

## QUESTIONS AND ANSWERS ON THE ENERGY SECURITY THROUGH TRANSPARENCY ACT - 2009

The Energy Security through Transparency Act would require all companies registered with the Securities and Exchange Commission (SEC) to report their payments to foreign governments for the extraction of oil, gas and minerals on a country-by-country basis. All payments would be disclosed as part of financial statements that are already required by the SEC. This would apply to both American and international companies listed with the SEC, which covers the majority of the largest oil, gas and mining companies in the world. The requirement would set an international standard for the public disclosure of such information.

### QUESTIONS:

1. Who would be covered by this regulation?
2. Would this bill be a disadvantage to U.S. firms? What about Chinese companies?
3. Would this bill be a disadvantage to U.S. markets?
4. How will this bill complement the Extractive Industries Transparency Initiative?
5. Will companies be in violation of their contracts by disclosing revenue information?
6. How much will this regulation cost companies?
7. Why is the ESTT Act necessary for investors?

### 1. Who would be covered by this regulation?

The regulation would apply to corporations that have issued securities that have been registered in the United States or who are required to file periodic reports with the SEC.

Of the 15 top oil and gas companies with international operations, ranked by Fortune magazine according to their total sales in 2007, all but one of them are listed with the SEC. Only four of these are American companies. The listed companies together accounted for nearly \$2.2 trillion dollars in sales and \$200 billion in profits.

The coverage of companies in the mining industry is also comprehensive. Of the 10 most successful companies, as ranked in the 2007 Forbes Global 2000, eight are listed with the SEC. Only two of those are American companies. Together, these eight companies accounted for over \$300 billion in sales and \$55 billion in profits in 2007.

Of the top 50 largest oil and gas companies by proven oil reserves, twenty are national oil companies that do not operate internationally. These companies are not registered with the SEC or any other exchange, only operate within their own country, and as such, these national oil companies do not compete with American companies. (i.e. Saudi Arabian Oil Company, Iraq National Oil Company, etc.). To suggest that it is a disadvantage to American firms that these companies are not covered by the regulation is disingenuous. Their operations are usually limited to their home country, where their operations are often not subject to open market competition.

Of the remaining 30 *internationally* operating companies, 27 would be covered by the proposed legislation. This includes Canadian, European, Russian, Chinese, Brazilian and other international companies. The three companies not covered are Gazprom (London); Petronas (Kuala Lumpur) and the Romanian National oil company (Bucharest). **Therefore, 90% of the major internationally operating oil companies would be covered by the ESTT Act.**

## **2. Would this regulation be a disadvantage to U.S. firms? What about Chinese companies?**

No, this regulation would not be a disadvantage to U.S. firms because it does not single out U.S. companies. As described above, it would apply not only to U.S. firms, but to all oil, gas and mining companies registered in the U.S. This includes a majority of the major extractive industry multi-nationals, including European, Canadian and Australian companies as well as those from emerging markets such as China, Africa, Brazil and Russia.

Thus, the regulation applies to most major global extractive companies and the smaller companies that the amendment does not apply to do not pose a competitive threat to U.S. companies.

There are three important things to note about the ESTT Act and Chinese companies. Many of the operations of Chinese companies will be covered by the ESTT Act. For example, Petrochina Company Ltd, the principle holding company of China National Petroleum Company (CNPC), is traded on the NYSE and files annual reports. The Chinese National Offshore Oil Company Ltd. (CNOOC) is covered by the ESTT Act, as are the operations within China of China Petroleum & Chemical Corporation (Sinopec).

Secondly, Chinese companies are currently relatively minor players outside of China. A 2007 report by the Brookings Institute points out that the Chinese companies hold only 3% of the total oil investments in Africa (*The Fact and Fiction of Sino-African Energy Relations*, Erica S. Downs, China Security, 2007.). The Chinese companies are still primarily limited to lower quality reserves or politically risky regions that were passed up by or off limits to the major international oil companies. Many of their overseas assets are as non-operators buying in to existing blocks. In terms of production, the *combined* total output of Chinese companies in Africa in 2006 was only about 1/3 of the production of a single US company, ExxonMobil, and 80% of the Chinese output came from Sudan.

Lastly, the Chinese NOCs lack the technology, expertise and capacity to compete with internationally competitive extractive companies. These NOCs also face their own constraints, including lack of access to capital, making them less of a competitive threat.

## **3. Would this bill be a disadvantage to U.S. markets?**

Several securities law experts have considered the potential ramifications of this new regulation for U.S. markets. They have come to the conclusion that it is unlikely to have an impact either on those companies currently listed on the exchange (i.e. “de-listing”) or those companies considering registering in the United States. The reasons are several: firstly, this is a low-cost regulation that does not directly impact corporate behavior. Secondly, this regulation is the latest in a series of efforts that are leading the way to an international standard of disclosure that many companies regard as inevitable. Thirdly, most of the oil, gas and mining companies registered with the Securities and Exchange Commission are willing to disclose this information through EITI and as the regulation only requires companies to publish data that many have already disclosed under EITI.

