



Elizabeth M. Murphy
Secretary, U.S. Securities and Exchange Commission
100 F Street, NE
Washington, DC 20549-1090

Re: File No. S7-42-10 – Disclosure of Payments by Resource Extraction Issuers

Dear Ms. Murphy:

Conflict Risk Network (CRN) is pleased to submit to the Securities and Exchange Commission (the “Commission”) the following comments as a contribution to the rulemaking process for Section 1504 of the Dodd-Frank Wall Street Reform and Consumer Protection Act (“the Act”).¹

CRN is a network of institutional investors, financial service providers and related stakeholders calling on corporate actors to fulfil their responsibility to respect human rights and to take steps that support peace and stability in areas affected by genocide and mass atrocities. CRN’s goal is to increase such behavior by corporate actors, and thereby reduce conflict. CRN is a project of Genocide Intervention Network / Save Darfur Coalition, a non-profit organization that seeks to empower individuals, communities and other actors with the tools to prevent and stop genocide and mass atrocities.

Recommendation regarding questions 49 and 52 relating to the definition of “subsidiary of the resource extraction issuer or an entity under the control of the resource extraction issuer” and other instances in which a resource extraction issuer should have to disclose payments made by a subsidiary or other entity:

By this submission, CRN responds to questions 49 and 52 which ask, respectively, whether a different definition should be included for a “subsidiary of the resource extraction issuer or an entity under the control of the resource extraction issuer,” and “whether there are instances, other than control in which a resource extraction issuer should have to disclose payments made by a subsidiary or other entity.” Further below, we discuss the case of PetroChina Company Ltd. and its parent, China National Petroleum Corporation, to illustrate the importance of understanding Section 1504’s disclosure requirements to include a resource extraction issuer’s parent in cases where the issuer is an alter ego or instrumentality of its parent.

With regard to question 49, we recommend that the definition of a “subsidiary of the resource extraction issuer or an entity under the control of the resource extraction issuer” be understood to

¹ The recommendations in this paper were developed with the assistance of Giulio Carini.

include a resource extraction issuer's *parent* where the resource extraction issuer is an alter ego or instrumentality of its parent. Section 1504 expressly contemplates that disclosure requirements cover payments made by a resource extraction issuer, its subsidiaries, and entities under its control. It does not, however, expressly address disclosure of payments made by a resource extraction issuer's parent.

Consistent with statutory language, it is the fact that a resource extraction issuer exerts control² over its subsidiaries that requires it to provide disclosure of its subsidiaries' payments relating to commercial development of oil, natural gas or minerals, even if these separate legal entities are not required to file an annual report with the Commission. It follows that where a resource extraction issuer is an alter ego or instrumentality of its parent, a situation in which there is common control with a parent (discussed further below), the resource extraction issuer should also disclose such payments made by its parent company, even if its parent company is not required to file an annual report with the Commission.

A narrower understanding of a "subsidiary of the resource extraction issuer or an entity under the control of the resource extraction issuer" (i.e. one which does not include the issuer's parent, where the issuer is merely the parent's alter ego or instrumentality) would mean that a resource extraction issuer could avoid payment disclosures which are otherwise covered by the terms of the statute. By "subsidiary" or "entity under the control of the resource extraction issuer," the statute already requires payment disclosures by an entity that the issuer "controls, is controlled by, or is under common control with."³ Though Section 1504 does not expressly consider parents, by this definition it should include an issuer's parent in an alter ego or instrumentality relationship, as this is a case in which the issuer "is under common control with" its parent.

In addition, or alternatively, we recommend in response to question 52 that the existence of an alter ego or instrumentality relationship between a resource extraction issuer and its parent is an instance in which an issuer should have to disclose payments made by an "other entity."

To understand the scope of the disclosure requirements more narrowly than what we recommend above would not only mean that resource extraction issuers could avoid disclosures which are otherwise covered by the definitions behind the statute, but would incentivize resource extraction issuers to create alter ego entities to circumvent the Act's requirements. As discussed below, the case of China National Petroleum Corporation ("CNPC") and PetroChina Company Ltd. ("PetroChina") illustrates this possibility and its risks. In addition, a narrower understanding of the scope of the disclosure requirements would undermine the purpose and intent behind the statute. As mentioned in the letters sent to the Commission by Senator Benjamin Cardin, one of the authors of Section 1504, the purpose of the statute is to bring greater transparency to

² As defined by the Exchange Act Rule 12-b-2 [17 CFR 240.12b-2] and Rule 1.02 of Regulation S-X [17 CFR 210.1.02], "control" (which includes the terms "controlling," "controlled by" and "under common control with") is defined to mean "the possession, direct or indirect, of the power to direct or cause the direction of the management and policies of a person, whether through the ownership of voting securities, by contract, or otherwise."

