Consultation on the UK Implementation of the EU Accounting Directive: Chapter 10 Extractive industries reporting

Response form

The closing date for this consultation is 16/05/2014

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Please return completed forms to:

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Email: extractivesconsultation@bis.gsi.gov.uk

	Business representative organisation/trade body
	Central government
	Charity or social enterprise
	Individual
x	Large business (over 250 staff)
	Legal representative
	Local Government
	Medium business (50 to 250 staff)
	Micro business (up to 9 staff)
	Small business (10 to 49 staff)
	Trade union or staff association
	Other (please describe)

Extractive Companies

The following information will help us to better understand the impact of this reporting requirement on your company or group of companies:

	Oil	Minerals	Gas	Logging of primary forests
Please indicate in which of the extractive industries your company is engaged (NB: this question is relevant only to those companies actively engaged in extraction and not to those providing support or ancillary services)	x		x	

Is your company listed on:	Yes	No
• the London Stock Exchange?	x	
• AIM?		x
• another recognised exchange within the EU? (if yes, please state which: **Euronext Amsterdam**)	x	
• another international exchange? (if yes, please state which: **New York Stock Exchange**)	x	
• are any of your subsidiaries listed on an exchange? (If yes, please provide details): **We have subsidiaries that are separately listed but none of them is engaged in oil and gas extractive activities.**		x

	Yes	No
Will your company be responsible for the preparation of the consolidated report on payments to governments for your group?	x	

	Micro	Small	Medium	Large
Please indicate the number of subsidiaries within your group that are active in the extractive industries **We estimate up to 200 subsidiaries. The actual number can only be determined upon**				

implementation. Classifying them by size is not feasible without significant effort. Moreover, it is not a relevant exercise for Shell since even small and medium sized subsidiaries would be in scope for reporting as a result of the Group being in scope.				

(1) We propose that the first report should be prepared in respect of financial years commencing on or after 1 January 2015 (Para 5.3 – 5.4)

Question 1.1 Do you agree that companies should only be required to produce whole year reports and should not be required to provide a partial year report for the period between the regulations coming into force and 31 December 2014?

☒ Yes ☐ No ☐ Not sure

If no, please indicate:

(a) The minimum period you think should be provided between the regulations coming into force and the date from which reporting of payments made to governments commences:

Minimum period……………….

and (b) How information from a partial year report will be used and the benefits that would arise from this approach.

Please provide comments on any difficulties/cost that might arise from requiring a partial report for 2014.

The timeframe would be too short for implementation. The information required by the draft regulations is not readily available within our existing systems. This requires the design, creation and testing of a separate data collection system. It also requires communication and training for our subsidiaries ahead of reporting.

Question 1.2 Do you agree that the first reports should relate to financial years commencing on or after 1 January 2015?

☐ Yes ☒ No ☐ Not sure

If no, please indicate your preference for the date from which reports should be required and provide an explanation for your preference. (Please note that UK-registered large extractives companies must report on in respect of financial years commencing on or after 20 July 2015 i.e. the deadline for transposition of the Directive.)

Preferred date: **financial years commencing on or after 1 January 2016**.

Reasons for preferred date:

Shell will be subject to transparency reporting rules from the U.S. Securities and Exchange Commission ("SEC"), as mentioned in question 10(i), and likely also from Canada, which have not yet been finalised. A later effective date provides potential for a more effective coordination of global reporting of payments, enables determination of the equivalency of these regimes, and allows companies to design reporting systems to satisfy all relevant requirements. We also understand that other EU Member States will not be requiring companies to report earlier than the period commencing January 1, 2016 so this will ensure consistency and fairness across the EU.

The information required by these draft regulations is not readily available within our existing systems. This requires the design, creation and testing of a separate data collection system. It also requires communication and training for our subsidiaries ahead of reporting. As mentioned in question 2.3 below, assuming an effective date of January 1, 2016, it is likely that implementation costs will be in the order of US$10 million, with ongoing running costs of around US$2 million per annum. Some of this work can only start when the regulations that Shell will have to comply with are certain. An effective date of January 1, 2015 would accelerate our implementation schedules, leaving us less time to implement an automated reporting solution and introducing some manual reporting, thereby significantly increasing our implementation costs.

A reporting period commencing January 1, 2016, with further clarity on proposals from other jurisdictions, will allow companies to design reporting systems to satisfy all relevant requirements, minimising the cost impact and saving time and effort.

(2) We propose that UK registered companies are required to publish the extractive report no later than 11 months after the end of their financial year. (Para 5.5 – 5.7)

Question 2.1 Do you agree that UK registered companies should be allowed a maximum of 11 months after the end of their financial year in which to prepare and publish their extractive reports?

☒ Yes ☐ No ☐ Not sure

If no, please indicate:

(a) The maximum period, if any, you think should be permitted after the (financial) year end for companies to prepare and publish their extractive reports:

Maximum period……………..

and (b) Indicate the benefits that would arise from this approach below.

Question 2.2 If a shorter period for reporting was imposed, what impact would this have on UK-registered extractives companies?

This question is less relevant for Shell because:

- **(i) under the Transparency Directive, Shell would have to publish no later than six months after the end of the financial year;**
- **(ii) as mentioned in question 1.2, Shell will also be subject to reporting rules from other jurisdictions. These jurisdictions may impose different reporting periods (e.g. the previous SEC rules issued in 2012 allowed a reporting period of five months). Assuming equivalency of reporting requirements, Shell aims to implement one reporting system to satisfy all requirements within a common timeframe.**

Question 2.3 If this approach would impose costs on business, please provide an estimate of the costs with an explanation of how these are derived.

Would such costs be recurring costs or transitional costs in the first year only?

