FINAL NOTICE

To: **The "Shell" Transport and Trading Company, p.l.c. ("STT")**

The Royal Dutch Petroleum Company NV ("RDP")

Care of: **Richards Butler**
Beaufort House
15 St Botolph Street
London EC3A 7EE

Date: **24 August 2004**

TAKE NOTICE: The Financial Services Authority of 25 The North Colonnade, Canary Wharf, London E14 5HS ("the FSA") gives you final notice of its decision to take the following action

ACTION

The FSA gave STT, RDP and the Royal Dutch/Shell Group of Companies (together "Shell") a Decision Notice dated 13 August 2004 which notified it that, for the reasons set out below, the FSA has decided to impose a financial penalty of £17 million:

i. pursuant to section 123 of the Financial Services and Markets Act 2000 ("the Act") for market abuse by Shell arising as a result of announcements or statements made prior to 19 April 2004 by or on behalf of Shell; and

ii. pursuant to section 91 of the Act for breaches of the FSA's Listing Rules by STT and RDP regarding Shell's hydrocarbon reserves.

Shell's misconduct amounting to market abuse and, by STT and RDP, breaches of the Listing Rules is based on substantially the same facts. The penalty for that misconduct is based on the FSA's finding of market abuse by Shell; in the particular circumstances of this case, no additional penalty is imposed for breaches of the Listing Rules by STT and RDP.

The FSA considers that Shell's actions were particularly serious and merit a substantial financial penalty in that:

- Shell announced false or misleading proved reserves and reserves replacement ratios to the market throughout the period 1998 to 2003 inclusive;

- The false or misleading reserves information was not corrected until a series of announcements between 9 January and 24 May 2004 in which Shell announced the recategorisation of 4,470 million barrels of oil equivalent, being approximately 25% of Shell's proved reserves;

- Shell's false or misleading announcements of proved reserves were made despite indications and warnings from 2000 to 2003 that its proved reserves as announced to the market were false or misleading;

- Shell failed to put in place or maintain adequate systems or controls over its reserves estimation and reporting processes; and

- Following the first announcement of its recategorisation of proved reserves on 9 January 2004, STT's share price fell from 401p to 371p (7.5%) reducing STT's market capitalisation on that day by approximately £2.9 billion. On 9 January 2004 trading in the shares of STT accounted for more than 10% of the total volume of shares traded on the FTSE 100, of which STT was the seventh largest constituent by market capitalisation.

The level of the financial penalty reflects the high degree of cooperation which Shell has shown to the FSA during the conduct of this investigation. But for that cooperation the FSA would not have been able to conclude its investigation into Shell in relation to the complex factual issues and extensive documentary and oral evidence in such a short time. Were it not for Shell's cooperation the level of the financial penalty would have been significantly higher.

REASONS FOR THE ACTION

The facts relied on by the FSA

1997 to 1999: Significant additional proved reserves announced

1. During 1997 Shell implemented a resource reporting guidelines project to clarify the guidelines for the year end reporting of the proved reserves to be included in the 20-F filings to the United States Securities and Exchange Commission ("SEC") and corresponding Regulatory Information Service announcements in the UK. The project was prompted by concerns within Shell that its guidelines resulted in over conservative reporting of proved reserves, particularly when compared with the practices of its competitors.

New Shell reserves guidelines

2. In September 1997 Shell issued revised Petroleum Resource Volume Guidance (Volume 1 Resource Classification and Reporting Requirements) to be used as the basis of reporting proved reserves under SEC Rule 4-10. Rule 4-10 defines "proved reserves" for reporting purposes as:

"the estimated quantities of crude oil, natural gas, and natural gas liquids which geological and engineering data demonstrate with reasonable certainty to be recoverable in future years from known reservoirs under existing economic and operating conditions, i.e., prices and costs as of the date the estimate is made."

