



SUDAN DIVESTMENT

TASK FORCE

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The Detrimental Presence of PetroChina/CNPC in Sudan: ***One Mind, One Will, One Corporation***

An Addendum to

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PetroChina, CNPC, and Sudan: Perpetuating Genocide
http://sudandivestment.org/docs/petrochina_cnpc_sudan.pdf

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A Report by
The Sudan Divestment Task Force

At its May 2007 annual shareholder meeting, Berkshire Hathaway addressed concerns raised about its holdings in PetroChina. Shareholders took issue with the holdings in light of documented connections between PetroChina and China National Petroleum Corporation's (CNPC) Sudan operations, operations that contribute to the ongoing genocide in the country's Darfur region. This document is a response to the views of Berkshire expressed at the meeting and to the company's ultimate decision not to exert shareholder pressure on PetroChina. It is meant to serve as a supplement to the report titled *PetroChina, CNPC, and Sudan: Perpetuating Genocide*, which includes research outlining PetroChina/CNPC's detrimental impact in Sudan, the companies' management structure and governance practices, and financial transactions and other operational links between the two firms.¹

Introduction

In February 2007, China National Petroleum Corporation (CNPC) President Jiang Jiemin visited oil Block 6 in Sudan, home to "some of the most horrific human rights violations"² in Sudan's Darfur region. Indeed, CNPC, which is 100% owned by the government of China, has been one of the most important corporate enablers of the government of Sudan's genocidal campaign in Darfur, and a consistent abuser of human rights in the country since its establishment there in 1996. As he toured CNPC's Block 6 facilities, Jiang Jiemin held two titles: President of CNPC and President of PetroChina, CNPC's largest publicly-traded subsidiary. As shareholders of PetroChina have begun to raise concerns about CNPC's involvement in Sudan, Jiemin's visit and dual roles embody the suspect nature of PetroChina's "separation" from CNPC's operations in Sudan. Indeed, while PetroChina claims that it has no operations in Sudan, this report demonstrates just the opposite: PetroChina is *not* a separate entity from its parent, but rather part and parcel of CNPC's operations. PetroChina therefore undeniably supports, financially and otherwise, CNPC's execution of human rights abuses in Sudan and its continued facilitation of the Darfur genocide.

With a majority of Sudan's oil revenue funneled into its military, oil ventures in Sudan are the chief source of financial support for the Sudanese government's genocidal policy in Darfur. As the largest investor in Sudan's oil industry, CNPC is consequently the largest single financial enabler of the Darfur genocide. Furthermore, CNPC's operations impart almost no benefit to Sudan's vast marginalized populations. Speaking specifically about Chinese oil investments, Deputy Governor of the Central Bank of Sudan, Elijah Aleng, stated in May 2007, "When you exploit oil and resources and nothing goes to the population, then you are financing the war against them with resources..."³ However, CNPC does not confine its support of human rights abuses to mere financial mechanisms; it often commits them itself. CNPC has repeatedly housed heavy military equipment used by the Sudanese regime in attacks on civilians, and has facilitated an uncontrolled arms trade between China and Sudan. PetroChina, controlled and directed by CNPC officials, functions as the company's main financier.

¹ Sudan Divestment Task Force, "PetroChina, CNPC, and Sudan: Perpetuating Genocide," April 15, 2007, <http://www.sudandivestment.org/position.asp#petrochina>.

² Amnesty International, "Sudan/China Appeal by Amnesty International to the Chinese Government on the Occasion of the China-Africa Summit for Development and Cooperation," November 1, 2006, <http://web.amnesty.org/library/Index/ENGAFR540722006>.

³ Lindsay Beck, Reuters, "Sudan Official Cautions China on Oil Investments," AlertNet, May 17, 2007, <http://www.alertnet.org/thenews/newsdesk/PEK306876.htm>.