☐ Recurring ☐ Transitional ☐ Not sure

(3) Comments are invited on any issues, such as changes to costs or benefits, that may arise from a later transposition deadline for the Transparency Directive. (Para 5.8)

Question 3.1 What issues might arise from a later transposition of the Transparency Directive? Please describe any possible impacts and, if appropriate, provide details of any costs or benefits that might result from this.

Issues would arise if the Transparency Directive became effective in 2014, with a first reporting Shell due date of June 2015. This would not be feasible for Shell to implement.

Issues would otherwise be the same as with the Accounting Directive, if the Transparency Directive required reporting in respect of financial years commencing on or after 1 January 2015 (see our response to question 1.2).

(4) Subsidiaries of overseas-registered companies will be unable to take advantage of the exemption until their parent company fulfils the obligation to

report in either the UK or another EU Member State. Comments are invited on any issues that may arise from this approach. Comments are particularly welcome from subsidiaries of overseas registered companies which may not be able to take advantage of this exemption until their parent companies are obliged to produce a consolidated report under rules imposed by another Member State. (Para 5.9 – 5.10)

Question 4.1 Please provide information on any issues that arise for UK-registered subsidiaries of EU-registered companies. If appropriate please provide details of any costs that arise as a consequence of being unable to (fully) exercise the exemption in 2015. (All EU Member States are required to implement the reporting requirements by July 2015.)
Please use this space for any general comments that you may have, comments on the layout of this consultation would also be welcomed.

Not applicable.

(5) We propose that extractive reports should be published (filed) electronically with Companies House in a format which complies with industry developed best practice (to be determined as part of the systems development). (Para 5.11 – 5.14)

Question 5.1 Do you agree that it is appropriate that industry should be encouraged to lead in the production of best practice guidance to support the production of extractive reports and encourage consistency?

☒ Yes ☐ No ☐ Not sure

If no, please provide supporting reasons for your view.

Question 5.2 Do you agree that reports should be published (filed) electronically with Companies House only i.e. the submission of paper reports is not required or permitted?

☒ Yes ☐ No ☐ Not sure

If no, please provide supporting reasons for your view.

(6) We propose that the penalty regime for non-compliance with the obligation placed on large extractive companies to prepare and publish annually reports on the payments they make to governments should reflect that in place for failure to prepare and file statutory annual reports.

We welcome views on whether the proposed penalty scheme is effective, proportionate and dissuasive. In particular, we would welcome views on:

- **the imposition of an offence for filing a report containing misleading, false or deceptive information,**
- **on how the penalty regime should apply in cases where external factors affect the preparation of a report or prevent a company from filing a report.**

Question 6.1 Do you agree that it is appropriate for the penalty regime here to reflect that in place for failure to prepare and file statutory annual reports?

☐ Yes ☒ No ☐ Not sure

If no, please indicate your preferred option and provide an explanation for your suggested approach.

We do not believe that the Companies Act 2006 penalty regime for failure to prepare and file statutory annual reports is suitable for direct application in this context, and suggest it would require material modification in order to be suitable and appropriate as a penalty regime for failure to prepare a report on payments to governments.

The consequences of failure to prepare and file statutory annual reports under the Companies Act 2006 broadly consist of a fine and potential criminal liability for directors, and a fine for (and potential de-registration of) the affected undertaking. There is little or no discretion exercised by the Registrar in administering this sanctions regime, which relies on (and is triggered by a failure of) companies filing their annual reports by the relevant deadline. Given the nature of the information to be reported in a company's annual report, and the fact that such information will generally be audited by external auditors, there is limited risk of a company being placed in a position, by virtue of some extraneous reason, where it is unable to properly prepare and file information required to be disclosed in its statutory annual report.

However, in the context of reporting in accordance with the draft regulations, the situation is very different. As explored in greater detail in the response to question 6.3 below, there are some limited but very real circumstances in which extractive companies could find themselves unable to disclose the information required to be disclosed under the draft regulations without breaching foreign criminal laws or other contractual or statutory obligations and thus subjecting themselves, their directors, and their local employees to possible criminal sanction in those foreign countries.

Accordingly, in our view the penalty regime in the regulations should contain an appropriate and proportionate mechanism for limited relief from sanction for those infrequent occasions where companies such as Shell are genuinely faced with a choice

between breaching the reporting requirement or potentially attracting foreign criminal or civil sanctions by complying with the reporting requirement. This could be achieved by developing a more flexible penalty regime under which individuals who are unable to file a complete report, despite taking all reasonable steps to do so, are not subject to sanction. We explain our proposals for such a regime in our response to question 6.3 below.

This could work in tandem with the imposition of an offence for filing a report containing misleading, false or deceptive information, as this would serve to clearly distinguish between those instances where a report is filed that expressly omits certain items of information, in a non-misleading way, as a result of laws in third countries prohibiting its disclosure; and other instances where misleading, false or deceptive information is deliberately included.

Question 6.2 Do you consider that the proposed penalty regime is effective, proportionate and dissuasive?

☐ Yes ☒ No ☐ Not sure

If no, please explain why you do not consider the regime would be effective, proportionate and dissuasive. Please provide any suggestions you may have as to how the regime could be improved.

If your suggestions relate to an existing regime, please provide appropriate references.

The reference in this consultation document to an "effective, proportionate and dissuasive" penalty regime comes from the text of the Accounting Directive. EU law is therefore relevant to the interpretation of this phrase.

The principle of legality under EU law requires criminal penalties imposed on individuals by legislative measures to be clearly defined. This is a basic requirement of fairness and justice which should apply to EU measures that expose persons to criminal liability indirectly, by imposing on them an obligation that can only be complied with by breaching a criminal law. EU law also recognises that legislative measures will not be justified where they impose an excessive burden on particular individuals or constitute a disproportionate interference with a substantive right. In our view, the exposure of persons to potential criminal and civil liability (as would be the case under the draft regulations) engages these principles.