3. Under Item 102(5) of Regulation S-K, issuers may not disclose in SEC filings estimates of oil and gas reserves other than "proved reserves" unless such disclosure is required under state law or the law of a non-U.S. jurisdiction.

Overstatements for 1997 and 1998 including Gorgon

4. The revised guidelines were implemented in four countries for the year ended 31 December 1997 and the estimated impact on the proved reserves figure for that year was the addition of 145.5 million barrels of oil equivalent ("boe"). Furthermore, the proved reserves figure for 1997 included an incorrect "revision" of over 550 million boe relating to Gorgon, an undeveloped frontier gas field off the north west coast of Australia.

5. In 1998 Shell created five Value Creation Teams ("VCTs") to find radical new ways to improve Shell's Exploration and Production business ("EP") profitability and reputation and hence aid growth in the EP business. One VCT was tasked with creating the maximum value from Shell's hydrocarbon reserves. A paper dated May 1998 entitled *"Creating value through Entrepreneurial Management of Hydrocarbon Resource Values"* made a number of recommendations including changing Shell's reserves guidelines. On 16 September 1998 the revised guidelines were issued to Shell's operating units. These revised guidelines resulted in an overstatement of Shell's proved reserves of 940 million boe for the two years ended 31 December 1999.

Overstatements for 1999: Nigeria and Brunei

6. A large proportion of the overstatement of proved reserves as at 31 December 1999, relating to the Shell Petroleum Development Company in Nigeria ("SPDC"), was dependent on unrealistic production forecasts that the proved portion of the reserves could be produced within the remaining licence period. These projections, in turn, depended on a number of assumptions concerning improved economic and operating conditions, such as improvements in the country's economic stability, increases in Shell's production quota from the Nigerian authorities and increases in Nigeria's production quota from OPEC. These *"assumptions"* did not comply with the requirement in Rule 4-10 that proved reserves be based on *"existing conditions"*. In addition the Nigerian operations had performed well below the previously projected levels throughout the period.

7. A further significant overstatement (250 million boe) related to Brunei Shell Petroleum SB ("BSP"). Half of this volume was as a result of the booking of proved reserves in 1986 which were made based on an overall anticipation of increased recovery. However, no specific projects for recovery of those reserves were identified. The remaining volumes related to new field developments planned beyond existing contract expiry for which there was no reasonable certainty of development.

2000 to 2001

8. On 31 January 2000 an internal presentation was made which showed a reserves replacement ratio ("RRR") of 37% for the year ended 31 December 1999. This RRR figure was robustly rejected and on 11 April 2000 Shell announced an RRR for 1999 of 56%.

9. The presentation highlighted concerns in relation to Nigeria that a substantial part of SPDC's reported proved reserves (perhaps more than 600 million boe) was constrained by licence expiry and depended on unrealistic production forecasts that appeared to have been *"reverse engineered"* solely to support the reserve figures.

10. The presentation also stated that no additional proved reserves could be booked in relation to Gorgon because of *"the limited market availability and already large uncommitted proved gas reserves"*. It further stated that *"proved gas volumes in Australia have been a point of challenge by the external auditors... for the last two years and incremental booking at present would be hard to support."*

11. The next month, the Group Reserves Auditor's ("GRA") report on Shell's 1999 proved reserves dated 8 February 2000 also raised issues in relation to Nigeria and stated that SPDC faced licence expiry problems and could support its proved reserves figures only through *"significant aspirational upturns in future offtake levels in order to justify their proved reserves levels."* The GRA also raised these issues, without Shell taking any steps to debook non-compliant reserves, in each of his next two annual reports.

12. By mid 2000, Shell had information indicating that the proved reserves figures reported to the market for at least the previous three years may have been overstated. Nonetheless, no further steps were taken to assess the accuracy of its reported proved reserves.

13. The above issues were not considered further until the annual procedure for reserves reporting was undertaken for 2000. On 30 January 2001 the GRA circulated his report. The report stated that Shell's proved reserves figure was receiving increasingly close attention from management and that annual target reserves additions were being set, with progress monitored throughout the year. The GRA concluded that, coupled with future proved reserves additions being much more challenging, the pressure on staff raised possible concerns with respect to the quality of future reserves bookings.

