Analysis of Section 1504 of the
Wall Street Reform and Consumer Protection Act
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Introduction

The following discussion examines the proposed implementation of section 1504 of the Wall Street Reform and Consumer Protection Act ("Act"). The Securities Exchange Commission ("Commission" or "SEC") has issued a request for comment in advance of developing a final rule.

The discussion below examines the issues raised by section 1504 from several distinct perspectives. It begins by assessing the arguments for intrusive disclosure under section 1504 in light of their inconsistency with long-standing U.S. policy goals and the conflicts such disclosure would create with international norms agreed to by U.S. negotiators as part of the Extractive Industries Transparency Initiative ("EITI").

The discussion then weighs the costs and benefits of differing approaches to disclosure. In particular, it looks at the potential unintended consequences of overly intrusive disclosure in light of shifts in the global energy sector over the past two decades, which suggest that imposing costly new rules on U.S. listed companies could ultimately lead to less, rather than more, transparency. The discussion also addresses the uncertainty and added cost of compliance that would flow from a radical departure from international norms and current practice under the Securities Act of 1933 and the Foreign Corrupt Practices Act ("FCPA").

Before turning to the implications for the SEC and U.S. capital markets, the discussion then assesses two concerns raised by U.S. industry. The first involves the threat to the safety and security of U.S. oil company personnel and assets abroad that would flow from detailed disclosure on a project-by-project basis. The second focuses on the likely damage to U.S. listed firms’ reputation as reliable suppliers if the SEC were to adopt deeply intrusive disclosure rules under section 1504 that forced U.S. listed firms to violate their existing contracts.

Lastly, the discussion examines the disturbing implications of casting the SEC as the enforcer of rules that have no obvious nexus to the Commission’s core function. The effort to compel the SEC to assume a role for which it is ill-suited seems fundamentally at odds with Congress’ intent in enacting the Wall Street Reform and Consumer Protection Act, which was to refocus the Commission on its

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primary responsibility of protecting U.S. investors and ensuring the fair and efficient functioning of U.S. capital markets.

What the analysis below strongly suggests is that demanding deeply intrusive disclosure, as some advocate, would prove counterproductive. The potential costs of such disclosure outweigh the benefits by a wide margin. There is, however, an elegant solution that avoids those downside risks.

The Act provides the Commission with the flexibility it needs to implement section 1504 in a manner that is consistent both with long-standing policy objectives and the international norms agreed to by U.S. negotiators and the affected U.S. energy companies under the EITI. That is the course the SEC should pursue.

I. Achieving Transparency

As former Supreme Court Justice Louis D. Brandeis wrote, “sunlight is said to be the best of disinfectants; electric light the most efficient policeman.” That simple truth has motivated the United States government’s pursuit of common global standards with respect to bribery and corruption over the past four decades.

The United States pursued that objective for two reasons. One was the belief that encouraging transparency in international business transactions was essential to the functioning of a global market economy and instrumental in assisting the developing countries of the world establish sound institutions that served the public interest, rather than lining the pockets of corrupt officials.

The other goal is particularly important to bear in mind in assessing the appropriate way to implement section 1504. That goal was to offset the competitive disadvantage faced by U.S. companies that were subject to the unique reporting obligations of the Foreign Corrupt Practices Act (“FCPA”).

The United States’ effort to achieve both goals reflected recognition that “bribery and corruption in foreign commerce could be effectively addressed only through strong international cooperation.” Bitter experience under the FCPA with lost sales to firms located in countries that not only tolerated bribery by those firms,

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2 L. Brandeis, Other People’s Money (1933).
3 As noted in the Justice Department’s guide to the anti-bribery provisions of the FCPA, motivated by a concern that U.S. companies were operating at a disadvantage compared to foreign companies who routinely paid bribes and, in some countries, were permitted to deduct the cost of such bribes as business expenses on their taxes, Congress, in the Omnibus Trade and Competitiveness Act of 1988, directed the Executive Branch “to commence negotiations in the Organization of Economic Cooperation and Development (OECD) to obtain the agreement of the United States’ major trading partners to enact legislation similar to the FCPA.” Department of Justice, Lay Person’s Guide to the Anti-Bribery Provisions of the Foreign Corrupt Practices Act.
but also offered them a tax deduction for the cost of suborning foreign government officials led Congress to direct the Executive to pursue international negotiations aimed at leveling the playing field.


The reports prepared by the Commerce Department in succeeding years tell a cautionary tale. Despite the United States’ 20-year campaign to encourage international cooperation against corruption, culminating in the Inter-American Convention Against Corruption in 1996, the OECD Convention in 1997, and the United Nations Convention Against Corruption in 2003, U.S. businesses continued to find themselves outflanked in international competition as a result of the broader scope of U.S. anti-bribery laws, resulting in the loss of billions of dollars in exports and an untold number of U.S. jobs.

The lack of progress in terms of international cooperation, combined with the continuing competitive disadvantage U.S. firms faced, led Congress to reinforce the mandate to negotiate global norms. That expression of Congress’ intent was enacted in the International Anticorruption And Good Governance Act ("IAGGA") in 2000. The IAGGA required the State Department to develop a coherent strategy for advancing the cause of transparency through international cooperation.

The most recent State Department report on its activities under the IAGGA reflects that mandate. It emphasizes the premium that both Congress and the Executive have placed on international cooperation, rather than unilateral U.S. sanctions, as a means of achieving the twin goals of transparency and a level playing field.

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6 Id. at section 6(a) (1).
7 Convention on Combating Bribery of Foreign Public Officials in International Business (Adopted by the Negotiating Conference on 21 November 1997); Inter-American Convention Against Corruption (Adopted at the third plenary session, held on March 29, 1996); United Nations Convention against Corruption (entered into force on 14 December 2005 in accordance with article 68 (1) of U.N. Resolution No. 58/4). With respect to the dollar amounts of international contracts or sales affected by bribery and corruption, see, e.g., U.S. Department of Commerce, Addressing the Challenges of International Bribery and Fair Competition 2004 – The Sixth Annual Report Under Section 6 of the International Anti-Bribery and Fair Competition Act of 2998 (July, 2004).
In that vein, the State Department report highlights the use of a “mix of diplomatic, policy, and programmatic tools” designed to promote “adoption of international standards and shared approaches” and their effective implementation and to provide “assistance to enhance transparency, accountability, and good governance.”\(^9\) The anticorruption framework laid out by the State Department report stresses the importance of “partnerships with others,” as well as effective enforcement of our own anti-bribery laws, as central pillars of the U.S. approach.\(^10\)

As the State Department report underscores, the lesson to draw from previous U.S. experience in combating corruption globally is that achieving real transparency depends heavily on creating a broad, multilateral, rather than unilateral, approach to the problem. While imposing unilateral measures on U.S. industry under the FCPA did improve the internal accounting disciplines applied by U.S. issuers subject to the SEC’s rules, it did little to alter conditions in the global marketplace or increase the transparency of international business generally. That required international cooperation painstakingly pursued over a 20-year period – a degree of cooperation that it would be wise to vindicate, rather than undercut by new unilateral U.S. sanctions.

If anything, the lessons to be drawn from past U.S. experience are still starker in light of the accelerating globalization of the world economy. While the United States remains unrivaled as the world’s largest economy, with the deepest, most liquid and most sophisticated capital markets, it is simply no longer the case – if it ever was – that adopting unilateral U.S. approaches to global problems will prove effective.

That is why Congress’ directive to pursue a multilateral approach to the challenge of bribery and corruption in international commerce, must shape the SEC’s implementation of section 1504. The SEC must ensure that its proposed regulations, when issued, adequately reflect and contribute to a multilateral approach to the problem, rather than assuming that unilateral steps by the United States that conflict with internationally agreed norms will work or somehow persuade other countries to follow suit.