As set out in greater detail in the response to question 6.3 below, there are some circumstances in which the disclosure of information required under the draft regulations could expose extractive companies such as Shell, its directors, and its local employees to criminal sanction under the laws of third counties (such as China and Qatar).

Furthermore, there are circumstances in which disclosure of that information could also put Shell in breach of confidentiality provisions in its contracts with state counterparties, leaving Shell open to civil liability as well as possible further criminal sanctions were the contractual counterparty to seek remedies such as court injunctions to prohibit disclosure. It is incompatible with basic notions of justice, and with the international law and fundamental rights principles on which the EU is founded, for legislation to require a person, on pain of criminal sanction, to breach the criminal or civil law of a third country,

thus exposing them to penalties. This is particularly so when the act required is detailed publication of commercial dealings with a foreign government in its territory. Legislation that obliges individuals or companies to take action that would put others in breach of such laws is equally legally objectionable.

In our view, the reporting obligation in the draft regulations goes beyond that which is reasonably necessary to achieve the objective of the Accounting Directive (and also the Transparency Directive). The legal basis for the Accounting Directive, and its stated objective in Recital (55) (i.e. "*facilitating cross-border investment and improving Union-wide comparability and public confidence in financial statements and reports* ...") is that it is an accounting harmonisation measure. The Recitals further state the following with respect to transparency of payments:

> **"*to provide for enhanced transparency of payments made to governments*…" (Recital (44));**
>
> **"*to help governments of resource rich countries to implement the EITI principles and criteria and account to their citizens for payments such governments receive*…" (Recital (45)).**

The proposed penalty regime, and in particular the imposition of criminal liability even where such a clash of laws exists, is not necessary to achieve the objective of the Accounting Directive or even the transparency of payments. There are many less onerous mechanisms that are equally capable of achieving these purposes, including the alternative proposed in response to question 6.3 below. We note that:

- **in our view, the limited circumstances elaborated upon below are not so pervasive that the objective of the law would be undermined or impaired if the penalty regime was adapted to provide a defence in such circumstances; and**
- **the EITI standard, which the Accounting Directive expressly seeks to implement, does not require transparency at the expense of existing contractual and criminal laws of countries in which an extractive company is operating. EITI Principle 6 provides that the companies, civil society organisations and governments who agreed the principles, "*recognise that achievement of greater transparency must be set in the context of respect for contracts and laws*".**

As such, we feel that the reporting requirement, in its current form, insofar as it requires Shell and its employees to breach contracts and/or act in violation of criminal laws, is itself disproportionate.

A second reason why Shell believes the reporting requirement to be disproportionate is that the disclosure obligations imposed by the Accounting Directive unnecessarily harm the competitiveness of the extractives industry in the UK (or the EU) as compared to companies not subject to the Accounting Directive. The majority of Shell's competitors are based outside the EU and therefore not subject to the reporting obligations of the Accounting Directive. Some, such as companies listed in the US, will be subject to other, less strict reporting obligations. Others, such as most of the national oil companies and private equity companies, will be subject to no reporting obligations whatsoever. Obviously, if UK companies have to publish commercially sensitive information and their competitors do not, this creates an uneven playing field. The harm to UK companies

could take various forms, including missed opportunities because of undercutting by competitors or because host countries do not want state secrets to be published.

To underpin such disproportionate reporting obligations with criminal liability for non-compliance is all the more disproportionate, given that it will impose actual hardship on both individuals and group undertakings, who will be exposed to foreign civil and criminal liability for complying with the requirements of the reporting obligation, while directors of Shell in the UK will be exposed to criminal liability for non-compliance.

The overreach of the Accounting Directive as implemented by the draft regulations is all the more concerning where neither the EU nor the UK have taken measures to provide protection to their subjects from contravening legislation in other countries as a result of this Directive. The EU and the UK could have sought conclusion of treaties protecting subjects such as Shell and its employees from prosecution, could otherwise have sought assurances from host countries regarding the permissibility of disclosure of their revenues, and could have provided for financial compensation in case compliance with the Directive would result in for example loss of contract in accordance with host country laws. None of these, nor any other, mitigating measures were taken.

Although the principles of legality and proportionality are generally applicable under EU law, in our view specific rights protected by the EU Charter of Rights (2007 C 83/313) are also engaged in the present context. Article 6 of the Charter protects the right to liberty and security of the person. Action taken to enforce criminal laws constitutes a paradigm instance of action taken against a person's liberty and security. Insofar as the Accounting Directive and the draft regulations require Shell to disclose information that could lead to the criminal prosecution of employees, it would have the effect of exposing them to a deprivation of liberty and interference with their personal security. Likewise, it would involve a grave interference with their right to private and family life under Article 7 of the Charter.

A conflict between the draft regulations and the laws of a host country is essentially a matter between governments. The Government can seek resolution of such matter in accordance with international law by negotiating a treaty with the host government in question. Shell is in no position to resolve the conflict of laws. Its only option to avoid the impossible position of a choice between breaching legislation implementing the Accounting Directive or breaching host government law, is to move its central base of operations outside the EU altogether, or divest from the host country concerned. Not only would this be an equally dramatic consequence of the reporting obligation under the Accounting Directive but it would be inconsistent with Article 16 of the Charter protecting the fundamental freedom to conduct a business.

Accordingly, we believe that the proposed penalty regime is disproportionate.

Question 6.3 Are there any special circumstances that the Government should take in to account when determining the penalty regime?

☒ Yes ☐ No ☐ Not sure

If so what are they, and do you have any suggestions about how these might be dealt with within the penalty regime?