³ *Id.*

extractive-related payments and its intent is to provide the broadest possible meaning to the term resource extraction issuer.⁴

Alter ego/instrumentality determination:

Under the Exchange Act, a subsidiary of a specified parent company is an affiliate controlled by the parent directly or indirectly through one or more intermediaries.⁵ A parent company, generally, owns all or at least a majority of the shares of the subsidiary. As the owner of the subsidiary, the parent may control the activities of the subsidiary. The parent and subsidiary remain separate legal entities, and the obligations of one are separate from those of the other. However, “[t]he notion of a separate corporate existence will not be recognized where a [subsidiary] corporation is so organized and controlled and its business conducted in such a manner as to make it merely an instrumentality of another.”⁶ When, because of the domination of the parent and the inextricable links between it and the subsidiary, no separate entity has been maintained, the corporate form is disregarded and the corporation is merely the “alter ego” or “instrumentality” of its parent.⁷

In making alter ego or instrumentality determinations, the Commission has looked to the practice of courts.⁸ An alter ego determination by the courts is highly fact-based and made *sui generis*. No precise test has been articulated.⁹ Instead, courts, and therefore the Commission, look at the totality of circumstances – a number of nonconjunctive and nonexclusive factors – in order to determine whether a subsidiary is the alter ego or instrumentality of a parent corporation.¹⁰ While no single factor is determinative, where these factors, in combination, show that a subsidiary shares common control with the parent, a subsidiary’s corporate form will be disregarded, and it will be found to be the alter ego or instrumentality of its parent.

Among the factors courts commonly consider are:

- The parent corporation owns most or all of the subsidiary’s stock;¹¹
- Corporate officers, directors and/or employees are common or overlapping;¹²
- The subsidiary’s directors do not act independently in the interest of the subsidiary, but in the interest of the parent;¹³

⁴ See Letter from Benjamin L. Cardin, United States Senator of Maryland, to the Honorable Mary L. Shapiro, Chairman of the Securities and Exchange Commission (December 1, 2010) available at <http://www.sec.gov/comments/df-title-xv/specialized-disclosures/specializeddisclosures-94.pdf>

⁵ Exchange Act Rule 12b-2 [17 CFR 240.12b-2] and Rule 1.02 of Regulation S-X [17 CFR 210.1.02].

⁶ *Krivo Indus. Supply Co. v. National Distillers & Chemical Corp.*, 483 F.2d 1098, 1103 (5th Cir. 1973), citing “See *U.S. v. LeHigh Val R Co*, 220 U.S. 257, 31 S. Ct. 387, 55 L. Ed. 458 (1911).”

⁷ *SEC v. Great Lakes Equities Co.*, 775 F. Supp. 211, 213 (E.D. Mich. 1991) (finding activities of an individual and his corporation “inextricably linked”)(citing *Bucyrus-Erie Co. v. General Products*, 643 F.2d 413, 418 (6th Cir. 1981)), *aff’d*, 12 F.3d 214 (6th Cir. 1993).

⁸ In the Matter of the Application of Jay Alan Ochanpaugh, For Review of Disciplinary Action Taken by the NASD Securities Exchange Act of 1934 Release No. 54363, August 25, 2006.

⁹ *Bucyrus-Erie Co. v. General Products*, 643 F.2d 413 (6th Cir. 1981).

¹⁰ *Sabine Towing & Transp. Co. v. Merit Ventures, Inc.*, 575 F.Supp. 1442, 1446 (E.D. Tex. 1983).

¹¹ *Fletcher Encyclopedia of the Law of Corporations*, 2006 Revised Volume (by Carol A. Jones, J.D.) Vol. 1, Sec. 41.10, p. 136.

¹² *Id.*

- The parent caused the incorporation of the subsidiary;¹⁴
- The subsidiary is being used as a facade for dominant shareholder dealings;¹⁵
- A failure to maintain an arm's length relationship between entities;¹⁶
- The subsidiary does not observe basic corporate formalities;¹⁷
- An absence of corporate records;¹⁸ and
- The corporations are so integrated through common direction, supervision and activities that they should be considered one single enterprise.¹⁹

It is important to point out that the theory of alter ego, or instrumentality, is a procedural claim, not a claim for substantive relief.²⁰ It exists to determine if separate corporate identities should be disregarded and the corporations treated as one entity. Plaintiffs do not have to establish fraudulent activity or bad faith on the part of the parent with respect to its relationship with its subsidiary as is required to pierce the corporate veil in liability cases.²¹ As emphasized by the Fifth Circuit court in *Krivo Indus. Supply Co. v. National Distillers & Chemical Corp.*, fraud is not a “necessary predicate for disregarding the corporate form”. In fact, federal courts have displayed some liberal tendencies in disregarding corporate existence. The Third Circuit found it appropriate to disregard corporate separateness when the corporations themselves do so, and when recognition of that fiction would threaten federal policy.²² If the Commission takes its guidance from the courts so should it disregard corporate separateness in such circumstances.