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At its annual shareholder meeting in May 2007, Berkshire Hathaway, the largest shareholder of PetroChina apart from CNPC, formally rejected requests to divest from or engage with PetroChina regarding the Darfur genocide based on the following four grounds:

- 1) PetroChina is a subsidiary of CNPC; subsidiaries do not control or influence parent company policies.
- 2) PetroChina is not in Sudan.
- 3) The real issue of concern is the Chinese government's involvement in Sudan, and that is the most appropriate target for engagement.
- 4) Even if it were appropriate to engage with PetroChina, a divestment or engagement policy with PetroChina/CNPC may have "unintended consequences" that outweigh any benefits for Darfur. Berkshire Hathaway points to two such potential consequences: i) CNPC would exit Sudan, Sudan would purchase its assets, and this would result in a windfall of revenue to the Sudanese government, and ii) even if Sudan did not purchase CNPC's assets directly, the government would negotiate a more lucrative production-sharing agreement with CNPC's replacement.

This report addresses Berkshire's claims and concludes that shareholder pressure on PetroChina by Berkshire and other major shareholders is a necessary and appropriate means to influence and alter CNPC's troubling behavior in Sudan.

Response to Berkshire's Arguments

Berkshire Hathaway: PetroChina is a subsidiary of CNPC; subsidiaries do not control or influence parent company policies.

Response: PetroChina's corporate form is a fiction. In substance, it is nothing more than the alter ego of CNPC; thus, shareholder pressure on PetroChina is tantamount to shareholder pressure on CNPC.

Berkshire points to PetroChina's subsidiary form to explain why shareholder pressure on PetroChina would have no impact on its parent, CNPC. If such corporate forms maintain their integrity and separate existence, this assumption is reasonable because a subsidiary does not necessarily exert any influence or control over its parent corporation. However, PetroChina and CNPC are not separate corporate forms but are in fact a single macroscopic entity.

In US courts, the corporate form is disregarded where no separate entity has been maintained and the corporation is merely the "alter ego" or "instrumentality" of its shareholders. Courts use a totality of the circumstances to determine whether a subsidiary is the alter ego of the parent corporation. Where the circumstances show that a parent substantially dominates its subsidiary, the subsidiary's corporate form will be disregarded, and it will be found to be the alter ego of its parent.

The following chart illustrates how PetroChina/CNPC measures against factors used in US courts to evaluate whether a parent corporation substantially dominates its subsidiary. (For more detail on the PetroChina/CNPC facts contained within the chart, see the SDTF report *PetroChina, CNPC, and Sudan: Perpetuating Genocide*, pp. 9-17):

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Factors Supporting Substantial Domination/ "Alter Ego" Determinations	PetroChina/ CNPC
Common directors or officers (p. 14-15)	√
Failure to maintain arm's length relationship with related entities (p. 11-12)	√
Absence of corporate records (p. 11-12; for connected party transactions, absence of transparent valuation methodologies, independently audited data, and other relevant publicly-available information)	√
Parent caused the incorporation of the subsidiary (p. 9-10; indeed, CNPC's express purpose in creating PetroChina was to allow the access to Western capital markets while shielding CNPC from investor concerns about its operations in Sudan)	√
Corporation being used as a façade for dominant shareholder dealings (p. 10-11; especially true given the "firewall" pledge CNPC made during PetroChina's IPO not to have PetroChina involved, in any way, in dealings surrounding Sudan)	√
Non-functioning corporate officers and/or directors (p. 14-15; with such overlap in officers/directors, the key function of independence is an impossibility)	√
Daily operations of the two corporations are not kept separate (p. 14-15; with near complete overlap of management, keeping daily operations separate is an impossibility)	√
Subsidiary does not observe basic corporate formalities (pp. 11,12,13,16; failure to create executive structures that support independence — e.g., the absence of a corporate governance committee and the failure of independent directors to meet independently - and the practice of keeping PetroChina cash on hand with CNPC's non-bank finance subsidiary without shareholder approval)	√
Unorthodox cross-subsidization (p. 10-14)	√
Manipulation of assets or liabilities to concentrate assets or liabilities (pp. 10-11; CNPC concentrates almost all profitable international assets with PetroChina while concentrating risky international liabilities, including CNPC's politically charged Sudan operations, in its own hands)	√
Public is misled about who they are dealing with (pp. 9-16, 17; evidenced by identical logos and company abbreviations, breakdown of promised "firewall" between PetroChina and CNPC, etc)	√

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It is clear from this checklist that PetroChina's subsidiary form would not hold in US courts, leaving the company as the mere instrumentality or "alter ego" of parent CNPC. In other words, CNPC so completely dominates PetroChina's operations that PetroChina cannot be said to have a separate mind, will, or existence of its own. This unity of interest and ownership makes it only logical that shareholder pressure on PetroChina would be, in effect, shareholder pressure on CNPC.