Fortunately, Congress left the SEC the flexibility to adopt regulations that would implement the agreed global norms reflected in the EITI, rather than adopting a unilateral approach inconsistent with the agreements reached by U.S. negotiators in the EITI process. The best way to harmonize the implementation of section 1504 with Congress’ long-standing admonition to pursue a multilateral approach would be to implement the EITI approach faithfully in any final rule adopted under the authority of section 1504.

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\(^9\) Fifth Report To Congress Pursuant To the International Anticorruption And Good Governance Act (2008).

\(^10\) Id.
II. The Extractive Industries Transparency Initiative

The early support of the EITI by both the U.S. government and by U.S. industry was motivated by the same two concerns that animated Congress’ actions reflected in IAFCA and IAGGA discussed above – one regarding the profoundly negative impact of bribery on economic development in a number of resource rich developing countries; the other recognizing the importance for U.S. commerce of engaging in cooperative, multilateral approaches to the problem of corruption.11

Launched by British Prime Minister Tony Blair at the World Summit on Sustainable Development, in Johannesburg, September, 2002, the EITI owes much of its success to that unique combination of government and business support, together with its practical focus. With a view toward ensuring the broadest possible participation in the initiative and avoiding the proliferation of inconsistent or conflicting reporting standards, the EITI principles emphasize the importance of “a broadly consistent and workable approach to the disclosure of payments and revenues” that was “simple to undertake and to use.”12

In that, the EITI reflects the reality that achieving real transparency depends not only on the information obtained from private developers of natural resources, but on the willingness of the resource-holders to open their books as well. It balances the obligations it imposes against the very real need to gain wide acceptance of those obligations both by private firms engaged in extractive industries and the governments that own the natural resources.

The EITI criteria manifestly achieve that objective. They call for the “[r]egular publication of all material oil, gas and mining payments by companies to governments . . . and all material revenues received by governments from oil, gas and mining companies . . . to a wide audience in a publicly accessible, comprehensive and comprehensible manner.”13 The criteria also require that all payments and revenues be subject to “a credible, independent audit, applying international auditing standards.”14

11 American oil and gas producers were among the first supporters of the initiative. See Final Attendance List, Extractive Industries Transparency Initiative London Conference (June 17, 2003). Their comments reflect the lesson gained over decades of experience in the global energy business, as well as in developing what are universally regarded as the best internal compliance programs among global businesses. See, e.g., Statement of EXXON MOBIL Corporation by Andrew P. Swiger Chairman, EXXONMOBIL International, Limited, Extractive Industries Transparency Initiative (EITI) London Conference, 17 June 2003 (supporting “transparency that applies universally to all companies attempting to do business within a country, allows for protection of proprietary information and does not violate the laws of host countries or breach contractual obligations”).
13 Id. at 10.
14 Id.
Significantly, the EITI criteria do not require publication of payments data on a company-by-company, much less a project-by-project basis. Nor do they require reporting or publication of payments on anything other than an upstream basis, which, in the end, is all that matters in terms of potential illicit payments related to the actual extraction of oil and gas or mineral resources.

Adopting far more intrusive disclosure rules for U.S. listed companies is not consistent with and does not complement the effective implementation and enforcement of the EITI, despite what the advocates of “enhanced information reporting” claim. Experience in the implementation of the OECD Convention and other international standards suggest that inconsistent standards invite regulatory arbitrage and create a constituency for lax enforcement in other participating states, precisely because the inconsistency in implementation creates the kind of competitive advantage that Congress has long sought to eliminate by its direction to negotiate global rules.

Given the EITI’s wide international acceptance by governments, private firms and non-governmental organizations, as well as the active role that both the U.S. government and major U.S. energy producers played in their development, the course of action best calculated to maximize transparency with respect to payments made by extractive industries globally would be simply to implement the norms agreed to as part of the EITI in U.S. law as discussed below.

III. Implementing the EITI in U.S. Law

Even in the absence of section 1504, the Securities Act of 1933 (“1933 Act”), the Securities Exchange Act of 1934 (“1934 Act”), and the FCPA would offer ample authority to vindicate Congress’ directive to pursue a multilateral approach to the challenge of bribery and corruption in connection with the extractive industries.\(^\text{15}\) The surest route to that end would be faithfully implementing the global norms agreed to by U.S. negotiators as part of the EITI.

As amended by the Sarbanes-Oxley Act of 2002, the 1934 Act requires issuers to file annual reports reflecting the financial conditions of their companies. SOX, moreover, obliges the high-ranking executives of any issuer filing an annual report to expressly attest not only to the information the annual filing contains, but to the effectiveness of the internal controls on which the information is based.\(^\text{16}\)

The FCPA adds further scope to the 1933 and 1934 Acts’ reporting requirements, prohibiting corrupt payments to a foreign official for the purpose of obtaining or retaining business from, or directing business to, any person.\(^\text{17}\)

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\(^{16}\) See 15 U.S.C. § 78m.

\(^{17}\) See 15 U.S.C. §§ 78dd-1, et seq.
the FCPA, companies issuing securities that are listed on U.S. exchanges must also satisfy the accounting provisions of the Act, which require corporations covered by the provisions to make and keep books and records that accurately and fairly reflect the transactions of the corporation and to devise and maintain an adequate system of internal accounting controls designed to inhibit illicit payments.  

Annual reporting requirements under the 1933 Act, as supplemented by the FCPA, provide an adequate vehicle for the SEC to obtain the information needed to satisfy the requirements of the EITI (i.e., information on payments related to upstream activities in a particular country). The SEC can, via its “EDGAR” system, make any compilation of that data on a country-by-country basis available to the public much as it does with the annual reports it now receives from U.S. listed companies. The same online system also allows for inquiries, tips and complaints from the investing public that would buttress any reporting obligations implementing the EITI principles. The SEC’s investigatory powers provide the ultimate backstop behind any reporting obligations imposed under the 1933 Act and the FCPA. The rising number of FCPA civil enforcement actions launched by the SEC in 2010 is testament to that fact. 

As the broad international agreement on the EITI reflects, listing payments solely on a countrywide basis and then only with respect to upstream activities in the oil and gas sector is more than sufficient to highlight any inconsistencies between the payments made and the amounts reflected in the host government’s coffers, to the extent the government cooperates by publishing its own books and accounts. Given the U.S. legal architecture outlined above, implementing the EITI rules in U.S. law would require no more than obliging U.S. listed companies to provide the information the SEC needs to compile the information on a country-by-country basis and make that aggregated data available to the public.

The advocates of far more intrusive disclosure will doubtlessly suggest that section 1504 requires more and the Congress specifically intended to expand the scope of disclosure required of companies listed on U.S. exchanges beyond the scope of the EITI. Those arguments, however, must be weighed in light of Congress’

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19 There has been no lack of enforcement that would lead objective observers to suggest that the SEC’s rules implementing the FCPA and its enforcement powers were insufficient for purposes of implementing the EITI principles. See, e.g., Andrew Weissman and Alixandra Smith, *Restoring Balance – Proposed Amendments to the Foreign Corrupt Practices Act* (October, 2010 (“Restoring Balance”)) 2-5. To the contrary, the OECD Working Group on Bribery in International Business Transactions expressly applauded the efforts of both the SEC and the Department of Justice in its most recent review of U.S. implementation of the OECD Convention under the authority of the FCPA, specifically noting the increase in SEC enforcement actions. OECD Working Group on Bribery in International Business Transactions, *United States: Phase 3 – Report on the Application of the Convention on Combating Bribery of Foreign Public Officials in International Business Transactions and the 2009 Revised Recommendation on Combating Bribery in International Business Transactions* (October, 2010) 17.
consistent admonition to pursue a multilateral approach and ensure that U.S. listed companies did not face a competitive disadvantage in global markets.