The Shell Business Principles govern the manner in which each entity in the Shell group operates and have for many years been fundamental to how we conduct business. Business Principle 8 is titled "Compliance" and states as follows:

> **"*We comply with all applicable laws and regulations of the countries in which we operate*".**

Shell's principal concern regarding the proposed penalty regime in the draft regulations is that it will have the result of placing Shell in an invidious (indeed impossible) position, namely that Shell would be required by law to disclose information even where this would breach local laws in some foreign countries and thereby:

a) **expose employees of Shell group companies to criminal prosecution in some foreign countries, such as China and potentially Qatar; and**
b) **expose Shell group companies and Shell group employees to civil penalties in the countries where they operate.**

These considerations are examined in turn below, together with proposals for how these might be dealt with through a flexible penalty regime and in a way that secures the overall policy objectives, which Shell supports. In our view, the formulation of the regulations must be sufficiently clear to allow individual directors of companies in the extractives sector to understand the reporting obligations and to obtain unequivocal advice as to their legal responsibilities. As such, it is essential that any potential inconsistency between UK and foreign laws is adequately addressed.

Please note that this section does not set out an exhaustive list of particular circumstances that could impact on a company's ability to file a report in accordance with the draft regulations. However, we consider it helpful to provide some concrete examples to ensure that the issues extractive companies may be faced with are fully understood.

(i) Criminal Consequences in China

If Shell were to report any information in the EU that amounts to a "state secret" under Chinese law, local Shell employees in China would be liable to criminal penalties, ranging from 5 years to life imprisonment. The propensity of the Chinese authorities to enforce these laws strictly (especially where state-owned enterprises are involved) with respect to revenue transparency reporting is yet to be tested. However, if Shell was placed in the invidious position whereby the obligations arising from the Accounting Directive required it to place even a single employee in potential breach of criminal laws in the country in which he or she works, that would be a matter of the gravest concern to Shell.

The Law of the People's Republic of China on Guarding State Secrets (the "State Secrets Law")[1] widely defines the type of information that is regarded as a state secret:

[1] Enacted 5 September 1988; amended 29 April 2010; effective 1 October 2010.

- **Article 2 of the State Secrets Law restricts the public disclosure of "*matters which have a bearing on the security and interests of the State*".**

- **These include (inter alia) matters concerning "*national economic and social development*" and "*other matters which are determined as state secrets*" by the relevant authorities.[2]**

The disclosure of entry fees, bonuses and royalties (all of which must be reported under the draft regulations) would in some circumstances reveal information such as the location, size and relative importance of key petroleum reserves.

The likelihood that such disclosures will be deemed to have "*a bearing on the security and interests of the State*" under Article 2 of the State Secrets Law is further increased by the existence of standalone state secrets legislation focussed on the petroleum industry.[3] This legislation categorises "*locations, statistics and relevant information of petroleum reserves*" and "*costs of major petrochemical export products*" as state secrets. Accordingly, the information required to be disclosed under the draft regulations is likely to be caught by the provisions of the State Secrets Law and supplementary Regulations .

Example

- **The reporting of production entitlements or payments calculated by reference to production on a project-by-project basis would signal the level of production at particular locations and thereby provide an indication of the relative strategic importance of such reserves.**

In addition to the state secrets legislation, there exists in China other legislation that prohibits the disclosure of commercial secrets. Those laws are particularly relevant to state-owned enterprises, with whom most of Shell's operations in China are connected. This means that disclosures of confidential information, which might elsewhere be considered a breach of contract with civil consequences, can in addition result in criminal liability in China.

The penalties for breaching commercial secrecy laws include imprisonment of up to 7 years as well as administrative fines of up to RMB 200,000 (£20,000) and civil damages.

At a minimum, the risk of contravention of Chinese law is real and that risk needs to be taken into account when devising an appropriate and proportionate penalty regime.

(ii) Criminal Consequences in Qatar

[2] Article 9 of the State Secrets Law.
[3] Regulations Regarding the Scope of State Secrets for the Industry of Petroleum and Petrochemicals (6 April 1996)

Shell is also concerned that disclosure of the information required under the draft regulations without the consent of the government of Qatar may amount to a breach of the Qatari Law on the Protection of Trade Secrets (Law No.5 of 2005). This law permits the owner of a trade secret to prevent access to (or use of) that secret without prior consent. Breaching the law carries criminal liability and a penalty of imprisonment for up to one year.

The term "trade secret" is defined as:

> ***"(a) information which in its totality, form or combined constituents is usually unknown, or cannot be easily accessed by any person involved or dealing with such type of information;***
>
> ***(b) information whose commercial value emanates from its confidentiality; and***
>
> ***(c) information whose confidentiality depends on the effective measures taken by the legal holder to maintain confidentiality."***[4]

The contractual arrangements that apply to Shell's operations in Qatar contain various restrictions on the disclosure of confidential information. The way in which the term "confidential information" is defined in those documents would mean that many of the types of data that are discloseable under the draft regulations would be caught. While there are provisions in the relevant contractual arrangements for permission to be sought from the Qatari government to disclose confidential information to regulatory authorities, we believe the main aim of those provisions is to afford the government an opportunity to seek injunctive protection from the local courts.

In response to the proposed introduction of oil and gas industry reporting requirements in the US, Shell received an unequivocal written statement / directive from the Qatari Minister for Energy and Industry that:

> ***"public disclosure of commercially sensitive information, including without limitation that on actual or projected production costs, revenues or reserves, in relation to your and your affiliates' activities in the State of Qatar, which would or could easily enable commercially sensitive information on the activities in the State of Qatar to be separately identified, is prohibited."***

Shell therefore believes the Qatari government may have made clear its position in relation to whether consent will be granted for the disclosure of the relevant payment information.