At Berkshire Hathaway's annual shareholder meeting, Berkshire CEO Warren Buffet argued that the relationship between PetroChina and CNPC was like that of Berkshire Hathaway and Wesco Financial Corporation (a majority-owned subsidiary of Berkshire). Admittedly, PetroChina and Wesco are similar in that both are majority-owned by their respective parent firms. Yet, the comparison falls apart upon closer examination. To note a few pointed dissimilarities:

- Wesco existed before Berkshire purchased it, in contrast to PetroChina, which CNPC set up for the explicit purpose of raising Western capital while shielding CNPC from investor criticism over its Sudan operations.
- As a truly independent entity, Wesco does not operate to provide cover for the dealings of Berkshire. By contrast, although PetroChina was set up with the explicit promise that it would not serve as a cover for CNPC's dealings in Sudan, the extensive and opaque asset transfers between PetroChina and CNPC have proven this promise an empty one.
- Wesco has only one senior management person overlapping with Berkshire, as well as a board of directors that is majority independent, as opposed to the nearly complete overlap in senior management between PetroChina and CNPC.
- There is no attempt by Berkshire and Wesco to present the two companies as the same entity to the public. Indeed, the average American citizen is often surprised to find out that companies as diverse as Wesco, Fruit of the Loom, See's Candy, Geico, and Nebraska Furniture Mart are all subsidiaries of Berkshire. In contrast, the average Chinese citizen would have a truly difficult time discerning whether a particular product or service was produced by CNPC or PetroChina.
- Wesco and Berkshire assets and liabilities are, for the most part, equitably distributed within each respective company. This stands in contrast to the very purposeful CNPC policy of concentrating assets with PetroChina and liabilities with CNPC.
- Wesco represents a trivial contribution (less than 2%) of Berkshire's total assets, depriving it of any practical influence over Berkshire. However, PetroChina accounts for 64% of CNPC's assets and 50% of CNPC's yearly profit, signaling dependence and a situation ripe for influence.

Berkshire Hathaway: PetroChina is not in Sudan.

Response: As the mere instrumentality of CNPC, PetroChina is in effect present in Sudan.

Given that PetroChina is little more than CNPC's alter ego, its geographical location cannot be viewed independently of CNPC's. As outlined above and in SDTF's full PetroChina/CNPC report, PetroChina's operations are so closely intertwined with CNPC, through both extensive financial support and directives from a singular CNPC/PetroChina management, that

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PetroChina is more accurately characterized as part and parcel of CNPC's operations, including those in Sudan.

Berkshire Hathaway: The real issue of concern is the Chinese government's involvement in Sudan, and that is the most appropriate target for engagement.

Response: CNPC is engaging in the market and should therefore be engaged through the market.

Mr. Buffet states that both CNPC and PetroChina are controlled by China, and, as a result, any civilian or shareholder effort to influence these corporations is merely an attempt to tell the Chinese government what to do. Berkshire Hathaway's Vice Chairman, Charlie Munger, states that this is foreign policymaking, and should be directed through the US government rather than PetroChina/CNPC shareholders.

However, the US government has explicitly demonstrated that it envisions and even supports civilian engagement of foreign instrumentalities such as state-owned enterprises (SOEs). In fact, of the few exceptions to the foreign sovereign immunities rules that dictate how foreign governments relate to the US judicial system, commercial activities of a government or its instrumentalities (corporate or otherwise), as opposed to its public acts, are not immune from civil engagement and action in a US courts.⁴

Moreover, in dealing with any SOE and its impact, it is unreasonable to rely solely on an intergovernmental path of engagement. Indeed, SOEs with publicly-traded subsidiaries, unlike governments, are unique in that they benefit from and are subject to the quickly changing tides of the market. Additionally, when an SOE chooses to raise money through capital markets, it follows that the company should be treated as a participant in that market; to not treat an SOE in this fashion is to allow the company the benefits of capital markets without subjecting the company to any of the market's incumbent obligations.