The negotiating history of the EITI reinforces that point. In the event, the far more intrusive disclosure advocated by those currently demanding “enhanced information reporting” under section 1504 was expressly rejected by the vast majority of stakeholders involved in the broadly inclusive EITI process, including the U.S. government negotiators.

The advocates for more intrusive disclosure had ample opportunity to present their views and an extensive discussion of the more intrusive approach ensued. Despite taking full advantage of the opportunity the inclusive EITI process allowed for them to make their case, the proponents of more intrusive disclosure under section 1504 simply failed to persuade a majority of the EITI stakeholders to adopt their position.  

Having failed to persuade the stakeholders engaged in the EITI process of the wisdom of their position, advocates for a mandatory and more intrusive approach determined to enforce their views through unilateral U.S. action, despite the evident inconsistency of that approach with both the principles of the EITI and the inclusiveness of its process. The Dodd-Frank legislation provided a convenient legislative vehicle for their purposes.

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20 The original discussion paper that became the basis for the principles to which the parties eventually agreed reflected a commitment to disclose “tax and non-tax payments to host country governments and government-linked entities,” and a counterpart commitment by governments to “transparency . . . over revenues” derived from the extractive industries in their jurisdiction. The Extractive Industries Transparency Initiative Discussion Paper for International Stakeholders Meeting 11-12 February 2003. Early on, non-governmental organizations such as Publish What You Pay urged the participants to impose mandatory reporting requirements that obliged companies to disaggregate their information on payments on a project-by-project basis on the ground that aggregating payments on a country-by-country basis would not allow “civil society” within the country in question to gain “access to information on a specific company’s financial flows to their government” and would make “make cross-checking of data significantly more difficult.” NGO Coalition Statement to the Extractive Industries Transparency Initiative High-Level Multi-Stakeholder Conference, Extractive Industries Transparency Initiative (EITI) London Conference (June 17, 2003). The summary of the initial discussions among EITI stakeholders prepared by the United Kingdom’s Department for International Development (“DFID”) highlights the extensive discussion of the issue, noting that it represented a “key question” to be resolved. Department for International Development, Report of the Extractive Industries Transparency Initiative (EITI) Workshop, 11-12 February 2003. The absence of any reference to publishing payment information on a disaggregated basis strongly suggests that the stakeholders rejected that approach in favor of the concepts put forward in the original discussion paper.

21 See, e.g., Testimony of Ian Gary, Oxfam America, before the House Committee on Financial Services (October 25, 2007) (arguing for the need “to move beyond a voluntary approach to extractive industries transparency,” as reflected in the EITI, in favor of a “‘cocktail’ of mandatory disclosure requirements than can capture the large majority of companies and producing countries”).
As a part of their effort, the advocacy groups sought to diminish the potential conflicts between section 1504 and the principles of the EITI, asserting erroneously that the disaggregation of payments they sought “mirrors the reporting required by EITI” and that such requirements would be “compatible” with the EITI’s approach. Comments submitted to the SEC by Senator Cardin, one of the original sponsors of the amendment that became section 1504, in response to the SEC’s notice of proposed rulemaking were both more frank and more revealing. There, Senator Cardin emphasized that his intent, at least, in urging, “reporting at the project level, disaggregated by payment stream . . . was to go beyond [the] requirements” of the EITI.

In other words, rather than “mirroring” the EITI principles and ensuring uniform, universally-agreed standards would be faithfully implemented in U.S. law, the proponents of section 1504 sought to implement a unilateral approach that was, by design, inconsistent with the standards that the U.S. government and U.S. industries had agreed to as a means of both maximizing transparency and leveling the playing field for U.S.-based firms. It was, moreover, deeply inconsistent with Congress’ long-standing admonition to pursue a multilateral approach.

The danger in that approach is that it ignores the balance that the EITI principles struck between the obligations they impose and the ability to encourage wide acceptance of those norms. In that, the proponents of a more intrusive approach to disclosure also ignore the lessons of 30 years of experience under the FCPA. Whatever positive contribution the FCPA made to the internal accounting disciplines applied by U.S. issuers, it would be dishonest to suggest that it led to any material advance in transparency globally. It did not serve, as the proponents of section 1504 often suggest, as an example that other countries followed.

Rather, as noted above, the FCPA created a constituency within other developed countries for policies that were deeply at odds with the goals of transparency. Major industrial firms in both France and Germany became vigorous opponents of anti-bribery initiatives and vocal supporters of the continuing tax deductibility of bribes precisely because that preferential treatment gave them a material advantage over U.S. firms in international competition.

22 Statement by Karin Lissakers, Director, Revenue Watch Institute, Concerning H.R. 6066, the Extractive Industries Transparency Disclosure Act before the Committee on Financial Services, House of Representatives (June 26, 2008); Opening Statement – Alan Detheridge, Extractive Industries Transparency Disclosure Act before the Committee on Financial Services, House of Representatives (June 26, 2008).


24 Id.
A broader interpretation of section 1504 risks a similar outcome in the case of extractive industries. The wiser choice would be to implement the EITI principles as agreed by the United States and over 30 other governments to date. Section 1504 expressly allows for that possibility. The statute authorizes the SEC to take the globally accepted standards reflected in the EITI into account when “practicable.”

The SEC should make use of the opportunity that the plain language of section 1504 provides to implement reporting obligations that are consistent with the EITI and by no means extend further than the ample and adequate reporting obligations called for under the 1933 Act and the FCPA. Specifically, the SEC should use its discretion provided under section 1504 to obtain only that information needed from U.S. listed companies to make a country-level compilation of the data available to the public only as related to upstream activities and only where consistent with host country law.

That is the only approach that would vindicate the long-standing U.S. commitment both to international cooperation on corruption and to a level playing field for U.S. firms.

IV. Avoiding Unintended Consequences

Using the flexibility provided by section 1504 to implement reporting obligations that are consistent with the EITI would pay enormous dividends from a U.S. perspective. As will be discussed in greater detail below, implementing the EITI in U.S. law would sharply reduce the uncertainty associated with adopting rules that are in conflict with existing corporate best practices, which is what the EITI norms reflect. It would also reduce the direct costs of compliance.

But, the biggest benefit by far would flow from avoiding the unintended consequences of imposing far more intrusive disclosure requirements on those firms that are at the forefront of the effort to encourage transparency, while effectively exempting those companies that are least committed to transparency and largely immune from any obligation to disclose at all.

Supporters of “enhanced informational reporting” tend to minimize or ignore the risks to transparency that arise when the rules apply solely to a subset of an industry or sector. Those risks are particularly acute in the oil and gas industry, where state-owned energy giants that are anything but transparent now dominate markets.

As the following chart attests, the top 16 oil companies in the world are state-owned and their size dwarfs that of the privately held international oil companies in...
the listing. By some estimates, national oil companies ("NOCs") now control 78 percent of worldwide oil and gas reserves.

Advocates for more intrusive disclosure take comfort in the fact that section 1504 applies to any company required to file reports with the SEC under U.S. securities laws, which, they maintain, applies to the state-owned companies engaged in the global development of energy resources, such as the China National Offshore Oil Corporation ("CNOOC"). To give the argument its due, public listing is, in fact, associated with greater openness and transparency on the part of national oil companies when they do choose to list, even on domestic exchanges.

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25 PetroStrategies, Inc., *World's Largest Oil and Gas Companies (updated November, 2010)*, http://www.petrostrategies.org/Links/worlds_largest_oil_and_gas_companies.htm (green bars signify OPEC members; red bars are Russian companies; blue bars are non-OPEC national oil companies; white bars represent public international operating companies).