(iii) Civil Consequences in Various Jurisdictions

Concession arrangements to which Shell subsidiaries are a party frequently contain an obligation to seek the permission of the contractual counterparty before disclosing any "confidential information" to third parties. At least some of the information required to be

[4] Article 1 of the Trade Secrets Law.

disclosed under the draft regulations will fall within the definition of "confidential information" in many of those agreements.

Example

The following are typical examples of how "confidential information" is defined:

- ***"all aspects of the Project as well as all data acquired, developed, received or otherwise obtained pursuant to this Agreement and the nature and extent of the Petroleum Operations".***

- ***"any information concerning the technical, financial or business activities of [counterparty] or its affiliates".***

- ***"all jointly owned information, data, materials, records".***

- ***"The Company and the Participants shall, at all times, treat as confidential the substance and status of all negotiations and all correspondence between the Government or any of its officials and the Company related to this Agreement or other agreements related hereto, as well as meetings held between the Company's representatives and any Government officials with respect to the subject matter of this Agreement. In addition, any information disclosed by any of the Participants, or Affiliates of a Participant or any Party, or any of them ("Disclosing Party") in connection with this Agreement, and which has been designated in writing by the Disclosing Party as confidential, and all jointly owned information, data, materials, records and information referred to herein ("Confidential Information") shall be treated as confidential by the party receiving such information (the "Receiving Party), and shall not be disclosed by it to any third party unless the Disclosing Party has giving its prior consent to such disclosure.***

Where data falls within the definition of "confidential information" in an agreement, the disclosure of that data will be subject to restrictions.

While many of these contracts provide for a carve-out in circumstances where disclosure is required by law or stock exchange rule, such carve-outs are sometimes limited in nature, and may not apply where specific legislation in a

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host state protects the information in question.

Below is an example of such a qualified carve-out, with the identity of the counterpart redacted:

"*When providing any such information, documents, data and reports, Contractor shall comply with the relevant secrecy laws and regulations of* [the host state] *and shall not provide to external entities any information that may be harmful to the national interest or the public interest of* [the host state]*.*"

Other contracts provide that, even in circumstances where Shell is required by law to disclose certain information, Shell is required under the contract to seek the consent of the Government. In such circumstances, Shell's only recourse against the counterparty would be to initiate proceedings for unreasonable withholding of consent, the prospects of which would be far from clear.

Payments made to a counterparty under a concession agreement are likely to be viewed as competitively sensitive information, since a foreign government or state-owned enterprise may not want one international oil company to know the amount of a signature bonus and other remuneration elements paid by another international oil company when negotiating future projects. Shell therefore legitimately anticipates that its counterparties will invoke their rights under the confidentiality provisions contained in their contracts with Shell to ensure that their consent must be obtained before any "confidential information", as defined in those contracts, is disclosed.

Where Shell is obliged to obtain the consent of its counterparty, it will be placed in a very difficult position. The counterparty may refuse to grant consent altogether if it has genuine concerns around commercial sensitivity, or it may take advantage of Shell's dilemma and attempt to extract some other concession from Shell as a condition for granting consent. In the absence of consent, Shell will be placed in breach of contract if it nonetheless complies with its reporting obligations under the draft regulations. That breach would in many instances be regarded as material and could lead to termination of the contract by the counterparty resulting in Shell losing its investment which in some contracts would be considerable.

Furthermore, in certain concession agreements, the counterparty is specifically entitled to seek injunctive relief where there is a disagreement as to what data can be disclosed. Indeed, obtaining a court injunction to restrain an actual or potential breach of contract is not an uncommon court remedy, even where contracts do not specifically provide for it. Generally, it is not a sufficient answer to an application for injunctive relief for the respondent to say that granting such an injunction would cause it to breach foreign (i.e. English and EU) law. It is therefore possible that Shell will be placed in breach of a court injunction if it complies with the reporting obligations in the draft regulations. The consequences of breaching such an injunction could include criminal sanctions and imprisonment, depending on the jurisdiction in question.

It is clear from the examples described above that, at the very least, there is a considerable risk of Shell being placed in breach of local laws and/or contractual obligations if it complies with the reporting obligations under the draft regulations. In most cases, the decision as to whether the relevant disclosure will be permitted is wholly outside Shell's control. Accordingly, the total absence of any exemption, defence or safeguard to protect Shell and its employees in such circumstances is of genuine concern to Shell.

(iv) Proposals for dealing with these concerns within the penalty regime[5]

The choice of penalties in implementing measures is a matter within the discretion of the UK authorities. Article 289 of the TFEU provides that Directives "*leave to the national authorities the choice of form and methods*" of implementation. If penalties are imposed, such penalties must be proportionate, analogous to those applicable to infringements of national law, and adequately dissuasive. It is our view that these requirements may provide a means for sensible and proportionate implementing measures of a tailored variety, which take account of the serious issues addressed above.

We set out below one possible solution that seeks to address the key concerns above. We do not consider the discussion below to be an exhaustive list of all possible implementation solutions, but rather a minimum threshold of what could be done to address some of the most serious concerns identified.

The UK is not under an obligation to establish a strict liability regime. Accordingly, the UK could implement the Directive in a manner that would take into account the ability of the reporting company and its directors to obtain and disclose relevant information pursuant to the regulations. In particular, where the ability to disclose is materially hindered as a result of statutory restrictions or other legal obligations in another state, there should be no (or minimal) penalties imposed on the company or its directors under the regulations (and the relevant company should not be subject to any action by the Registrar of Companies to strike it off the Companies Register in such circumstances). To provide certainty to all stakeholders, the test for whether the company or its directors are protected against exposure to sanctions for a failure to report in accordance with the regulations in these circumstances should be objective and clear. For example, in order to satisfy the test, a company and its directors, having reasonably determined that there exist statutory restrictions or other legal obligations vis-à-vis the host government or a National Oil Company which may restrict or prohibit the disclosure of information as required by the regulations, would be required to demonstrate that they have sought permission to disclose the relevant information from the relevant host government or National Oil Company and have not received such permission.