PetroChina Company Ltd. and China National Petroleum Corporation – a case for requiring disclosure by a resource extraction issuer’s parent in an alter ego or instrumentality relationship:

PetroChina is one of the world’s largest oil companies, and plays a dominant role in the oil and gas industry in China.²³ It engages in a wide range activities relating to oil and natural gas, including exploration, production and marketing.²⁴ PetroChina, which listed on the New York Stock Exchange (NYSE) in April 2000, meets Section 1504’s definition of “resource extraction

¹³ BERGESEN dy A/S v. Lindholm, 760 F. Supp. 976 (D. Conn. 1991).

¹⁴ *Id.*

¹⁵ Galgay v. Gangloff, 677 F. Supp. 295, 299-300 (M.D. Pa. 1987).

¹⁶ Wm. Passalacqua Builders, Inc. v. Resnick Developers South, Inc., 933 F.2d 131, 32 Fed R. Evid. Serv. 1218 (2d Cir. 1991).

¹⁷ *Id.*

¹⁸ Galgay, at 300.

¹⁹ Fletcher.

²⁰ *Id.*

²¹ Network for Good v. United Way of the Bay Area, Case Number CGC-04-436186, Filing Date October 19, 2007. http://www.mwe.com/info/pubs/peregrine_hlw121707.pdf.

²² American Bell Inc. v. Federation of Telephone Workers of Pennsylvania, 736 F.2d 879, 886 (3d Cir. 1984), citing Zubik v. Zubik, 384 F.2d 267, 273 (3d Cir. 1967).

²³ PetroChina, 2009 Annual Report, at F-42, available at <http://www.sec.gov/Archives/edgar/data/1108329/000095012310060898/h0418ge20vftm#111>. (“CNPC, the controlling shareholder of the Company, is a state-controlled enterprise directly controlled by the PRC government”). PetroChina ranks first in the annual Financial Times list of the world’s 500 most valuable listed companies, with a market capitalization of \$329.3 billion. See <http://www.ft.com/reports/ft500-2010>.

²⁴ “About PetroChina,” PetroChina Company Limited website, at http://www.petrochina.com.cn/Ptr/About_PetroChina/Company_Profile/.

issuer” and must disclose payments made to a foreign government or the Federal Government for the purpose of the commercial development of oil, natural gas, or minerals.

PetroChina’s parent, the state-controlled CNPC, is the largest integrated oil and gas company in the People’s Republic of China with operations in various countries. Because it is not required to file an annual report with the Commission, CNPC does not have to disclose payments under Section 1504 (unless, as recommended above, the Commission understands the scope of Section 1504’s disclosure requirements to include parents of resource extraction issuers where an alter ego or instrumentality relationship exists).

The relationship between CNPC and PetroChina suggests that PetroChina is the alter ego or instrumentality of CNPC, which is involved heavily in extractives activities around the world, including in Sudan, where numerous stakeholders have raised concerns about its relationship with the government. To summarize the sections below, the two companies are not separate corporate forms but are in fact a single (commonly controlled) entity because they are substantially similar corporations with overlapping management, frequent asset transfers and strong mutual dependence.²⁵ As a result, shareholder investment in PetroChina is linked inextricably to CNPC, which, through PetroChina, is able to gain significant access to U.S. capital markets while shielding its payments from the requirements of Section 1504.

This case demonstrates the need for the Commission to define a “subsidiary of the resource extraction issuer or an entity under the control of the resource extraction issuer” to include the parent company of a resource extraction issuer where the resource extraction issuer is an alter ego or instrumentality of its parent.

Under the interpretation proposed in this letter, PetroChina, as a resource extraction issuer that is an alter ego or instrumentality of its parent, should disclose payments made by CNPC to foreign governments including the Government of Sudan, even if CNPC does not file an annual report with the Commission.

PetroChina is an alter ego or instrumentality of CNPC:

The CNPC–PetroChina relationship began in 1999 with CNPC’s failed attempt at an initial public offering (IPO) on the NYSE. At the time, western investor concerns about CNPC’s operations in Sudan²⁶ forced the company to scrap its initial IPO plans and instead carve out and

²⁵ KLD Research & Analytics, Inc., “Public Companies Operating in Sudan: The Relationship of PetroChina Company Ltd. to China National Petroleum Corporation” p.5, May 9, 2007, available at http://www.kld.com/newsletter/archive/press/pdf/KLD_Analysis_of_PetroChina_Company.pdf. “The dominant ownership position of CNPC and the substantial overlap between CNPC’s and PetroChina’s board of directors and executive leadership indicate that CNPC exercises a considerable level of control over PetroChina. Therefore, KLD concludes that investors should treat CNPC and PetroChina as if they were a single entity.”