In the specific case of China, SOEs may be especially suitable for market pressure. Xu Weizhong, director of the Department of African Studies at the China Institute of Contemporary International Relations, a Chinese government think tank in Beijing, notes that many Chinese SOEs now have significant room to maneuver without consideration of government objectives, sometimes going so far as to refuse government policies.⁵

Berkshire Hathaway: Even if it were appropriate to engage with PetroChina, a divestment or engagement policy with PetroChina/CNPC may have "unintended consequences" that outweigh any benefits for Darfur. Berkshire Hathaway points to two such potential consequences: i) CNPC would exit Sudan, Sudan would purchase its assets, and this would result in a windfall of revenue to the Sudanese government, or ii) even if Sudan did not purchase CNPC's assets directly, the government would negotiate a more lucrative production-sharing agreement with CNPC's replacement.

Response: The most likely outcome of shareholder pressure on PetroChina/CNPC would be a change in PetroChina/CNPC's behavior and its relationship with Sudan.

Berkshire states that even if shareholder pressure were appropriate and CNPC left Sudan under such pressure, CNPC's exodus would carry unintended consequences. Specifically, Berkshire predicts that CNPC's substantial hard, fixed assets in Sudan would be purchased by the

⁴ 28 U.S.C Sec.1603-5 (2005).

⁵ Danna Harman, "In Sudan, China Focuses on Oil Wells, Not Local Needs," *Christian Science Monitor*, June 25, 2007, <http://www.csmonitor.com/2007/0625/p11s01-woaf.html>.

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Sudanese government at a bargain price. This outcome is neither likely nor supported by the facts (see pp. 21-24 of the SDTF report *PetroChina, CNPC, and Sudan: Perpetuating Genocide*). With a foreign debt exceeding its GDP and lackluster technical expertise, Sudan simply lacks the resources to make this prospect a reality. A recent report by the United States Department of Energy issued in April 2007 confirms that Sudan is in no position to manage CNPC's assets, noting that:

“The [state-owned] Sudan National Petroleum Corporation (Sudapet) is active in Sudan's oil exploration and production. However, due to its limited technical and financial resources, Sudapet often develops joint venture with foreign companies in oil projects”.⁶

Indeed, in all active oil projects in Sudan, Sudapet has intentionally elected to take on no more than an 8% stake. For Sudapet to suddenly assume operational control of the multiple oil blocks where CNPC is primary operator would assuredly send the blocks into operational and financial ruin. In any case, given that Sudan represents one of China's top sources for imported oil and a key facet of China's national energy strategy, it is highly unlikely that China would leave Sudan and Berkshire's hypothetical be realized. Even if it were, in light of Sudan's lack of financial and technical resources, it is much more probable that Malaysia or India's para-statal firms, which are already consortium partners in CNPC's Sudan operations, would purchase the assets directly from CNPC. For reasons laid out in SDTF's report *PetroChina, CNPC, and Sudan: Perpetuating Genocide* (specifically, pp. 21-24), this outcome, although highly unlikely, is markedly preferable to CNPC remaining behind in Sudan without changing its behavior.

Finally, Berkshire argues that even if Sudan did not purchase CNPC's assets directly upon exit, the government would negotiate a more lucrative production sharing agreement with CNPC's replacement. There is no evidence that the government of Sudan can renegotiate a consortium contract when one party to a consortium sells its stake to another firm. In fact, when purchasing such a stake in a consortium, the incoming company buys the assets from the exiting firm and receives exactly what that firm had at contract—no more, no less. History bears this out. When Talisman Energy, Lundin Petroleum, and OMV, participants in three of Sudan's largest oil consortiums, sold some of their Sudan assets in 2003 the incoming parties simply assumed the companies' positions in the consortiums without any change in revenue sharing.

In sum, after addressing each one of Berkshire's hypothetical “unintended consequences,” SDTF confidently concludes that every conceivable outcome of shareholder pressure on PetroChina/CNPC over its Sudan operations is preferable to the status quo.

⁶ Energy Information Administration, U.S. Department of Energy, “Sudan,” April 2007, <http://www.eia.doe.gov/emeu/cabs/Sudan/Oil.html> (accessed July 23, 2007).