Overstatements for 2000 including Oman

14. A further 315 million boe of proved reserves had been incorrectly booked for 2000 as a result of the revised reserve guidelines issued in 1998. The total overstatement of proved reserves for 1998 to 2000 was therefore 1,255 million boe. When added to the overstatement of proved reserves for 1997, the total overstatement for the period 1997 to 2000 was 1,950 million boe.

15. A significant proportion of the additional overstatement for 2000 related to Shell's interests in Oman, which derived from Shell's indirect 34% ownership of Petroleum Development of Oman ("PDO"), an Omani company 60% of which is owned by the Omani government. Shell is the largest private shareholder in PDO and serves as PDO's technical adviser.

16. On 31 December 2000, Shell and PDO agreed to raise PDO's proved reserves estimates in accordance with Shell's revised guidelines and added 251 million boe to Shell's reported proved reserves for 2000.

SEC guidance

17. On 31 March 2001 SEC staff issued guidance on the application of Rule 4-10. This guidance did not result in any change to Rule 4-10. However, the guidance:

- emphasised the conservatism underlying the definition of proved reserves;
- observed that *"economic uncertainty such as the lack of a market (eg stranded hydrocarbons)... can also prevent reserves from being classified as proved"*;
- specifically advised that, in *"developing frontier areas ... issuers must demonstrate that there is reasonable certainty that a market exists for the hydrocarbons and that an economic method of extracting, treating and transporting them to market exists or is feasible and is likely to exist in the near future... significant lack of progress on the development of such reserves may be evidence of a lack of commitment. Affirmation of this commitment may take the form of signed sales contracts for the products"*; and
- with respect to hydrocarbon volumes whose production depends on the extension of government permits or licences, indicated that automatic renewal of such permits or licences *"cannot be expected ... unless there is a long and clear track record which supports the conclusion that such approvals and renewals are a matter of course"*.

18. In mid-2001, PDO began experiencing a steep decline in production. Within a few months the situation had grown so serious that PDO took the highly unusual step of withdrawing its long-term business plan for 2002. The production decline also prompted the Omani government to question the volume of expectation and proved reserves PDO was carrying. As a result Shell agreed to a $30 million *"down payment"* to the Omani government on what was expected to be an eventual refund of expectation reserve booking fees it previously had received. By the end of 2001, as its production continued to drop, PDO had no reliable or realistic long-term plan on which to base its proved reserves reporting. With Shell's encouragement, PDO instead adopted an *"aspirational"* production forecast to support its reported proved reserves figures.

19. In October 2001 the presentation given on 31 January 2000 was again called to the attention of Shell. Despite the significantly different environment in relation to reserves that existed compared with when the presentation was originally circulated, Shell did not take any further steps to address the issues raised.

2002 to 2004: further information is available

Overstatement for 2001 and identification of Shell's "potential exposures"

20. The GRA report for 2001 was circulated on 30 January 2002. The report stated that Shell's reserve guidelines had been reviewed against industry practice in 1998 and as a result there had been an increase in proved reserves of some 1,250 million boe in

relation to mature fields. Clarification of the reserves reporting requirements issued by the SEC in 2001 had shown that Shell's reserve guidelines regarding the first time booking of proved reserves in new fields was in some cases too lenient. The GRA recommended that Shell's guidelines be reviewed and first time bookings be more closely aligned to Rule 4-10. Further they should be allowed only for firm projects with technical maturity and full economic viability.