²⁶ CNPC is the largest player in Sudan’s oil industry, holding the controlling and managing stake in the majority of Sudan’s oil-producing blocks. This industry provides Khartoum with the great bulk of its revenue, some seventy percent of which has reportedly been directed towards its military. When Sudan’s first significant oil exports hit the market in early 2000, Sudanese army spokesman Gen. Mohamed Osman Yassin said that Sudan would that year “reach self-sufficiency [in weapons]” thanks to its “unprecedented economic boom, particularly in the field of oil exploration and exportation.” See “Sudan to achieve self-sufficiency in weapons: spokesman,” AFP, Khartoum, July 1, 2000.

offer to the public a subsidiary, PetroChina, which CNPC pledged would not be involved in Sudan activities.²⁷

A report by the Sudan Divestment Task Force titled “PetroChina, CNPC, and Sudan: Perpetuating Genocide,”²⁸ and its addendum, “The Detrimental Presence of PetroChina/CNPC in Sudan: One Mind, One Will, One Corporation,”²⁹ detail the extensive links between CNPC and its partially publicly traded subsidiary, PetroChina. The relationship between the two companies, as detailed below is such that PetroChina is an alter ego or instrumentality of CNPC.

The following illustrates how PetroChina/CNPC measures against previously mentioned factors used to evaluate whether a subsidiary should be considered an alter ego or instrumentality of its parent.

1. The parent corporation owns most or all of the subsidiary’s stock: CNPC owns 86.285% of PetroChina’s shares,³⁰ and is almost completely dependent on the company for its financial health.³¹ Investing in PetroChina is investing in CNPC’s main source of profit – part of which is reasonably assumed to be diverted to (or to free up other funds for) CNPC’s Sudan operations.
2. Common or overlapping corporate officers, directors, and employees: In addition to the roughly one-half million of CNPC’s 1.5 million employees PetroChina took with it when it went public,³² there is a history of overlap and interchange of management personnel between the two corporations.³³ As of January 2011, eight of the eleven top CNPC officers hold concurrent top-level positions in PetroChina.³⁴ CNPC has appointed a PetroChina Board that is nearly indistinguishable from CNPC. The PetroChina Board is comprised of 14 Directors, only five of whom are independent. Eight out of the nine

²⁷ “Statement by Harvard Corporation Committee on Shareholder Responsibility (CCSR) Regarding Stock in PetroChina Company Limited,” Harvard University Gazette, April 4, 2005, at http://www.hno.harvard.edu/gazette/daily/2005/04/04-sudan_statement.html (link no longer available; copy retained by CRN).

²⁸ “PetroChina, CNPC, and Sudan: Perpetuating Genocide,” Sudan Divestment Task Force report, April 15, 2007, at http://home.comcast.net/~berkshire_hathaway/reports/PetroChina_CNPC_Sudan.pdf.

²⁹ “The Detrimental Presence of PetroChina/CNPC in Sudan: One Mind, One Will, One Corporation,” Sudan Divestment Task Force report, January 3, 2008, at http://investorsagainstgenocide.net/petrochina_cnpc_addendum.pdf.

³⁰ PetroChina FY 2009 Form 20-F, as filed with the United States Securities and Exchange Commission, 25 June, 2010 at <http://www.sec.gov/Archives/edgar/data/1108329/000095012310060898/h04189e20vf.htm#110>

³¹ Ron Haruni, “PetroChina To Buy 50% Stake in CNPC for \$11.8B,” Seeking Alpha, August 26, 2008, at <http://seekingalpha.com/article/92685-petrochina-to-buy-50-stake-in-cnpc-for-11-8b>.

³² Braden Penhoet, “Wall Street Sings the Dragon PetroChina’s Failed IPO,” Multinational Monitor, May 2000, at <http://www.multinationalmonitor.org/mm2000/052000/penhoet.html>.

³³ See “Hong Kong-listed PetroChina picks Shenzhen Petroleum chairman as vice-president,” Thomson Financial News, posted on Hemscoff online, November 24, 2007, at <http://www.hemscott.com/news/latest-news/item.do?newsId=53878217726982> (subscription required).

³⁴ “CNPC: About CNPC: Company Profile: Top Management,” China National Petroleum Corporation website at <http://www.cnpc.com.cn/en/aboutcnpc/companyprofile/topmanagement/default.htm>; “PetroChina: About PetroChina: Executive Profiles,” PetroChina Company Limited website, at <http://www.petrochina.com.cn/Ptr/About/PetroChina/Executive Profiles/>; “PetroChina’s Jiang Steps Down as President-Report,” Thomson Financial News, Forbes News, May 12, 2008, at <http://www.forbes.com/markets/feeds/afx/2008/05/12/afx4999702.html>.

current non-independent Directors of the Board have current or former connections to CNPC. The Board's Chairman is also the President of CNPC. Furthermore, CNPC's Chief Accountant and six out of eight CNPC Vice Presidents also serve as Directors on PetroChina's Board. The Chief Accountant of CNPC also sits on the Audit Board Committee of PetroChina.³⁵ PetroChina's Board's Vice Chairman, Zhou Jiping, is the current Deputy Manager of CNPC and a former president of Greater Nile Petroleum Operating Company (GNPOC), the petroleum exploration and production consortium in Sudan in which CNPC has the largest stake.³⁶