27 See, e.g., Statement by Karin Lissakers, Director, Revenue Watch Institute, Concerning H.R. 6066, the Extractive Industries Transparency Disclosure Act before the Committee on Financial Services, House of Representatives (June 26, 2008); Opening Statement – Alan Detheridge, Extractive Industries Transparency Disclosure Act before the Committee on Financial Services, House of Representatives (June 26, 2008).

28 According to a report prepared for the World Bank by the Center for Energy Economics at the University of Texas at Austin, the "impact of public equity listings is substantial, resulting in disclosure of "substantive information . . . regarding the NOC and its business segments, . . . even for
That said, as the chart above amply demonstrates, the frequently repeated claim that section 1504 would apply “to a very high percentage of those companies listed on stock exchanges around the world” does not withstand serious scrutiny. Given that the international oil companies “now control less than 10 percent of the world’s oil and gas resource base, it would be more honest to say that any mandatory disclosure rules adopted under 1504 are only assured of reaching 10 percent of the global energy sector, rather than the 90 percent figure often cited by the advocates of more intrusive disclosure.\(^29\)

There are a number of reasons why. First, none of the NOCs that make up the 10 largest oil companies in the world are publicly listed on stock exchanges. Second, none of those that are listed publicly are necessarily obliged to do so. Third, there is nothing to suggest that the state-owned energy giants would remain listed if faced with the sort of disclosure that advocates of a more intrusive approach to disclosure under section 1504 support, particularly given the demonstrated aversion of many of the governments who own the NOCs to openness and public debate of their operations generally.

The Chinese NOCs offer a case in point. While CNOOC is listed in the United States and has tapped the U.S. financial markets for financing, a significant share of the capital it has raised has come from other financial markets – markets that would not be subject to the mandatory disclosure rules of section 1504. Those markets will look increasingly attractive to CNOOC as an alternative to listing in the United States if the SEC implements intrusive new disclosure rules under section 1504.

Equally important, as state-owned enterprises, the Chinese NOCs have recourse to sources of financing unavailable to the privately owned international operating companies. The Chinese NOCs benefit, as do other Chinese firms, from explicit government support of their efforts to “go global.”\(^30\) That includes the option of turning to the Chinese sovereign investment fund, the China Investment Corporation, which currently holds well over $200 billion that it uses to assist Chinese companies with overseas investments.

Where the NOCs choose not to list their securities in the United States, or choose to delist in response to the intrusive disclosure requirements that a broad reading of section 1504 would compel, they lie entirely beyond the reach of the SEC rules and U.S. law generally due to the limits that international law imposes on the prescriptive jurisdiction of the United States. Where a firm’s operations lie outside those NOCs listed only on domestic exchanges.” Center for Energy Economics, University of Texas at Austin, A Citizen’s Guide to National Oil Companies, Part A Technical Report (October, 2008) (“Citizen’s Guide”) 31.


\(^{30}\) Xiaojie Xu, Chinese NOCs’ Overseas Strategies: Background, Comparison and Remarks (2007) 4-5.
the territory of the United States (as is true of the largest NOCs) and the firm has no
other obvious contact with the U.S. stream of commerce, U.S. legal norms would not
apply, even under the broad interpretation of its prescriptive jurisdiction that the
United States’ routinely asserts as a matter of international law.31

To mitigate concerns regarding what increasing NOC involvement in global
energy markets means for the effort to increase transparency, advocates for more
intrusive disclosure frequently point to the fact that NOCs have, traditionally,
“operate[d] solely within their own countries.”32 That is simply no longer the case.
The NOCs are increasingly looking to invest and operate in other countries.33

The submission of competing bids by CNOOC and another of China’s state-
owned firms, the Sinochem Group, for a 40 percent stake in a Brazilian oil field
owned by the Norwegian state oil company Statoil ASA this past year offers the most
compelling evidence of this paradigm shift.34 The transaction involved two state-
owned companies bidding for the rights owned by a third state-owned company in a
country in which none of the three state-owned companies were domiciled.

Seen in that light, pursuing the sort of intrusiveness that a broad reading of
section 1504 would compel is that it could lead to less, rather than more,
transparency in the extractive industries globally. Any marginal added benefit in
terms of transparency that greater intrusiveness might offer would not be worth the
price if it comes at the expense of discouraging broader international cooperation
on the challenge of corruption that often plagues resource rich developing
countries.35

31 The state-ownership of the NOCs reinforces that limit on the ability of U.S. regulators to reach the
conduct of such firms. Under well-established rules of international law and the U.S. Foreign
Sovereign Immunities Act, which implements those norms in U.S. law, the functions of a foreign
government and its instrumentalities cannot be subjected to the dictates of U.S. law. The only
potentially applicable exception, under both U.S. and international law, involves the conduct of
commercial activities by a state-owned enterprise. While the U.S. courts have given that exception
an expansive reading, the functions of state-owned energy producers create unique problems
because of the nexus of their activities to legitimate functions of the state. But, still more practically,
the exception for commercial activity under U.S. and international law still requires some nexus to
U.S. commerce. The state-owned energy giants have little need to engage in investments or
operations in the United States that would subject them to the reach of U.S. law, much less any
intrusive disclosure rules enforced under section 1504.

32 See, e.g., Opening Statement – Alan Dettridge, Extractive Industries Transparency Disclosure Act
before the Committee on Financial Services, House of Representatives (June 26, 2008).
33 Citizen’s Guide at 33; Changing Role of NOCs at 9.
34 Sinochem, Cnooc Bid for Stake in Brazil Oil Field, Wall Street Journal (May 10, 2010),
35 See, e.g., Testimony of Professor Terry Lynn Karl before the House Committee on Financial
Services (October 25, 2007) (describing the “the paradox of plenty” – otherwise commonly referred
to as the “resource curse” – as “an increasingly perverse development pattern rooted in the
interaction between oil, gas mineral dependence and weak states . . . inextricably intertwined with
the lack of transparency in the extractive industries”).
That would prove extraordinarily shortsighted from the perspective of encouraging transparency in the extractive industries worldwide. The downside risk of adopting rules that conflict with EITI norms augurs in favor of faithfully implementing the EITI principles under section 1504, rather than imposing unilateral U.S. rules that would discourage listing and transparency generally.

V. Creating Certainty and Reducing the Costs of Compliance

In his recently announced executive order calling for a government-wide review of regulation, President Obama emphasized that “[o]ur regulatory system must protect public health, welfare, safety, and our environment while promoting economic growth, innovation, competitiveness, and job creation.”36 Toward that end, the President emphasized that one of the goals of our regulatory system should be to “promote predictability and reduce uncertainty.”37

Making use of the flexibility section 1504 allows to implement the EITI principles as originally agreed by U.S. negotiators would fulfill the President’s commitment to reduce the uncertainty and improve the predictability of the rules on disclosure. By the same token, the SEC’s adoption of more intrusive disclosure rules under section 1504 that conflict with effective, established international norms would run directly counter to the President’s goal in launching his review.

While the SEC rulemaking process is justly applauded for its openness, any realistic hope for greater certainty will await not only the publication of the SEC’s rules, but their application. In that regard, the FCPA offers a useful, if troubling, benchmark. The fact is that both the SEC and the firms it regulates are still working out the appropriate standards of conduct over 30 years after the enactment of the law. That lack of clarity affects the direct outlays that firms have to make in terms of compliance. It also raises unanswerable questions for investors trying to assess the risks associated with the new regulations and any future enforcement actions on the earnings of affected firms.

The uncertainty raised by section 1504 is not limited to the application of domestic law alone. One of the main reasons that the U.S. government has consistently pursued a multilateral approach that ensures international cooperation is the experience of both the government and U.S. businesses in dealing with the consequences of often conflicting rules adopted by the United States and other countries.