21. The report also stated:

"The widespread use of reserves targets in score cards affecting variable pay is seen to affect the objectivity of staff in some [operating units] *when proposing reserves additions...Awareness of Group and SEC reserves booking guidelines was seen to be less than desirable at senior levels in* [operating units] *and in support functions in the centre."*

22. On 11 February 2002 an internal Shell memorandum summarised Shell's reserves position as at 31 December 2001, following the reserves audit procedures. The note included a section on *"Exposures"* and stated:

"Recently the SEC issued clarifications that make it apparent that the Group guidelines for booking Proved Reserves are no longer fully aligned with the SEC rules. This may expose some 1,000 mln boe of legacy reserves bookings (eg Gorgon, Ormen Lange, Angola and Waddenzee) where potential environmental, political or commercial 'showstoppers' exist."

23. A second category of exposures was reported in relation to the end of licences in some operating units, including Oman and Nigeria. The memorandum stated:

"no further proved reserves can be booked since it is no longer 'reasonably certain' that the proved reserves will be produced within license. The overall exposure should the [operating unit] *business plans not transpire is 1,300 mln boe."*

24. The note stated that work had begun to address this important issue. The total potential exposure to the 2001 reported proved reserves, identified in the note, was 2,300 million boe, compared with Shell's total proved reserves of 20,000 million boe.

25. The EP Business Appraisal for 2001 was circulated on 20 February 2002 and was presented at a meeting on 25 and 26 February 2002. Both the *"Main Issues"* section and the main body of the Appraisal stated that the SEC's guidance made it clear that the approach advocated by the Shell guidelines was, in many cases, too aggressive and would be likely to affect future bookings in new fields such as Nigeria and possibly existing bookings representing some 1,000 million boe. The Appraisal also referred to reserves which could no longer be booked because of licence expiry issues and production limitations amounting to an additional 1,000 million boe.

26. On 2 April 2002 Shell issued revised reserves guidelines because it considered that its previous guidelines were ambiguous and had led to misunderstandings and inconsistency of application. Further, Shell had acknowledged that revised guidelines were needed because of the SEC guidance on Rule 4-10 issued on 31 March 2001.

27. Following the 11 February 2002 memorandum, a further, more comprehensive, memorandum was issued on 18 July 2002 in respect of Shell's reserves outlook. The objectives of the 18 July memorandum were to provide full transparency as to the nature of Shell's resource base, to outline the challenges faced in booking proved reserves and to indicate actions that would enhance performance.

28. The memorandum included details of all hydrocarbon reserves, including those classified as proved, and highlighted areas of concern. In particular, the memorandum separately identified oil and gas reserves that relied on planned significant increases in production rates and gas reserves that were potentially *"prematurely"* booked, notably Gorgon.

29. The 18 July 2002 memorandum was presented to a meeting on 22 and 23 July 2002. The meeting noted that it was considered unlikely that potential over-bookings would need to be de-booked in the short term but that reserves that were subject to project risk or licence expiry could not remain on the books indefinitely if little progress were made to convert them to production in a timely manner. There was no discussion as to what *"indefinitely"* or *"a timely manner"* meant in practice. The meeting also recognised that some booking practices had been too aggressive in the past although there was little discussion as to the basis on which existing proved reserves bookings could be maintained.

Shell's exposures catalogue

30. In September 2002, Shell decided to implement a system to ensure greater awareness and control of the proved reserves inventory in the form of an exposures catalogue. The first such exposures catalogue was included in a note for discussion at a meeting on 7 November 2002.

31. The exposure catalogue included seven specific potential exposures, totalling 905 million boe, the largest being 506 million boe in respect of Gorgon. The notes to the exposure catalogue stated that, in addition, the reserves in some operating units would be at risk if production rate increases did not materialise. It further stated that the catalogue captured reserve bookings that were fully justified at present but that might come under threat of de-booking, for example, should the SEC further clarify its rules to imply that more conservatism should be applied by Form 20-F registrants.