With the Board dominated by past and present CNPC officials, it should be no surprise that PetroChina's executive team is also dominated by CNPC's management. CNPC's President is the Chairman of PetroChina's Board. The President of PetroChina is CNPC's Deputy General Manager. One of PetroChina's eight Vice Presidents is also a Vice President at CNPC, and five others have past connections to the company. The overwhelming overlap in management between PetroChina and CNPC suggests that CNPC and PetroChina should be considered a single macroscopic entity.³⁷

3. Subsidiary's directors do not act independently in the interest of the subsidiary but in the interest of the parent: The overwhelming overlap in management between PetroChina and CNPC is another reason to doubt the ability of PetroChina's directors to act with the necessary independence from the parent, and suggests that PetroChina is merely an alter ego of CNPC.

PetroChina lists on the NYSE, the Shanghai Stock Exchange (SSE), and the Hong Kong Stock Exchange (HKSE). In its filing with the Commission for 2009, PetroChina stated that CNPC's ownership percentage enables it to elect PetroChina's board of directors without the concurrence of any other shareholders. If PetroChina is a sufficiently distinct entity from CNPC but still under CNPC's control, CNPC would install and/or retain PetroChina Directors that diverge at least partially from CNPC's management team. This would be consistent with the approach taken by other parent companies towards their subsidiaries.³⁸

4. Parent caused the incorporation of the subsidiary: It appears that CNPC created PetroChina with the specific purpose of gaining access to western capital markets while shielding itself from investor concerns relating to its Sudan operations. After incurring

³⁵ "PetroChina: About PetroChina: Executive Profiles," PetroChina Company Limited website, at http://www.petrochina.com.cn/Ptr/About_PetroChina/Executive_Profiles/.

³⁶ Zhou was president of GNPOC when the Canadian government documented GNPOC forces displacing local populations and even possibly participating in the summary execution of citizens. See "PetroChina, CNPC, and Sudan: Perpetuating Genocide," Sudan Divestment Task Force report, April 15, 2007, at http://home.comcast.net/~berkshire_hathaway/reports/PetroChina_CNPC_Sudan.pdf. This former position is noted on Zhou's executive profile on CNPC's website, but not on the profile that appears on PetroChina's website or in its filing with the Commission.

³⁷ "PetroChina: About PetroChina: Executive Profiles," PetroChina Company Limited website, at http://www.petrochina.com.cn/Ptr/About_PetroChina/Executive_Profiles/.

³⁸ "PetroChina, CNPC, and Sudan: Perpetuating Genocide," Sudan Divestment Task Force report, p. 15, April 15, 2007, at http://home.comcast.net/~berkshire_hathaway/reports/PetroChina_CNPC_Sudan.pdf.

large debt obligations in the 1990's, CNPC attempted to gain capital by going partially public in April 1999. Its attempts to list on the Hong Kong, London and New York exchanges immediately encountered difficulty because of its human rights record and investments in Sudan.³⁹ Opponents in the United States noted that CNPC's raising money through an IPO on the NYSE would bypass U.S. sanctions on Sudan, and asked the Commission to disapprove of the listing.⁴⁰ In response, Goldman Sachs, the firm handling CNPC's IPO, restructured the deal to create PetroChina,⁴¹ a publicly traded holding company.

5. Corporation being used as a façade for dominant shareholder dealings: PetroChina's own statements suggest that it is a vehicle for its parent's dealings. In its 2009 filing with the Commission, PetroChina stated that due to its ownership percentage CNPC is in a position to "control our policies, management and affairs ... affect the timing and amount of dividend payments...and otherwise determine the outcome of most corporate actions and ... cause our company to effect corporate transactions without the approval of minority shareholders."⁴² PetroChina also noted that it "cannot assure [the Commission] that CNPC, as our controlling shareholder, will always vote its shares in a way that benefits our minority shareholders."⁴³

Following its creation, PetroChina was given CNPC's most productive and potentially profitable assets, which in addition to the information above, strongly suggests that it was created to raise capital that CNPC could not due to its Sudan operations.⁴⁴

When opposition forced the IPO to be cut back, CNPC pledged to build a "firewall" between itself and PetroChina, separating their assets and ensuring that proceeds from the IPO would exclusively be used domestically in China, not in CNPC's overseas

³⁹ KLD Research & Analytics, Inc., "Public Companies Operating in Sudan: The Relationship of PetroChina Company Ltd. to China National Petroleum Corporation" p.3, May 9, 2007, available at http://www.kld.com/newsletter/archive/press/pdf/KLD_Analysis_of_PetroChina_Company.pdf.