Moreover, this measure has the potential to protect companies from reputational risk, as several extractive companies themselves have pointed out, including Newmont Mining Corporation. There are often negative sentiments toward extractive companies within a country based on environmental and social concerns as well as a lack of benefits from extractive projects. Regarding concern about the lack of local benefits, Newmont has said that by publishing their payment information, the focus regarding benefits from revenues shifts away from them and towards the government, as citizens can demand accountability from their government once they know how much money it has received.

#### **4. How will this bill complement the Extractive Industries Transparency Initiative?**

The EITI is a critical first step in the global effort to increase transparency and fight the resource curse. But any voluntary agreement necessarily has limited reach. The EITI helps make the case for the ESTT Act and the ESTT Act helps advance the goals of the EITI.

This regulation will be a complement to EITI, and in fact, the reporting requirements of the bill are modeled after those of the EITI. In several important respects the ESTT Act goes further than EITI because companies will be required to disaggregate their payments and will have to report payments to countries that have not yet signed up to EITI. The Chairman of the Board of EITI, Dr. Peter Eigen, has said that it welcomes any legislation that reinforces the goals of EITI, which the ESTT Act certainly does.

Voices from the investment community agree. In his written testimony for a Congressional hearing on the legislation, Robert Jenkins, Chairman of F&C Investments, stated, "We do not share the view that countries that are already EITI supporters will abandon the Initiative.... In fact, it is firmly rejected by many well-informed observers, including extractive companies, who argue that few countries will allow US law to determine whether they embrace or reject the EITI."

No single initiative is sufficient on its own. We view the ESTT Act and the EITI as part of a comprehensive package to ensure transparency and accountability in the oil, gas and mining industries. The ESTT Act would add momentum to the global transparency movement and we hope countries would be encouraged to join the EITI once ESTT Act disclosure begins.

Outgoing EITI Board member Karina Litvack of F&C Asset Management, a strong supporter of the legislation, stated that the ESTT Act will help to further the EITI by creating home-grown demand from citizens for the initiative through empowering them with information about natural resource revenues. After all, the end goal of EITI, the ESTT Act and similar initiatives is not transparency for its own sake, but rather good governance and accountability.

#### **5. Will companies be in violation of their contracts by disclosing revenue information?**

Revenue Watch Institute and the Columbia University Law School undertook a study of extractive industry contracts to determine if a stock market requirement of revenue payment disclosure would force companies to break their contracts, if those contracts contained confidentiality clauses. The research found that **confidentiality clauses do not prevent disclosures related to securities regulation**. Contracts often include confidentiality clauses that require information flowing from the extractive project to be kept confidential. However, these clauses are not an impermeable shield, keeping all information confidential all of the time. Many confidentiality clauses explicitly cite disclosure related to securities regulation, stock exchanges and compliance with law as permissible exceptions. Even if the contract does not, compliance with law, including stock market disclosure requirements, is a generally considered an exception to confidentiality obligations.

Securities regulators and stock exchanges often require the disclosure of what is arguably commercially sensitive information. On a broad view, almost all information generated by companies could be considered commercially sensitive. Many policy considerations are taken into account when striking the proper balance between required disclosures and the protection of trade secrets, intellectual property, and commercially sensitive information. Nonetheless, securities regulation often requires disclosure by companies of such information.

#### **6. How much will this regulation cost companies?**

The cost to extractive companies to report payments should be minimal as companies already conduct internal audits and have revenue information available. The requirement would simply mean that companies need to incorporate reporting requirements into their integrated auditing.

Thirty-seven companies have officially signed on as supporters of the EITI. In supporting EITI, companies implicitly showed a willingness to assume the costs of disclosure wherever and whenever the initiative was implemented. As this bill's disclosure requirements are in line with those called for by EITI, it does not place an undue or unforeseen burden on companies.

#### **7. Why is the ESTT Act necessary for investors?**

It is well documented that a lack of transparency in the oil, gas, and mining industries, especially in countries that depend heavily on income from these sectors, often goes hand-in-hand with government corruption. In the oil, gas and mining sectors it is not enough to merely target bribery: highly complex financial arrangements coupled with a lack of transparency mean that the funds of overseas mining and oil companies—including American companies—often end up being channeled to corrupt purposes.

Investors need to be able to assess the risks of their investments. Investors need to know where, in what amount, and on what terms their money is being spent in what are often very high-risk operating environments. These environments are often poor developing countries that may be politically unstable, rife with corruption and have a history of civil conflict fueled, in part, by natural resources.

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