The company and its directors would then be required to make reference to the restrictions on disclosure of the relevant information in the report submitted to the Registrar, and supply supporting documentation to the Registrar (on a confidential basis) in order to confirm satisfaction of the requirements set out above.

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[5] In this section, we have not addressed the implementation of the Transparency Directive. However, if the provisions of that directive are to be implemented through the Disclosure and Transparency Rules, then we believe that the same comments can apply.

This solution provides the necessary minimum protection against criminal and administrative sanctions for reporting companies and its individual directors and employees.

The inclusion of such a protection would be entirely consistent with the objectives of the Directive and would be more in line with existing safeguards found elsewhere in the Accounting Directive, such as Article 18(2), which allows disaggregated turnover figures to be omitted where such granularity would be "seriously prejudicial" to the undertaking, and Article 44(3)(b), which allows certain information to be omitted from the consolidated report of payments to governments where it cannot be obtained without "disproportionate expense or undue delay".

Any attempt to argue that this is not consistent with a full implementation of the Directive would be met by strong EU proportionality arguments, since such a position would have to proceed on the basis that the Directive requires placing individuals in a conflict of laws dilemma.

We note that this proposal does not address implementation of the Transparency Directive, although this will likely raise similar issues.

Question 6.4 Are there any other issues that the Government should consider in developing the penalty regime?

☒ Yes ☐ No ☐ Not sure

If yes, please provide an explanation and supporting evidence where appropriate.

In October 2012, the American Petroleum Institute was successful in its lawsuit in the United States challenging the US Securities and Exchange Commission's ("SEC") implementation of the provisions in the Wall Street Reform and Consumer Protection Act 2010 (the "Dodd-Frank Act") that require certain companies within the oil, natural gas and mining industries to report payments to foreign governments. As a result, the SEC is reconsidering, in conjunction with relevant stakeholders, its implementation of those provisions.

We believe that these subsequent developments should be taken into account in the UK's implementation of the penalty regime in the Accounting Directive, to ensure a co-ordinated and consistent regime so far as possible.

The relevance and impact of developments in the implementation of the transparency provisions in the Dodd-Frank Act in the United States is covered in more detail in our response to Question 10 below under the heading (i) "*Position in the United States*".

(7) A copy of the draft regulations implementing Chapter 10 has been included within the consultation document.

Question 7.1 Do you have any comments on the draft regulations included at Annex 4?

☒ Yes ☐ No ☐ Not sure

If yes, please provide details. Please note that the UK does not have the discretion to amend the requirements set out in the Directive. As such comments should relate to matters of understanding or those areas where the UK has discretion in determining an option e.g. the timeframe within which an annual report must be published.

The regulations implementing the Accounting Directive in the UK need to set out the relevant obligations and penalties in a clear and detailed manner. This is all the more important where criminal liability is likely to attach to certain circumstances of non-compliance. Unfortunately, the manner in which some of the definitions are drafted leaves a degree of ambiguity and raises the prospect of uncertainty as to whether particular payments would be captured under the reporting obligations. We set out below our key concerns in this regard.

This lack of clarity has the potential to increase compliance costs, cause unnecessary uncertainty for companies and employees and lead to inconsistencies with other regimes. Given that the Government has asked the International Association of Oil and Gas Producers (the "OGP") to prepare industry guidance on these draft regulations, we suggest that implementation should await the publication of those OGP guidelines.

The comments below do not address any substantive matters pertaining to the proposed penalty regime in the draft regulations, as these matters are addressed separately in the responses to questions 6.1 to 6.4 (inclusive) above.

It should be noted that many of the comments set out below are applicable to both the draft regulations and the Directive itself. We note that the UK does not have the discretion to amend the requirements set out in the Directive, but may nonetheless have a degree of discretion to clarify and/or elaborate upon some of the Directive's provisions. Given the importance of legal certainty, and the relatively minor amendments that would be required to address our concerns, we believe that the Government should consider using its discretion as far as possible.

(i) Companies subject to reporting obligations

The Regulations apply to UK-incorporated entities and their activities.

Regulation 5 exempts a subsidiary undertaking from preparing a report if its parent undertaking is also subject to the regulations and the subsidiary's activities are consolidated into the report drawn up and submitted by the parent.

However, we note that regulation 7(2) is drafted so as to require consolidated reporting by the parent undertaking of relevant activities carried out by (i) the parent undertaking and (ii) any subsidiary undertaking that would have been required to report under regulation 3 (thereby capturing only those subsidiaries that are UK incorporated entities). As such, the draft regulations do not require reporting of activities of non-UK subsidiaries. We anticipate that this is not the intended effect of regulation 7(2).

(ii) Meaning of 'government'

The draft regulations provide that 'government' means any '*national, regional or local authority of a country, and includes a department, agency or undertaking that is a subsidiary undertaking where the authority is the parent undertaking*'.