Overstatements for 2002

32. On 31 January 2003, the report of the GRA in relation to proved reserves for the year ended 31 December 2002 was circulated. The report stated that the most significant comment was that serious efforts had been made during 2002 towards further alignment of Shell's proved reserves with Rule 4-10 and Shell's own guidelines. The report stated that the overall finding from the audit visits and the year-end review was that there was a possibility of an overstatement of Shell's proved reserves in cases where booked reserves were not fully in accordance with Rule 4-10 or Group guidelines. The amount of this possible overstatement was 200 million boe or 1% of Shell's proved reserves portfolio.

33. The report considered areas where there was an issue with product licence constraints. In relation to SPDC in Nigeria, the GRA concluded that the proved reserves had been

overstated in previous years and a conservative estimate was that the correct figure for proved reserves was some 20%, or 600 million boe, less than reported proven reserves. In respect of Oman (PDO), the GRA estimated that the overstatement could be of the order of 65 million boe. The conclusion is that there had been a *"breach of Proved reserves guidelines by PDO and, more seriously, by SPDC."* This overstatement was in addition to the potential exposure shown in the exposure catalogue of 905 million boe.

34. A memorandum was circulated on 17 July 2003 and was discussed on 22 July 2003. The memorandum included an updated exposure catalogue and stated that of Shell's 19,350 million boe proved reserves *"some 1040 million boe (5%) is considered to be potentially at risk."* The note concluded that *"at this stage, no action in relation to entries in the* [Proved Reserves Exposure] *Catalogue is recommended... It should be noted that the total potential exposure listed in Appendix C is broadly offset by the potential to include gas fuel and flare volumes in external reserves disclosures."*

35. The Proved Reserves Exposure Catalogue in Appendix C to the Note quantifies *"exposures"* at approximately 1,000 million boe and *"threats"* at approximately 1,600 million boe, or a total of approximately 2,600 million boe potentially at risk of non-compliance with Rule 4-10.

36. A memorandum dated 26 August 2003 was circulated to the Group Audit Committee ("GAC") which addressed possible areas of non-compliance with Rule 4-10. The GAC was advised that *"much, if not all, of the potential exposure arising from interpretation of the factors... is offset by Shell's practice of not disclosing reserves in relation to gas production that is consumed on site as fuel or (incidental) flaring and venting"*. The memorandum included the exposure catalogue in the attachments with *"potential exposures"* totalling 1,000 million boe and "threats" of 1,600 million boe.

37. However, prior to the circulation of this note, the potential for booking reserves including fuel and flare was discussed between EP's technical staff. A note dated 9 July 2003 stated that changing Shell's policy to include of the order of 1,000 million boe should not be considered lightly and that were it to do so a detailed explanation would have to be provided as there was a risk that:

    "the gain would be seen purely as a 'paper exercise': many analysts have concluded that reserves replacement is the key challenge facing Shell over the next few years and they might react negatively to this one-off adjustment to the figures. Moreover, this difference in reporting practice... provides an offset to other elements of existing proved reserves inventory that could be viewed as being potentially at risk... the potential exposure that they represent is also of the order of 1,000 million boe."

38. The note concluded that it would not be prudent to include fuel and flare in proved reserves figures until a decision had been taken to remove the potential exposures from proved reserves.

39. On 30 September 2003 the GRA issued an *"unsatisfactory"* audit report in relation to SPDC. The audit found that SPDC's proved reserves appeared *"far less mature"* than during the last (1999) reserves audit.

40. The 26 August 2003 memorandum was presented at the GAC meeting on 21 October 2003. The GAC was not advised of the unsatisfactory audit report on Nigeria, nor were

they advised of the initial conclusions of the SPDC review that there was a significant *"gap"* between proved reserves carried and those that could be supported. Further additional work had been done in relation to fuel and flare and the estimate of the potential offset had been reduced from 1,000 million boe to 300 million boe. The GAC were not advised of the reduction.

41. On 3 November 2003 the GRA issued a second unsatisfactory audit, this time in relation to Oman. The fact of these two unsatisfactory audits was reported on 18 November 2003.