Inconsistencies between U.S. law and universally agreed international standards have, in the past, led to continuing conflicts of jurisdiction and continuing complaints regarding the extraterritorial application of U.S. law. From the

36 Executive Order - Improving Regulation and Regulatory Review (January 18, 2011).
37 Id.
perspective of U.S. businesses trying to compete in the global economy, the uncertainty created by those conflicts of jurisdiction has real competitive consequences, wholly apart from their impact in terms of undermining international cooperation.

What that suggests for the SEC’s approach to implementing section 1504 is that the wisest course would be to implement the globally agreed principles reflected in the EITI. That also happens to be the surest way to reduce the direct costs of complying with the terms of section 1504 and any implementing regulations.

The principle advantage of adopting the EITI norms is their wide acceptance by U.S. companies that were among the most vigorous participants in the EITI’s development and implementation. Those norms have become the current best corporate practices, which means that the costs of compliance with any regulations issued under section 1504 that implemented the EITI norms have already been largely absorbed by the affected companies.

Adopting far more intrusive disclosure requirements under section 1504 would, on the other hand, reach well beyond current best practices and would undoubtedly entail real economic costs in excess of what its proponents claim. The advocates of a broad interpretation of section 1504 attempt to minimize the potential cost of implementation, by asserting that the compliance costs will be nominal at best and, even at their worst, would not prove cost prohibitive.38

That, of course, would contradict actual experience with the implementation of both the FCPA and the more recent Sarbanes-Oxley Act of 2002. Thirty years after the implementation of the FCPA, those costs are still a concern. A recent report prepared for the U.S. Chamber of Commerce details the extraordinary cost of compliance, particularly for firms enmeshed in an FCPA investigation, even when they have made a voluntary disclosure of potentially problematic payments.39

The U.S. Chamber’s report also highlights a number of the hidden costs of compliance. One is the reality that many companies confront in dealing with the SEC and other U.S. regulatory agencies, which regularly “outsource” their investigatory functions by compelling firms under their jurisdiction to undertake comprehensive internal investigations.40 The other cost is potentially more serious...

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38 Statement by Karin Lissakers, Director, Revenue Watch Institute, Concerning H.R. 6066, the Extractive Industries Transparency Disclosure Act before the Committee on Financial Services, House of Representatives (June 26, 2008); Opening Statement – Alan Detheridge, Extractive Industries Transparency Disclosure Act before the Committee on Financial Services, House of Representatives (June 26, 2008).
40 Id. at 5. It would be far easier to dismiss the concerns regarding the cost of implementing section 1504 if the current approach to compliance under the FCPA were not specifically endorsed by the
– every additional requirement incorporated in the SEC’s rules, in fact, creates new opportunities for the plaintiffs’ bar to file class action suits against U.S. listed companies, a fact that accounts for securities litigation becoming one of the fastest growing areas for civil suits over the past three decades.41

The costs of compliance with any rules adopted under authority of section 1504, as is true of the FCPA generally, have been amplified by the requirements of the Sarbanes-Oxley Act of 2002. One of the most significant lessons of the implementation of SOX has been the extent to which the direct costs of compliance vastly exceeded the expectations.

The SEC’s initial estimates of the cost to companies of implementing section 404 of SOX suggested that the additional compliance burden would amount to no more than “an additional 5 burden hours per issuer in connection with each quarterly and annual report.” In its final rule, the SEC revised its estimate upward to “around . . . $91,000 per company” in response to comments received in the rulemaking process. By mid-decade, the actual costs of implementation were estimated to be $4.36 million per issuer, for a total direct cost of $6 billion.42

A broad reading of section 1504 by the SEC would lead to reporting requirements that exceed the already expansive requirements of the 1933 Act, as supplemented by SOX, and the FCPA by a wide margin. The extraordinary potential reach of the new disclosure requirements flows from section 1504’s expansive definition of entities that qualify as a “resource extraction issuers;” what constitutes the “commercial development” of oil, natural gas or minerals; and what constitutes a “payment” in this context. 43

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41 See, e.g., Assistant Attorney General Lanny Breuer, Prepared Address at the 22nd National Forum on the Foreign Corrupt Practices Act (Nov. 17, 2009), available at http://www.justice.gov/criminal/pr/speeches-testimony/documents/11-17-09aagbreuer-remarks-fcpa.pdf (“We recognize the issues of costs to companies to implement robust compliance programs, to hire outside counsel to conduct in-depth internal investigations, and to forego certain business opportunities that are tainted with corruption. Those costs are significant and we are very aware of that fact. The cost of not being FCPA compliant, however, can be far higher.”).


43 “Resource extraction issuers” covers any issuer of securities engaged in the commercial development of oil, natural gas, or minerals that is otherwise obliged to file an annual report with the SEC. Pub. L. No. 111-203, § 1504 (July 21, 2010). “Commercial development” includes virtually any act even tangentially related to the production of the listed natural resources, including exploration, extraction, processing, export, or the acquisition of a license for any such activity (as well as any other “significant” actions relating to such resources as the SEC may determine). Id. “Payments” include taxes, royalties, fees (including license fees), production entitlements, bonuses, and any other
Broadly read, section 1504 would require the disclosure of the nature and total amount of payments made for each of the company's projects, as well as the type and total amount of such payments made to each government. The difference between that approach and the more than adequate disclosure the EITI principles require of payments on a country-by-country basis are not nominal, as the proponents of more intrusive disclosure suggest. They are significant and potentially costly.

The difference between the accounting methods used by the international oil companies listed on U.S. exchanges and those that would be required to account for payments on a project-by-project basis alone represent a significant additional cost from the companies’ perspective. To see that in context, it helps to understand that federal regulations already require the affected companies to keep three sets of books – one for financial reporting purposes, one for tax purposes, and a third to be able to calculate the alternative minimum tax. Because of the differences in accounting for the payments on cash versus accrual basis, a broad reading of section 1504 that compelled the disaggregated accounting for payments on a project-by-project basis would, effectively, require the companies to keep a fourth set of books.

The point is not that the implementation of section 1504 alone will add the sort of additional burden that the initial implementation of the FCPA or SOX imposed, despite its potential scope. Rather, the point is that the estimates of the actual cost of compliance always vastly exceed the initial estimates of the burden imposed.

The lesson that the implementation of SOX holds for the SEC is that such regulation should be strictly limited to the information needed to achieve the objectives of the statute and that the Commission should rely on existing reporting requirements and internal controls whenever possible in order to reduce the cost to issuers – a step that augurs in favor of faithfully implementing the global standards adopted under the EITI in U.S. law.

VI. Weighing the Benefits and Costs

Adopting the rule suggested above (i.e., limiting disclosure solely to that needed to achieve the objectives of the statute) would impel the SEC to implement the EITI norms as agreed by U.S. negotiators, rather than sanctioning the effort to rewrite the agreement in ways that satisfy the advocates of far more intrusive disclosure.

“material benefits” the SEC determines are part of the “commonly recognized revenue stream” for the commercial development of oil, natural gas, or minerals. Id.
The heart of the proponents’ argument is that the “disaggregation” of payments “is vital to achieving the stated objectives of” the legislation that became section 1504.\textsuperscript{44} They assert “lump sum payment disclosure would make it easier for illegitimate payments to be hidden among legitimate payments.”\textsuperscript{45} They reason, in addition, that different payment streams are often collected by different institutions within a producing state, which can “vary widely” in terms of their “position and level of accountability.”\textsuperscript{46}

The first of the arguments seems plausible on its face, but even a cursory look at the relationship between the affected companies and the resource-owning states that are the target of disclosure suggests that the proponents’ arguments are misplaced. The conventional relationship between a government resource holder and a developer entails a lease or contract authorizing exploration and development in return for a royalty and certain upfront payments. It also generally involves the separate taxation of economic activity within the jurisdiction of the resource owning state and the income derived from those operations.