Based on the definition of parent and subsidiary undertaking in the Companies Act 2006, this definition could be interpreted as capturing not only national, regional and local

government bodies operating in their local jurisdiction, but also extends to those undertakings where the relevant state directly or indirectly holds a controlling interest (State-Owned Entities, or "SOE's"). Consequently, the draft regulations may capture, and require payment reporting in relation to, arrangements entered into by corporate entities with (inter alia):

a) **SOEs operating outside of the relevant state's home jurisdiction; and**

b) **SOEs which are classified as such by virtue of their being controlled by a sovereign wealth fund (i.e. a financial investor) or other state-owned investor (e.g. state-controlled banks and other financial institutions). By way of a hypothetical example, the reporting obligations would currently appear to capture a payment to an oil and gas company majority-owned by the Qatari Investment Authority, by reference to a royalty payable as part of the consideration for the acquisition of an interest in a project located in Malaysia.**

The scenario in (a) will bring within the scope of the draft regulations payments made between what are, in reality, two commercial parties in the context of negotiated joint venture, farm-in or similar arrangements and transactions, purely on the basis that one of those commercial parties is an SOE, even though the SOE has no connections with the relevant host state. We question whether the Accounting Directive was designed or ever intended to capture these types of commercial arrangements with the result that negotiated commercial terms will require public disclosure.

The scenario in (b) will equally be of concern for corporates active in the extractives industry as, in order to ensure compliance with the regulations, it will require those entities to understand and monitor ultimate ownership of their contract counterparties on an ongoing basis in order to identify whether they are in fact dealing with a SOE (e.g. as a result of its acquisition of a pre-existing counterparty). In the case of sovereign wealth funds investing in the extractives industry, this may present difficulties as it is possible that visibility in relation to a sovereign wealth fund's holdings will be limited (and by their nature subject to change).

(iii) Payments requiring disclosure

Considering that the draft regulations appear to cover payments made to SOEs (widely defined, as noted above) operating in a commercial joint venture partner capacity (as opposed to the granting state party under the relevant licence, concession or production sharing agreement) as noted above, the inclusion of these commercial type payments would require reporting of key commercial deal terms between counterparties (which would otherwise be confidential between the parties). For example, under a farm-in arrangement where the holder of the interest to be farmed in to is a SOE, the incoming investor would need to report all costs of the project paid on behalf of that SOE under the farm-in arrangement (above the materiality threshold) as consideration for the relevant licence or concession interest being acquired.

The 'payment' definition includes payments made by an undertaking for infrastructure improvements. While any such payments must be made for 'relevant activities', this could potentially capture a very wide range of cash and in kind commercial payments to a government or SOE (whether or not that government or SOE is operating in its home state) in connection with the building or development of new infrastructure for the

purposes of a project. It is also unclear in what respect the infrastructure payment must be 'for relevant activities'.

Payments made by an undertaking for infrastructure improvements are an example of a commercial payment that is not specific to extractive companies or specific to the extraction of the natural resources wealth of a state. Requiring companies in the extractives industry to disclose such commercial terms between counterparties in this way potentially discriminates against extractive companies in an arbitrary, unjustified, and unprincipled way; as companies operating in different industries (but perhaps on identical projects), such as banks or construction companies, would not have to disclose such commercial terms.

Given that infrastructure assets are increasingly an attractive investment for financial investors (which may include sovereign wealth funds), the potentially broad scope of this limb of the payment definition is all the more concerning. For example, there is an increasingly large amount of investment being made by the Chinese SOEs in Africa. While we expect that reporting entities will be permitted to take a pragmatic approach here to ensure that that reporting of payments made for infrastructure improvements captures the 'state' type payments that we anticipate are the proper focus of the Directive and the regulations, we would welcome any clarification from the Government within the regulations or associated guidance in relation to the payments that this particular limb of the definition is intended to capture.

As explained above, the inconsistencies and ambiguities brought about by the various definitions as currently drafted will cause serious uncertainties. This further aggravates our existing concerns regarding the proportionality of the proposed penalty regime, since it cannot be proportionate to threaten criminal liability for a failure to comply with vague or imprecise obligations.

(8) The Government would like to gather information which is directly relevant to UK registered companies on the anticipated costs of implementing this reporting requirement. (Para 7.1)

Question 8.1 We would welcome views on the impacts (costs and benefits) arising on business from this new reporting obligation. It would be particularly helpful if you could provide monetised information relating to any additional costs or benefits you identify. Where possible, please indicate if these additional costs are transitional or recurring costs.

In responding to this question, please note:

(i) *where a company voluntarily produces a similar or related report already*, the costs identified for this purpose should represent only the additional costs necessary to comply with this requirement and not the total cost of production.

(ii) BIS is happy to receive information considered to be commercially sensitive separately from the consultation response or, if requested, to remove such information from a response prior to its publication on the consultation website.

At this stage it is difficult to reliably estimate the additional costs of these draft regulations. Based on preliminary work done to meet the requirements of the similar US

revenue transparency rules, it is likely that implementation costs will be in the order of US$10 million, with ongoing running cost of around US$2 million per annum. This assumes an effective date of January 1, 2016 and a reporting period no later than six months. This includes the design, creation and testing of a separate data collection system; the creation of reporting guidance and training material; and the recurring costs of system maintenance, communication, assurance and reporting costs.

Question 8.2 Please describe any other issues associated with this requirement that you would like to draw to our attention.

There are two other important transparency regimes in place or currently being implemented - the regime set out in the Dodd-Frank Act, which would apply to US companies; and the Extractive Industries Transparency Initiative ("EITI") regime, which would apply in countries that have implemented EITI. Different companies would be caught by (or voluntarily apply) different regimes.

There are companies such as Shell that would be caught by all three regimes. Not only would the reporting costs of preparing different reports covering different levels of reporting requirements be vastly increased, it would similarly be difficult to meaningfully compare reports created to satisfy the reporting requirements of different regimes.

One of the key underlying objectives of introducing a reporting regime is to enable stakeholders and civil society to understand and evaluate the nature and value of payments received by their governments from the extractives sector. If the implementation of such regimes is inconsistent between different countries and regions, it will be impossible for interested individuals and organisations to compare like-for-like across different reports for different companies subject to different reporting regimes. This would arguably undermine a primary intent and purpose of the Directive and the EITI. It would also constitute a disproportionate burden in terms of costs, given the common origin and goals of these initiatives.