42. At this time Shell was concerned to establish the extent of the issue relating to reserves and the extent to which downward revisions needed to be made *"as a result of overly aggressive or optimistic bookings in the past."*

43. At the end of November 2003 a presentation intended for a meeting of Conference (a committee made up of the Boards of both STT and RDP) on 3 December 2003 was prepared. A draft of the presentation was distributed to some members of Shell's senior staff which stated that, in relation to SPDC and Oman, *"the total volume not in compliance with SEC guidelines in the proved reserved filing in the 20-F as per 31/12/02 has become significant (2.1 bln boe or 11% of the Group's total proved reserves)"*. In the event this presentation was not made to Conference.

44. A detailed report dated 8 December 2003 was presented. The report quantified reserves that were not compliant with Rule 4-10 as 2,100 million boe and reserves that potentially were not compliant with Rule 4-10 as 1,500 million boe, a total of 3,600 million boe. As a result, a full investigation to determine the extent of the reserves misstatement was initiated. It was not until 9 January 2004, when the majority of this work had been done, that any announcement was made to the market.

45. Shell's announcement on 9 January 2004 stated that:

"...following internal reviews, some proved hydrocarbon reserves will be recategorised. The total non recurring recategorisation, relative to the proved reserves as stated at December 31st 2002, represents 3.9 billion barrels of oil equivalent ('boe') of proved reserves, or 20 % of proved reserves at that date."

46. Following this announcement the share price of STT fell 7.5%, representing a reduction in market capitalisation of £2.9 billion. STT has 9,667.5 million shares on issue and approximately 240,000 share holders.

47. Shell made further announcements on 5 February 2004 and 3 March 2004 and on 18 March 2004 announced a further recategorisation of 250 million boe as the end of 2002. On 19 April 2004, Shell announced a total recategorisation of 4,350 million boe and released the executive summary and proposed remedial measures sections of a report commissioned by the GAC into the facts and circumstances surrounding the recategorisation of Shell's hydrocarbon reserves.

48. On 2 July 2004 Shell published amended statements of its proved reserves for each of the years 1997 to 2002 inclusive.

Relevant statutory provisions and guidance

49. Section 118(1) of the Act defines *"market abuse"* as *"behaviour... which...*

    (a) occurs in relation to qualifying investments traded on a market to which this section applies;

    (b) satisfies any one or more of the conditions set out in subsection (2); and

    (c) is likely to be regarded by a regular user of that market who is aware of the behaviour as a failure on the part of the person or persons concerned to observe the standard of behaviour reasonably expected of a person in his or their position in relation to the market."

50. The relevant condition is that set out in section 118(2)(b) of the Act:

    "the behaviour is likely to give a regular user of the market a false or misleading impression as to the supply of, or demand for, or as to the price or value of, investments of the kind in question".

51. Shares in STT and RDP, being traded on the London Stock Exchange ("LSE"), are qualifying investments and dealing in such shares is behaviour occurring in relation to such investments for the purposes of section 118(1) of the Act.

52. The term "regular user", in relation to a particular market, means *"a reasonable person who regularly deals on that market in investments of the kind in question"* (section 118(10) of the Act).

53. Under section 119 of the Act the FSA has issued the Code of Market Conduct ("the Code"), which contains guidance as to whether or not behaviour amounts to market abuse. Under section 122 of the Act, the Code may be relied on so far as it indicates whether or not particular behaviour should be taken to amount to market abuse. In respect of this Decision Notice, the FSA has had regard to MAR 1.2 of the Code which sets out guidance on the regular user and MAR 1.5 of the Code which sets out guidance on false or misleading impressions.

54. Under section 123(1) of the Act, the FSA may impose a financial penalty of such amount as it considers appropriate if the FSA is satisfied that a person has engaged in market abuse.

55. Under Part VI of the Act, the FSA is responsible for the official listing of securities in the UK. The FSA's Listing Rules set out the requirements for the admission of securities to the Official List and the continuing obligations of issuers whose securities are so admitted.