⁴⁰ Jemera Rone, "Sudan, Oil, and Human Rights," Human Rights Watch, p. 612, 2003, at <http://bit.ly/dXcXZN>.

⁴¹ "Endowment tied to Sudan," *The Harvard Crimson*, October 25, 2004, at <http://www.thecrimson.com/article.aspx?ref=504045>. (At the time of PetroChina's IPO application, CNPC's promise to maintain an absolute firewall between PetroChina and CNPC's Sudan assets was met with skepticism by many U.S. investors, who pointed out that any revenue generated by PetroChina for CNPC (for example, in the form of dividend payments) was inherently fungible and could therefore be used, even if indirectly, to fund CNPC's Sudan operations.)

⁴² PetroChina FY 2009 Form 20-F, as filed with the United States Securities and Exchange Commission, 25 June, 2010 at <http://www.sec.gov/Archives/edgar/data/1108329/000095012310060898/h04189e20vf.htm#110>.

⁴³ *Id.*

⁴⁴ Braden Penhoet, "Wall Street Sings the Dragon PetroChina's Failed IPO," *Multinational Monitor*, May 2000, at <http://www.multinationalmonitor.org/mm2000/052000/penhoet.html>; KLD Research & Analytics, Inc., "Public Companies Operating in Sudan: The Relationship of PetroChina Company Ltd. to China National Petroleum Corporation" p.9, from May 9, 2007, available at http://www.kld.com/newsletter/archive/press/pdf/KLD_Analysis_of_PetroChina_Company.pdf.

ventures.⁴⁵ The vice-president of Goldman Sachs made numerous public statements regarding this firewall that later resulted in a sanction from the Commission.⁴⁶

They were also inaccurate. Analysts estimate that 10% of the proceeds, some U.S. \$270-\$300 million, went directly to CNPC. Additionally, any other revenue generated by PetroChina for CNPC (for example, in the form of dividend payments) is inherently fungible and could therefore be used, even if indirectly, to fund CNPC's Sudan operations. Analysts have called the firewall a 'smoke screen'.⁴⁷ In a letter to SEC chair Arthur Levitt, Representative Spencer Bachus observed that elements of the proposed IPO "eviscerate the assertion that a legal firewall has been created."⁴⁸ CNPC claimed its auditor, PriceWaterhouseCoopers, would monitor the firewall. However, the secretive nature of state-owned businesses in China raises doubts about whether sufficient independent monitoring is possible.⁴⁹

In 2005, Wang Guoliang, then Chief Financial Officer for PetroChina (current Board member) and Chief Financial Officer for CNPC, said PetroChina intentionally left CNPC's most prized and profitable oil outpost, its Sudan operations, out of ongoing asset transfers for "political reasons."⁵⁰ PetroChina's calculation is, per its own admission, an attempt to avoid concern directed at CNPC for its Sudan operations.⁵¹

6. Failure to maintain arm's length with related entities: In its 2009 filing with the Commission, PetroChina reported that its transactions with CNPC may not have the same character as those with unrelated parties and are not necessarily arms-length transactions between equal and independent parties. PetroChina's filing describes a number of transactions that fall into this category, including a wide range of services, from sales and construction to loans totalling in the billions in 2009 alone.

The long history of fluid asset transfers and significant management overlap between the two companies reinforces the idea that they are one macroscopic entity. When PetroChina was offered to the public it incurred \$15 billion in debt from CNPC, some of which was acquired in connection with CNPC's Sudan operations.⁵² Since the public

⁴⁵ "PetroChina Hopes to Shake Off Its Past --- As Big Stock Offer Looms, Beijing Hopes Oil Giant Can Shed Political Roots," *Wall Street Journal*, January 14, 2000.

⁴⁶ "As Goldman exec, Obama nominee played key role in Sudan-linked IPO," Public Accountability Initiative, July 21, 2009, at <http://www.scribd.com/doc/17549361/As-Goldman-exec-Obama-nominee-played-key-role-in-Sudanlinked-IPO>.

⁴⁷ "Endowment tied to Sudan," *The Harvard Crimson*, October 25, 2004, at <http://www.thecrimson.com/article.aspx?ref=504045>.

⁴⁸ Letter from Spencer Bachus to Arthur Levitt, March 16, 2000.

⁴⁹ "The Scorched Earth: Oil and Water in Sudan," United Nations Environment Program, February 8, 2007, at http://postconflict.unep.ch/sudanreport/sudan_website/doccatcher/data/documents/The%20scorched%20earth.pdf.

⁵⁰ Karen Teo, "PetroChina buys 50pc of parent's overseas assets," *The Standard*, June 11, 2005, at <http://www.thestandard.com.hk/stdn/std/Business/GF11Ae01.html>.

⁵¹ "PetroChina, CNPC, and Sudan: Perpetuating Genocide," Sudan Divestment Task Force report, April 15, 2007, at http://home.comcast.net/~berkshire_hathaway/reports/PetroChina_CNPC_Sudan.pdf.