It is true that the payments – royalties and taxes – made by the U.S. companies that fall within the scope of section 1504 are often made to separate agencies of the host government. But, the blunt fact is that disaggregating the payments between the two entities says nothing about the validity of the payments to either agency.

In point of fact, either the royalty or the tax payment could provide a vehicle for illicit payments, but disaggregating the payments to the two different government entities alone will not reveal whether that is the case. That will require a deeper inquiry that is more appropriately undertaken in an enforcement context for cause based on evidence of wrongdoing, rather than simple disaggregation of the payments between entities. That level of disclosure lies beyond even what the most zealous advocates of disclosure would demand and appropriately so.

The second argument on which the proponents rely is no more availing. The fact that different agencies of a particular government “vary widely” in terms of their “position and level of accountability” proves nothing in terms of the justification of more intrusive disclosure, particularly in light of the costs discussed above. Again, the fact that agencies vary widely in terms of their relative station within a particular government or their accountability does not mean that disaggregating the payment streams between the agencies will be any more revealing in terms of the willingness of an official in either agency to solicit a corrupt payment.

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\textsuperscript{44} Statement by Karin Lissakers, Director, Revenue Watch Institute, Concerning H.R. 6066, the Extractive Industries Transparency Disclosure Act before the Committee on Financial Services, House of Representatives (June 26, 2008).

\textsuperscript{45} Id.

\textsuperscript{46} Id.
More broadly, both of the proponents’ arguments in support of deeper disclosure start from the same false premise. The nature of the challenge confronting the resource-owning state tends to be one of increasing dependence on oil and gas or another commodity as the principal source of government revenue.\(^{47}\) The ready availability of that revenue obviates the need for the development of alternative means of public finance, such as a mature tax system.\(^{48}\) What that tends to do is reduce the public’s stake in knowing much about how concessions are granted, under what terms resources are sold, or how much is paid in the form of royalties relative to income taxes.\(^{49}\)

There is nothing about disaggregating the payments of revenue to the various agencies that will alter the incentives or disincentives that the dependence on the resource creates for active citizen engagement and scrutiny of the activities of the government agencies administering the leasing of natural resources or a country’s public finances. As Mancur Olson pointed out in *The Logic of Collective Action*, an individual citizen’s diffuse interest, combined with the relatively high cost of altering the underlying political and economic dynamics at work in a society, tends to reinforce the ability of organized interests to actuate their economic demands through the political process.\(^{50}\) The availability of information on payments disaggregated between various agencies of a particular government will not alter that fact. It will not change the incentive or disincentive of an individual or organized political interest to pursue accountability from either an individual agency or the government as a whole.

In short, the more intrusive disclosure that the proponents of “enhanced information reporting” seek is of marginal value at best and certainly outweighed by the direct cost of compliance and the cost of uncertainty that would attend implementing standards in U.S. law that differ materially from the international norms negotiated as part of the EITI. The fact that the costs vastly outweigh the benefits of far more intrusive disclosure reinforces the arguments in favor of implementing the globally agreed EITI principles in U.S. law, rather than adopting unnecessarily intrusive disclosure requirements under color of section 1504.

### VII. Addressing Industry Concerns

Industry voices have raised a number of concerns regarding the implementation of section 1504. One of the most salient of those concerns involves the question of the safety and security of company personnel and assets in what often are very challenging environments. Running a close second in terms of concerns from the perspective of the affected companies is the potential effect of

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\(^{48}\) *Id.*

\(^{49}\) *Id.*

\(^{50}\) See M. Olson, *The Logic of Collective Action* (1965).
more intrusive disclosure from a commercial perspective, particularly on their reputation as reliable partners in the development of strategic oil and gas or mineral resources.

The U.S.-based oil and gas companies operating in some of the most challenging security environments in the world are justifiably concerned about the safety and security of their employees and their capital assets located there. The most recent State Department travel advisory on Chad, where two major U.S. listed firms have significant investments, has this to say about conditions there:

The Department of State warns U.S. citizens of the risks of traveling to Chad and recommends that U.S. citizens avoid all travel to eastern Chad and all border regions. This Travel Warning is due to the insecurity caused by high levels of violent crime, the continuing risk of clashes between Chadian government and armed opposition forces, and the constant risk of sudden outbreak of conflict among the populations living in these areas. In particular, as Chad enters its dry season, the risks increase for incidents of carjacking and kidnapping for ransom or as part of factional conflict.\textsuperscript{51}

The challenge of operating in Nigeria mirrors, and may exceed, that of operating in Chad in some respects. Because of the risks of kidnapping, robbery, and other armed attacks, the State Department warning strongly discourages U.S. citizens from “all but essential travel to the Niger Delta states of Akwa Ibom, Bayelsa, Delta, and Rivers; the Southeastern states of Abia, Edo, Imo; the city of Jos in Plateau State; and Bauchi and Borno States in the northeast.”\textsuperscript{52} The warning indicates that, since January 2009 alone, over 111 foreign nationals have been kidnapped in Nigeria, including 21 in 2010, with two U.S. citizens being killed in separate abduction attempts in Port Harcourt in April, 2010.\textsuperscript{53}

More directly in response to the concerns voiced by U.S. industry, the State Department’s warning confirms their fears regarding the security implications of intrusive disclosure. The Department’s warning specifically highlights attacks against oil installations by a loose alliance of militant groups in the Niger Delta region.\textsuperscript{54}

One unintended consequence of the public disclosure of payments on a project-by-project basis would be to identify the location of the firms’ most important personnel and their most important capital assets. Given the current state of affairs in Chad, Nigeria and other oil-rich states, it would seem intuitively

\textsuperscript{51} U.S. Department of State, Bureau of Consular Affairs, Travel Warning – Chad (December 08, 2010).
\textsuperscript{52} U.S. Department of State, Bureau of Consular Affairs, Travel Warning – Nigeria (October 19, 2010).
\textsuperscript{53} Id.
\textsuperscript{54} Id.
obvious that handing criminals, terrorists or partisans in the Chadian or Nigerian conflicts the financial equivalent of a roadmap to the U.S. listed firms’ personnel and most significant capital assets would be unwise.

The willingness of the SEC to use the flexibility available to it under section 1504 to implement the agreed international norms of the EITI in U.S. law would avoid the very real potential for violence against persons or property in the employ of U.S. based oil and gas companies in Chad, Nigeria and elsewhere around the globe.

Beyond the security concerns intrusive disclosure of payments at the project level raise, a variety of industry representatives have stressed the potential negative commercial effects of mandating such disclosure. One of the specific concerns raised in that regard is the potential for more intrusive disclosure requirements obliging U.S. listed companies to violate confidentiality clauses in their contracts. Those clauses generally prohibit the release of certain information without the written consent of the other party, usually the resource-owning state. The sanction for such disclosures, of course, involves termination of the contract and liability for any damages that accrue as a result of the breach.

The proponents of a more intrusive approach have attempted to minimize those concerns, glibly asserting their belief “that these concerns are "not well founded."55 They dismiss the concerns regarding the breach of the U.S. companies’ contracts on the basis of their own review of the terms of such contracts, asserting that the contracts invariably “exempt disclosure to stock exchanges or offer a general exemption for compliance with law.”56

The contractual clauses routinely included in international contracts to excuse breaches compelled by law are nowhere near as sacrosanct as the advocates of intrusive disclosure suggest. Force majeure clauses in international contracts account for much of international civil litigation and international commercial arbitration, attesting to the fact that the simple assertion of an obligation to comply with U.S. law is nowhere near as compelling as the advocates of intrusive disclosure suggest.