56. Chapters 9 and 17 of the Listing Rules set out the continuing obligation requirements on primary listed issuers (such as STT) and overseas companies (such as RDP) respectively. Listing Rules 9.3A and 17.24A provide that listed issuers:

    "must take all reasonable care to ensure that any statement or forecast or any other information it notifies to a Regulatory Information Service or makes available through

the UK Listing Authority is not misleading, false or deceptive and does not omit anything likely to affect the import of such statement, forecast or other information."

57. Under section 91(1) of the Act the FSA may impose a penalty of such amount as it considers appropriate if the FSA considers that an issuer of UK listed securities has contravened any provision of the Listing Rules.

58. Under section 93 of the Act the FSA has published a statement of its policy with respect to the imposition and amount of financial penalties for breaches of the Listing Rules. The FSA's policy in this regard is set out in Chapter 8 of the UKLA Guidance Manual (the "Manual") which was first issued in December 2001. The principal purpose of financial penalties is to promote high standards of regulatory conduct by deterring those who have breached regulatory requirements from committing further contraventions and by demonstrating generally the benefits of compliant behaviour.

59. The FSA has considered the contraventions by STT and RDP in this context and has had regard in particular to the relevant factors set out in paragraphs 8.5 and 8.8 of the Manual. These factors are broadly the same as those set out in the FSA's Enforcement Manual and are considered below under the heading "Penalty".

Shell engaged in market abuse

60. The FSA considers that a regular user of the market was, and was likely to have been, given a false or misleading impression as to the price or value of UK listed Shell shares and that market abuse within the meaning of that expression in section 118(2)(b) of the Act occurred.

61. The behaviour of Shell considered by the FSA to amount to market abuse is:

    (a) Shell's announcements of its hydrocarbon reserves throughout the period 1998 to July 2004 in which Shell disseminated false or misleading information as to the true extent of its proved reserves;

    (b) as a result of announcing false or misleading proved reserves information, Shell announced false or misleading reserves replacement ratios for each year in the period 1997 to 2002 inclusive;

    (c) Shell failed to put in place or to maintain adequate internal guidelines accurately to assess the extent of its proved reserves throughout the period 1998-2003 inclusive;

    (d) Shell failed to put in place or to maintain adequate internal controls in relation to its proved reserves reporting and disclosure throughout the period 1998 to July 2004;

    (e) Shell did not follow up indications in 2000 and 2001 that its disclosed proved reserves were false or misleading;

    (f) Shell did not follow up warnings in 2002 and 2003 that its disclosed proved reserves were false or misleading;

62. By reference to the three required elements under section 118(1) of the Act (which makes reference to section 118(2)), the behaviour of Shell, as described in the preceding paragraph, amounted to market abuse in that the behaviour:

    (a) occurred in relation to UK listed Shell shares, which are qualifying investments traded on the LSE, which is a prescribed market for the purposes of the regime;

    (b) was likely to be regarded by a regular user of the LSE as that which would, or would be likely to, give a false or misleading impression as to the price or value of UK listed Shell shares; and

    (c) was likely to be regarded by a regular user of the LSE as a failure on the part of Shell to observe the standards of behaviour reasonably expected of a UK listed company traded on the LSE.

63. MAR 1.2.10 states that the regular user, when determining whether behaviour had fallen below the expected standards, would be likely to consider the need for market users to conduct their affairs in a manner that does not compromise "*the fair and efficient operation of the market as a whole or unfairly damage the interests of investors.*" Shell's conduct failed to meet this need.

64. The FSA considers that the regular user in relation to STT's listed equity securities should be given the attributes of the average investor in UK officially listed securities which trade as part of the FTSE 100 index. The FSA expects that the regular user would expect the information announced by such issuers of UK listed securities to be true and not false or misleading and that this expectation is fundamental to the fair and efficient operation of the market. Accordingly, the regular user in these circumstances would not expect the information disclosed to the market by STT and RDP as to Shell's proved reserves, being information which is relevant to determining the price or value of securities, to be false or misleading.