⁵² "Statement by Harvard Corporation Committee on Shareholder Responsibility (CCSR) Regarding Stock in PetroChina Company Limited," *Harvard Gazette*, April 4, 2005, at http://news.harvard.edu/gazette/story/2005/04/ccsr_statement/.

offering, there have been dozens more asset transfers between PetroChina and CNPC, all executed under a non-competition agreement signed jointly by the companies at the time of PetroChina's IPO. Immediately following the IPO, the two companies cemented their interdependence by agreeing to a Comprehensive Products and Services Agreement, a Land Use Rights Leasing Contract, a Building Leasing Contract, and several other agreements involving cross-provision of goods and services.⁵³ More recently, cross-company asset transfers have occurred as PetroChina seeks international assets. Because Chinese law forbids PetroChina from entering into production sharing contracts directly with foreign oil and gas companies, the company acquires foreign assets through CNPC,⁵⁴ as detailed in the Asian edition of the Wall Street Journal in October 2006: "PetroChina's parent, CNPC, has basically taken on the task of investing in and developing high-risk or capital-intensive projects, and then selling them to the listed company at favourable prices -- a boon to investors who find the value of their company rising with few of the downside risks associated with exploring and developing. PetroChina and its parent have formed a joint venture that owns most of CNPC's overseas fields -- except its holdings in Sudan."⁵⁵

In September 2010, PetroChina's new China-based \$1.6 billion refinery came online. It was configured to refine low-sulphur, acidic Sudanese crudes drilled by CNPC.⁵⁶ Construction support for building the refinery came from the parent under the Comprehensive Products and Services Agreement between the two companies.⁵⁷ This project put PetroChina as close to CNPC's Sudan operations as possible while still shielding itself from investor concerns raised during the IPO. Political pressure from the U.S. government has blocked the PetroChina plant from refining Sudanese crude, which may cause PetroChina to transfer this asset to its parent, further highlighting their close and interdependent relationship.⁵⁸

Such non-arms length transactions frequently involve subsidiaries that were not listed at the time of transfer, and therefore do not have publicly available financial information. This makes valuations of the subsidiaries virtually impossible without more transparent disclosure from CNPC and PetroChina. Furthermore, where financial advisors are retained to make an opinion with regard to the fairness of these transactions, their

⁵³ PetroChina FY 2009 Form 20-F, as filed with the United States Securities and Exchange Commission, F-43, 25 June, 2010 at <http://www.sec.gov/Archives/edgar/data/1108329/000095012310060898/h04189e20vf.htm#110>.

⁵⁴ *Id.*; the 20-F form specifically notes, "PetroChina does not have the capacity to enter into production sharing contracts directly with foreign oil and gas companies under existing [Chinese] law. Accordingly, CNPC will continue to enter into production sharing contracts [internationally]. After signing a production sharing contract, CNPC will, subject to approval of the Ministry of Commerce, assign to PetroChina most of its commercial and operational rights and obligations under the production sharing contract as required by the Non-competition Agreement between CNPC and PetroChina."

⁵⁵ "PetroChina, CNPC, and Sudan: Perpetuating Genocide," Sudan Divestment Task Force report, April 15, 2007, at http://home.comcast.net/~berkshire_hathaway/reports/PetroChina_CNPC_Sudan.pdf.

⁵⁶ "PetroChina starts \$2 bln new refinery in south China," Reuters, September 9, 2010, at <http://www.reuters.com/article/2010/09/09/petrochina-refinery-idUSTOE68804420100909>.

⁵⁷ "PetroChina: Refinery for Sudanese Crude," Energy Tribune, January 22, 2007, at <http://www.energytribune.com/articles.cfm?aid=361&idli=1>.

⁵⁸ "PetroChina told no Sudanese crude at new plant-sources," Reuters, July 5, 2010, at <http://www.reuters.com/article/2010/07/05/petrochina-crude-sudan-idUSTOE66407I20100705>.

conclusions are generally based on non-public, un-audited financial data supplied by CNPC and PetroChina.⁵⁹

This raises the possibility that CNPC may structure transactions above or below market value in order to provide or extract a hidden subsidy from PetroChina, bypassing the company's independent shareholders. PetroChina's 2009 SEC 20-F filings go so far as to acknowledge such a possibility: "[PetroChina] has extensive transactions with other companies in the CNPC and its subsidiaries. Due to these relationships, it is possible that the terms of the transactions between [PetroChina] and other members of the CNPC and its subsidiaries are not the same as those that would result from transactions with other related parties or wholly unrelated parties."⁶⁰

The Chinese business paper, *The Standard*, noted that the "[t]ransparency in the relationship between PetroChina and CNPC is so poor that investors are often in the dark about potential cross-subsidies."⁶¹ While it is impossible to calculate the total value of all cross-subsidization between the two companies, PetroChina's 2009 SEC 20-F form reveals tens of billions of dollars in related party transactions every year, all in the context of a non-competition agreement.⁶² Clearly, the absolute firewall promised to PetroChina investors at the time of its IPO is undermined by the company's intricate and opaque financial relationship with CNPC. While it is not clear what benefits are conferred on PetroChina by such non-arms length transactions, their existence is strongly indicative of it being CNPC's alter ego.