But, what is most striking about that assertion from the perspective of anyone experienced in international commercial transactions, particularly with foreign governments, is its naivety about the predicament that U.S. listed companies would face. Where a U.S. oil and gas firm violated its disclosure obligation, the other party to the contract would have two options. One would be to pursue its claim via any dispute settlement process available under the terms of the contract itself. The other would be to take whatever peremptory action it could to avoid damages from

55 Statement by Karin Lissakers, Director, Revenue Watch Institute, Concerning H.R. 6066, the Extractive Industries Transparency Disclosure Act before the Committee on Financial Services, House of Representatives (June 26, 2008).
56 Id.
the breach. For a government resource owner, that recourse could include cancellation of the contract for cause and, potentially, taking possession of the U.S. firm’s assets, to the extent needed to complete the terms of the contract.

The history of the international oil and gas industry is, of course, replete with instances of oil states taking peremptory actions at the expense of oil companies with considerably less cause or colorable claim than the breach of a confidentiality clause in a concession contract would offer. At that point, the onus of bringing a legal action to secure its rights and protect its personnel and assets would fall on the U.S. firm, rather than the government resource-owner. The track record of American companies in such litigation has not been particularly positive, both because of the difficulties in mounting a legal challenge to a sovereign government and because of the practical reality that the firm’s physical assets are often fixed within the foreign government’s territory.

57 The operations of international oil companies have often been the target of expropriation, beginning with the Shah of Iran’s unilateral cancellation of the Anglo-Persian Oil Company’s concessions in 1932 and Mexico’s nationalization of its oil industry in 1938. See generally, D. Yergin, The Prize – The Epic Quest for Oil, Money & Power (1991). The resort to nationalization, despite the recurring problems it causes in terms of declining investment and reduced oil production, is continuing, with significant nationalizations in Russia, Venezuela, Bolivia and Ecuador in recent years. See, e.g., S. Guriev, A. Kolotilin, and K. Sonin, Determinants of Nationalization in the Oil Sector – A Theory and Evidence from Panel Data (2009), Appendix B (identifying 98 instances of expropriation of international oil company assets from 1960-2006 alone).

58 Even when the substantive legal standards favor the international oil companies’ claim, “there are many hurdles standing between them and full compensation for their expropriated investment—even with an arbitration clause.” E. Witten, Arbitration of Venezuelan Oil Contracts: A Losing Strategy?, 4 Texas Journal of Oil, Gas, and Energy Law 55 (2008). What is more, “[e]ven if a favorable arbitral decision is rendered, an award can be difficult to collect, and the process can take years.” Id.

59 The most recent example of this phenomenon arose in June, 2007, when ExxonMobil Corporation and ConocoPhillips, two of the largest international oil companies, abandoned multi-billion dollar investments in the Orinoco basin in Venezuela due to a continuing impasse in negotiations with the government of President Hugo Chavez and the Venezuelan national oil company, Petroleos de Venezuela (“PDVSA”). See R. Pirog, The Role of National Oil Companies in the International Oil Market, U.S. Congressional Research Service (2007). Other international oil companies, including Total SA from France, Statoil from Norway, BP from Great Britain, and Chevron from the United States, which did accept the Venezuelan government’s terms, were forced to cede an additional 40 percent of their existing operations to the Venezuelan NOC, giving PDVSA a controlling interest of roughly 80 percent of the entities. Id. In short, Venezuela effectively nationalized even those remaining operations and did so in the absence of any alleged violation of the companies’ contracts. Venezuela’s expropriation of the international oil companies’ operations led to demands for arbitration. The outcome thus far is instructive. Some 4 years later, the International Centre for the Settlement of Investment Disputes (“ICSID”) only recently ruled that it, in fact, had jurisdiction over EXXONMOBIL’s claim against Venezuela and PDVSA. Still more troubling than the delay, the ICSID arbitrators held that their jurisdiction reached only those claims of damages from 2006 until the date of expropriation based on the bilateral investment treaty between Venezuela and the Netherlands which provided the legal basis for EXXONMOBIL’s arbitration claim. That ruling led EXXONMOBIL to cut its damages claim nearly in half, from $12 billion to less than $7 billion. The outcome does not augur well for the prospects of similar claims filed by ConocoPhillips and other injured parties.
Beyond that practical reality, the attempt to diminish the industry’s concerns largely ignores the history of other instances in which the United States has unilaterally attempted to impose sanctions with extraterritorial effect. A series of disputes in the early 1980s over the extraterritorial reach of U.S. law, which compelled U.S. companies to breach their contracts in energy-related projects, resulted in a permanent loss not just of the contracts, but entire markets to foreign competitors.\(^\text{60}\) American companies were deemed unreliable suppliers as a result of their breach of contract and found themselves closed out of the market.\(^\text{61}\) Nothing in the various statements by advocates of more intrusive disclosure under section 1504 explains why they think that a different result would prevail in this instance.

Having said that, the SEC does have the means at its disposal to eliminate the cause of the U.S. industry concerns. It could faithfully implement the EITI principles as agreed to by the U.S. negotiators in any final rule issued under authority of section 1504 and expressly ensure against any potential conflict of laws in the regulations it finally issues.

**VIII. Implications for the SEC and U.S. Capital Markets**

Over the past decade since the passage of the Sarbanes-Oxley Act of 2002 (“SOX”), evidence has mounted that the increasing complexity of the U.S. regulatory scheme has damaged the competitiveness of U.S. capital markets.\(^\text{62}\) The problem stems not from corporate governance\(^\text{per se,}\) which is as essential to the sound management of an enterprise as it is to well-functioning capital markets. Rather, the problem stems from the multiple, often-conflicting requirements that firms face and the tendency for any new reporting obligation to be grounds for litigation.

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\(^\text{61}\) The most prominent example involved Caterpillar’s loss of market share to its Japanese rival, Komatsu, as a result of a series of unilateral U.S. sanctions that barred U.S. companies from participating in the development of the Yamal gas pipeline in what was then the Soviet Union. *Id.*; see also K. Rodman, *Sanctions Beyond Borders – Multinational Corporations and U.S. Economic Statecraft* (2001) (“Rodman”). Before the sanctions, Caterpillar held 85 percent of the market for imported heavy equipment in the former Soviet Union. Rodman at 93. After the sanctions were imposed and Caterpillar was forced to breach its contractual obligations, its competitive position with Komatsu was reversed – Caterpillar’s market share fell to 15 percent; Komatsu claimed the 85 percent share that Caterpillar previously held. *Id.* Even after the U.S. sanctions were lifted with respect to Caterpillar’s equipment exports to the Soviet Union, Caterpillar was not asked to bid because of the perception that it was an “unreliable supplier.” *Id.* American agricultural interests suffered a similar fate as a result of President Carter’s 1980 grain embargo against the Soviet Union. Office of Technology Assessment, *Technology and East-West Trade: An Update* (1983).

As reflected in the discussion above, section 1504 plainly falls in that latter category. The expansive nature of the reporting obligations, the uncertainty surrounding their implementation, their inconsistency with global standards, the significant cost relative to dubious marginal benefit in terms of transparency, and the frank intent of the authors to create a vehicle for purposes other than the protection of U.S. investors all reinforce that conclusion.

In that respect, section 1504 goes some distance toward making U.S. capital markets distinctly less competitive, an act that seems particularly unfortunate in light of the punishing effect the recent financial crisis has had on those markets and U.S. investors. But, the more troubling aspect of section 1504 is its implications for the Commission and its core responsibility for ensuring both the protection of U.S. investors and well-functioning capital markets.

Indeed, as noted above, the proponents of more intrusive disclosure under section 1504 had an avowedly broader purpose in mind – one unrelated to the purpose or function of either the SEC or the U.S. securities laws. Senator Cardin’s submission in response to the Commission’s notice of proposed rulemaking makes an attenuated argument in support of deeper disclosure because of its relevance to potential investors, but his comments stress that the central purpose is “to provide information important to citizens seeking to hold their government accountable for extractive revenues.”