(9) The same reporting requirements apply to listed extractives companies under the amended *Transparency Directive*. The Government would like to gather information which is directly relevant to these companies on the anticipated costs of implementing this reporting requirement.

Question 9.1 Please outline any quantifiable costs and benefits specifically relating to the following issues:

- Economic impact
- Legal implications
- Practical implications
- Competitiveness impact including the position of the UK as a centre for international listings

Economic impacts:

The sensitivity for host governments of the information required to be reported under the draft regulations and the Transparency Directive may put Shell significant economic harm by putting it at a serious competitive disadvantage when bidding for new or

renewed contracts against other international oil companies that are not subject to the requirements. This is covered in more detail in our response to question 10 below under heading (ii) *"Competitive Harm".*

Legal implications:

As noted in the question, the UK implementation of the Transparency Directive will impose the same reporting requirements on listed companies as those in the Accounting Directive. However, it is not yet clear how and in what form the penalty regime in the Transparency Directive will be implemented in the UK. As a company that will be subject to the reporting regimes in both Directives, it is a key concern for Shell that the UK implementation of the penalty regime of both directives is consistent in scope, approach, and application. It is a further key concern for Shell that there is no duplication in sanctions for those companies that are subject to the reporting regimes in both Directives.

Practical implications:

Competitiveness impact including the position of the UK as a centre for international listings:

(10) The Government would welcome any other comments on the implementation of Chapter 10 within the scope of this consultation

Do you have any other comments that might aid the consultation process as a whole?

Please use this space for any general comments that you may have, comments on the layout of this consultation would also be welcomed.

(i) Position in the United States

As the Government will know, prior to efforts within the European Union to improve transparency in the extractives industry, the United States Congress introduced provisions under the Dodd-Frank Act requiring certain companies within the oil, natural gas and mining industries to report payments to foreign governments. This was achieved through amendments to the existing Securities Exchange Act 1934, which required the "SEC" to issue final rules setting out the precise reporting obligations applicable to the relevant companies. The SEC issued its final rule in September 2012 (the "Rule").

In October 2012, the American Petroleum Institute (the "API"), which is the principal lobbying organisation for the oil industry in the United States, together with the US Chamber of Commerce (the "US Chamber"), issued a lawsuit to challenge the Rule. The US District Court decided to annul the Rule, based on findings that the SEC had drafted and issued the Rule on the basis of flawed interpretations of the Dodd-Frank Act, namely that it (the SEC) considered itself to have no discretion (i) to prevent public disclosure where certain information was commercially sensitive and would impose high costs on shareholders and investors, and (ii) to allow an exemption where foreign law prohibits disclosure. Following annulment of the Rule, the SEC has reconsidered its

implementation of the relevant provisions of the Dodd-Frank Act and is currently in discussions with stakeholders as to how it will do so.

Given (i) the clear intention of the European Commission in its original legislative proposal to implement obligations "*comparable*" to those in the United States, (ii) the importance of achieving a consistent reporting mechanism where different reports prepared under different regimes can be compared, and (iii) the costs to industry of complying with different levels of reporting, we believe that these subsequent developments should be taken into account in the UK's implementation of the Accounting Directive.

In the light of the above, we suggest that the Government should liaise with the US authorities before finalising the UK's implementation of the EU regime, to ensure a co-ordinated and consistent regime so far as possible. We would also suggest that implementation should seek to maintain consistency with the EITI principles and guidelines where possible, insofar as it is within the Government's powers to do so.

(ii) Competitive Harm

There is at a serious risk that Shell and other companies caught by the draft regulations would be placed at a significant competitive disadvantage when negotiating with state counterparties and when bidding for new or renewed contracts against other international oil companies that are not subject to the reporting requirements.

Example

The following are necessarily fictional (since the draft regulations or any similar legislation applicable to Shell has not yet come into force) but entirely possible scenarios for how Shell's competitiveness might be disadvantaged in this way:

1. **A state counterparty is willing to grant favourable tax and royalty terms to make a project economically viable; but does not want those terms publicised to avoid creating pressure for itself to grant comparable terms on other projects. The project is therefore awarded to a foreign oil company that is not subject to the reporting requirements.**

2. **Shell acquires high-potential exploratory acreage in a particular country. The acreage acquisition requires Shell to pay bonuses to the government. Because Shell must disclose these bonuses, along with the name of the acreage, its identity is revealed. A foreign competitor of Shell not subject to the reporting requirements steps into the market and begins bidding for remaining available acreage, driving up Shell's costs significantly. At the same time, the foreign competitor is able to continue acquiring acreage in**

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another part of the country on a confidential basis.

3. **For economic, competitive, and foreign policy reasons, a host government considers the specific commercial terms of its agreements to develop natural resources to be state secrets and has accordingly passed laws prohibiting public disclosure of such terms. Given its reporting requirements, Shell is not invited to bid on projects in that country. As a result, companies that are not required to report what the host government considers to be sensitive terms win contracts to develop that country's natural resources.**

4. **From the financial information disclosure in the report, a state counterparty determines the rates of return that Shell has accepted on other projects. That information is used to negotiate more favourable terms where Shell is used as a stalking horse for the negotiations, where the outcome, if Shell drops out of the negotiations, will never be known.**

Thank you for taking the time to let us have your views. We do not intend to acknowledge receipt of individual responses unless you tick the box below.

Please acknowledge this reply ☒

At BIS we carry out our research on many different topics and consultations. As your views are valuable to us, would it be okay if we were to contact you again from time to time either for research or to send through consultation documents?

☒ Yes ☐ No

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