL COMPANY, http://www.lukoil.com/static_6_5id_2162_.html (last visited Dec. 1, 2011).

[286] PIROG, *supra* note 23, at 17.

[287] This figure corresponds to economic rights. The Brazilian federal government holds 63.6% of the voting rights. PETROBRAS, *supra* note 215, at 28.

[288] *"Uzbekneftegaz" (oil & gas) National Holding Company*, THE GOVERNMENT PORTAL OF THE REPUBLIC OF UZBEKISTAN, http://www.gov.uz/en/other_institutions/companies/1585 (last visited Dec. 1, 2011).

[289] EGYPTIAN GENERAL PETROLEUM CORPORATION, http://www.egpc.com.eg/index.html (last visited Dec. 1, 2011).

[290] *Major Shareholdings*, ENI, http://www.eni.com/en_IT/investor-relation/eni-stock-markets/shareholders/relevant-partecipation/relevant-partecipation.shtml (last visited Dec. 1, 2011).

[291] *See* PETRODAR OPERATING COMPANY, *supra* note 97.

[292] *See* OIL & NATURAL GAS CORP. LTD., *supra* note 199.

[293] *About*, STATE OIL CO. OF AZERBAIJAN REPUBLIC, http://www.socar.az/about-en.html (last visited Dec. 1, 2011).

| Rank | Company | Ownership |
|---|---|---|
| 33 | KazMunaiGas | 57.90% state owned[294] |
| 34 | StatoilASA | 70.90% state owned[295] |
| 35 | Pertamina | 100.00% state owned[296] |
| 36 | OAO Novatek | Publicly held |
| 37 | Sonangol | 100.00% state owned[297] |
| 38 | SPC | 100.00% state owned[298] |
| 39 | TNK-BP | Joint venture[299] |
| 40 | Sinopec | 75.84% state owned[300] |
| 41 | Canadian Natural Resources | Publicly held |
| 42 | EnCana | Publicly held |
| 43 | Occidental | Publicly held |
| 44 | YPFB | 100.00% state owned[301] |
| 45 | Suncor | Publicly held |
| 46 | CNOOC | 64.41% state owned[302] |
| 47 | BG Group | Publicly held |
| 48 | Devon Energy | Publicly held |
| 49 | Bashneft | Publicly held[303] |
| 50 | Apache | Publicly held |

294 KAZMUNAIGAS, *supra* note 201.

295 PIROG, *supra* note 23, at 17.

296 *Id.*

297 *About Sonangol EP*, SONANGOL, http://www.sonangol.co.ao/wps/portal/epNew/sonangolEP/historia (last visited Dec. 1, 2011).

298 *See* Wang, *supra* note 98.

299 TNK-BP, *supra* note 218.

300 China Petroleum & Chem. Corp., *supra* note 236, at 60.

301 Ken Parks, *Bolivia's YPFB Sees $10.7 Bln In Oil, Gas Investment In 2009-15*, WALL ST. J. (Oct. 12, 2011, 6:13 PM), http://online.wsj.com/article/BT-CO-20111012-714785.html.

302 CNOOC Ltd., *supra* note 240, at 80.

303 BASHNEFT, *supra* note 205.