63 Senator Cardin’s comments raise serious and, as yet, unanswered questions regarding the Commission’s jurisdiction and the function of the U.S. securities laws. The SEC’s sole responsibility is and should be the protection of U.S. investors against fraud and the fair and efficient operation of U.S. capital markets.

The U.S. Supreme Court reinforced that point in its most recent decision on the jurisdictional reach of the U.S. securities laws. In Morrison v. National Australia Bank Ltd., the Court reinforced the presumption against the extraterritorial reach of U.S. law, emphasizing that the securities laws were never intended to punish deceptive conduct in general regardless of its location, but only deceptive conduct in connection with the purchase or sale of securities in the United States.64


64 Morrison v. National Australia Bank Ltd., Slip Op. No. 08–1191 (argued March 29, 2010; decided June 24, 2010). More specifically, the Court held that section 10(b) of the 1934 Act proscribes only “the use of a manipulative or deceptive device or contrivance only in connection with the purchase or sale of a security listed on an American stock exchange, and the purchase or sale of any other security in the United States.” Id. Significantly, in adopting that transactional test, the Court expressly rejected the SEC’s own claim to a broader jurisdictional reach. Id.
There is nothing in the more intrusive disclosure demanded by the proponents of “enhanced information reporting” that advances that goal. Nor, as Senator Cardin’s comments reveal, was that the purpose of demands for increased disclosure under section 1504.

The reality is that the SEC already has access to the information it needs to ensure that corporations listed on U.S. exchanges implement effective internal controls, particularly as it affects the potential misuse of corporate funds to pay bribes. The extraordinarily active SEC enforcement effort under the FCPA is testament to that fact.

It is also manifestly clear to any investor from annual reports filed with the SEC and routinely made available to the investing public whether or not a particular company is operating in a country or environment in which corruption is endemic. The exact amount the corporation pays to individual agencies within such a country on a project-by-project basis is no more informative of the nature or the extent of the risk to the company and the investor of endemic corruption than is knowledge of the simple fact that the company is leasing natural resources in a country or region where corruption thrives and the operations of the local government are opaque. In short, there is nothing in the nature of the more intrusive disclosure sought by proponents of enhanced information reporting that actually bears materially on the central responsibility of the Commission.

Nor would more intrusive disclosure add measurably to the information available to the Commission or advance its ability to execute that responsibility. Indeed, opting for a broader reading of section 1504 and more intrusive disclosure could actually undercut the Commission’s ability to achieve its core objectives, particularly at a time when the SEC is deferring action on a wide range of activities related to its supervision of the U.S. market due to “budgetary uncertainties.”

As noted above, adopting standards that diverge from international norms, as is the case in all areas of regulation, invariably creates the opportunity for regulatory arbitrage. To the extent that more intrusive disclosure requirements dissuade U.S. and foreign firms engaged in the development of oil and gas from listing on U.S. exchanges, section 1504 would have the effect of diminishing the competitiveness of U.S. capital markets and limiting the investments available to the average U.S. investor.

The implementation of SOX is instructive and bears on that exact point. The evidence to date strongly suggests that the implementation of the SOX requirements led to declines in the U.S. share of the global market for initial public offerings, a rising number of foreign firms delisting from U.S. exchanges, a rising number of U.S.
firms avoiding public listings or going private in response, and a growing resort to the Eurobond, rather than U.S. bond, market for debt issuances.65

What the example of SOX suggests is that, to the extent that the SEC rules reach beyond reporting requirements that are more than adequate for any legitimate purpose section 1504 serves in terms of informing U.S. investors or ensuring the efficiency of U.S. capital markets, those disclosure rules will increase the inclination of both U.S. and foreign firms to pursue alternatives to the U.S. market for financing.66

The net effect would be less transparency, rather than more, as the authors of section 1504 intended. The current structure of the global oil industry highlighted above reinforces that concern. What that will do is condemn many resource-rich developing countries to fall prey to the widely acknowledged “resource curse,” rather than encouraging the changes internally within the country that would break its path dependence and alter its development path.

Conclusion

Taken together, the insights reflected in the discussion above lead to the same central conclusion – the SEC should make use of the flexibility section 1504 allow to implement the EITI principles as agreed to by U.S. negotiators, the affected U.S. companies and their counterparts around the world. The SEC should require only that disclosure from U.S. listed firms that is needed for the SEC to create and publish a country-by-country compilation of the payments made by the listed companies in the oil and gas industry as a whole and, then, only as related to their upstream activities and when such disclosure does not create conflicts with host country laws.

Doing so would reinforce, rather than detract, from the long-standing U.S. policy goals of improving transparency, while ensuring that U.S. firms do not suffer a competitive disadvantage in global markets. Adopting international norms agreed to by U.S. negotiators as part of the EITI would vindicate, rather than demean,

65 See Bainbridge; Interim Report; and Butler and Ribstein, supra, n. 57.
66 An in-depth analysis of the choice by existing issuers between listing on different international exchanges post-SOX suggests that the decline in listings on U.S. exchanges reflects the firms’ assessment of the marginal cost of compliance relative to the benefit that flows from the implicit endorsement that accrues to firms listing on U.S. exchanges. J. Piotroski and S. Srinivasan, Regulation and Bonding: The Sarbanes-Oxley Act and the Flow of International Listings (January 2008). Recent events in U.S. securities markets, both those that contributed to the recent financial crisis and those that form a part of the regulatory response, may well alter that calculus in ways that are less favorable to listing on U.S. exchanges generally. But, even holding that prospect aside, the study suggests that increasing the cost of compliance, as section 1504 will do for companies engaged in the exploration, development and production of oil and gas, will shift the balance in ways that are less favorable to U.S. markets. That may be particularly important to firms, such as the state-owned oil firms discussed above, that may be considering an initial placement and find both the cost of such a placement in the U.S. rising, while the value of being listed on U.S. exchanges has declined.
Congress’ intent to ensure that the United States pursues a multilateral approach to the challenge of bribery and corruption in international business transactions.

Implementing the agreed global norms of the EITI would also avoid the unintended consequences of demanding far more intrusive disclosure from that limited subset of the global energy sector that privately owned international oil companies now represent. Given the sharply negative implications for transparency, this is truly an instance where less is more.

Adopting the globally agreed norms of EITI in U.S. law would also eliminate much of the uncertainty and added cost of compliance that would flow from a radical departure from international norms. It would, moreover, be consistent with President Obama’s recent call for a review of federal regulations to ensure that they are not written in ways that would harm the competitiveness of U.S. industry and the job prospects of U.S. workers that depend on enterprises that can compete effectively in the global economy.

Applying the internationally agreed norms of EITI would, at once, eliminate the potential for deeply intrusive disclosure to jeopardize the safety and security of U.S. oil company personnel and assets abroad, as well as the potential damage to the companies’ reputations as reliable suppliers that would flow from attempting to comply fully with conflicting U.S. standards.

Lastly, making use of the flexibility section 1504 allows to implement the globally-accepted EITI principles faithfully in U.S. law would also eliminate the inherent conflict between the aim of intrusive disclosure (i.e., to bring pressure to bear on foreign governments to be accountable to their own public) and the core mission of the SEC, which is to protect U.S. investors from fraudulent practices and ensure the fair and efficient operation of U.S. capital markets.

As noted at the outset, there is one elegant solution that avoids the downside risks. That would involve the SEC making use of the flexibility that section 1504 allows to implement the international norms agreed to by U.S. negotiators and all of the affected U.S. energy companies as part of the EITI. That is the course the SEC should pursue.