7. Subsidiary does not observe basic corporate formalities: Under NYSE corporate governance rule 303A.03, a listed company must have a corporate governance committee consisting entirely of independent directors, and with a written charter covering certain minimum duties. Rule 303A.04 also requires a majority of independent directors on its board.⁶³ While PetroChina, as a foreign issuer majority-owned by a parent, is not subject to these listing requirements, the company could – but has chosen not to – comply with them to help establish a degree of independence from CNPC. Similarly the rule requires the non-executive Directors of a listed company to meet at regularly scheduled executive sessions without management.⁶⁴ The SSE and HKSE rules do not include this requirement and as such the company chooses not to hold such sessions.⁶⁵

⁵⁹ "PetroChina Company Limited Form 6-K Report of Foreign Issuer, as filed with the United States Securities and Exchange Commission, April 2007. at <http://www.sec.gov/Archives/edgar/data/1108329/000114554907000492/h01126e6vk.htm>.

⁶⁰ PetroChina FY 2009 Form 20-F, as filed with the United States Securities and Exchange Commission, 25 June, 2010. at <http://www.sec.gov/Archives/edgar/data/1108329/000095012310060898/h04189e20vf.htm#110>.

⁶¹ Karen Teo, "Assets plan for PetroChina in global drive," *The Standard*, October 25, 2004, at http://www.thestandard.com.hk/stdn/std/Front_Page/FJ25Aa01.html.

⁶² PetroChina FY 2009 Form 20-F, as filed with the United States Securities and Exchange Commission, 25 June, 2010. at <http://www.sec.gov/Archives/edgar/data/1108329/000095012310060898/h04189e20vf.htm#110>.

⁶³ *Id.*

⁶⁴ Corporate Governance Structure, PetroChina Company Website, at http://www.petrochina.com.cn/Ptr/Investor_Relations/Corporate_Governance_Structure/gszljg_10.htm.

⁶⁵ *Id.*

8. Absence of corporate records: Transactions between the two connected corporations commonly transpire, with unaudited data and undisclosed valuation methodologies.⁶⁶ Financial statements, upon which financial advisors' recommendations are based, are frequently not verified independently, relying on the quality of the data provided by CNPC or PetroChina.⁶⁷
9. The corporations are so integrated through common direction, supervision and activities that they should be considered one single enterprise: In addition to having significant overlap in management, CNPC and PetroChina share similar public images. They have an identical corporate logo, which appears on their documents and websites. For years following the IPO, CNPC and PetroChina both used the same company abbreviation, "Zhongguo Shiyou (Chinese Petroleum),"⁶⁸ and CNPC's website listed PetroChina's stock ticker and share price without indicating that it is a separate company.⁶⁹ Currently their websites provide prominently placed links to each other on the permanent navigation bars which appear on every page on their sites.⁷⁰

Conclusion:

We thank you for the opportunity to comment on the Commission's implementation of Section 1504 of the Dodd-Frank Act. While CRN is generally supportive of the Commission's proposed ruling, we ask that the Commission understand the definition of a "subsidiary of the resource extraction issuer or an entity under the control of the resource extraction issuer" to include the parent of a resource extraction issuer when the resource extraction issuer is merely the alter ego or instrumentality of its parent, such as in the case of PetroChina and CNPC. Additionally, or alternatively, we ask the Commission to recognize that the existence of an alter ego or instrumentality relationship between a resource extraction issuer and its parent is an instance in which an issuer should have to disclose payments made by an "other entity." A narrower understanding of the disclosure requirements will mean that payments that should be covered under the intent and scope of the statute will not be disclosed.

Sincerely,



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Director, Conflict Risk Network

⁶⁶ "PetroChina, CNPC, and Sudan: Perpetuating Genocide," Sudan Divestment Task Force report, p. 12, April 15, 2007, at http://home.comcast.net/~berkshire_hathaway/reports/PetroChina_CNPC_Sudan.pdf.

⁶⁷ *Id.*

⁶⁸ *Id.* at 17.

⁶⁹ "PetroChina, CNPC, and Sudan: Perpetuating Genocide," Sudan Divestment Task Force report, p. 17, April 15, 2007, at http://home.comcast.net/~berkshire_hathaway/reports/PetroChina_CNPC_Sudan.pdf.

⁷⁰ See "CNPC," China National Petroleum Corporation website, at <http://www.cnpc.com.cn/en/>; "PetroChina," PetroChina Company Limited website, at <http://www.petrochina.com.cn/ptr/>.