65. The FSA is therefore of the view that Shell's behaviour would be deemed by the regular user to have fallen below the standards expected of an issuer of UK officially listed securities which trade as part of the FTSE 100 index.

66. Under MAR 1.5 Shell's behaviour will amount to market abuse if it was likely to give rise to, or to give an impression of, a price or value of its UK listed securities which was materially false or misleading. In order to have been likely, there must have been a real and not fanciful likelihood that the behaviour would have had such an effect.

67. Shell's behaviour was such that it failed to correct the false or misleading proved reserves information it had announced and continued to announce to the market. This failure continued despite warnings that Shell's announced proved reserves were false or misleading from a number of internal and external sources including:

    (a) from staff who were responsible for determining and reporting on Shell's reserves;

    (b) through internal reports, notes, emails, reviews and presentations; and

    (c) negative external impacts on Shell's proved reserves.

68. In the period 2000 to 2003 Shell's dissemination of information which was relevant for the purposes of s118 of the Act created a false or misleading impression in the market as to Shell's proved reserves and RRR.

69. Shell's proved reserves, as announced to the market, were a key component of Shell's RRR. Shell's RRR was a key performance indicator for Shell and others in the oil and gas industry. As such, any material misstatement by Shell of its proved reserves or RRR was likely to give rise to a price or value for Shell's UK listed securities which was materially false or misleading.

STT and RDP breached the Listing Rules

70. By reason of the behaviour set out in paragraph 61 above, STT and RDP failed to take all reasonable care to ensure that its proved reserves and RRR which they announced to the market in the period 1998 to 2003 were not misleading, false or deceptive and did not omit anything likely to affect the import of that information.

Penalty

71. In determining the appropriate level of penalty in this case, the FSA has had regard to Chapter 14 of the Enforcement Manual ("ENF 14") headed "Sanctions for Market Abuse".

72. In enforcing the market abuse regime, the FSA's priority is to deliver clean, fair and orderly markets on which qualifying investments are traded and to protect market users from behaviour which falls below the standards reasonably expected of, amongst others, issuers of UK listed securities. The effective and appropriate use of the power to impose penalties for market abuse will help to maintain confidence in the UK financial system by demonstrating that high standards of market conduct are appropriately enforced in the UK financial markets. The public enforcement of these standards also furthers the public awareness of the FSA's protection of consumers objective, deterring future market abuse (ENF 14.1.3).

73. In accordance with the FSA's published policy (ENF 14.4), in determining whether to take action in respect of market abuse, and in determining the level of any penalty, the FSA has regard to all the circumstances, including the nature and seriousness of the abuse, the persons' conduct following the abuse, the nature of the market that has been abused, the likelihood of abuse of the same type being repeated, the need to deter such abuse and the previous history of the persons concerned.

74. Previous action taken by the FSA in similar cases would also normally be taken into account (ENF 14.4.2(5), 14.6.2(4) and 14.7.4(7)). However, as this is the first market abuse case based on false or misleading impressions given by a corporate entity considered by the FSA, no previous decisions are of direct relevance. The FSA has concluded that there is little guidance to be gleaned from action taken under its disciplinary powers in other types of cases and decisions made by predecessor bodies as to the penalties that are appropriate for this kind of conduct under the market abuse regime.

75. The FSA has taken all the relevant circumstances into account in deciding that it is appropriate to impose a financial penalty in this case and that the level of the penalty is

proportionate. The FSA has particular regard to the guidance set out in ENF 14.4, 14.6 and 14.7 and to the following considerations:

(a) Shell reported proved reserves which it either knew or ought to have known included reserves which were non-compliant with Rule 4-10;

(b) Shell was either reckless or took insufficient care as to the compliance of its reported proved reserves with Rule 4-10; and

(c) Shell either ignored or did not adequately respond to the indications and warnings given from January 2000 and:

  (i) did not further investigate its true proved reserves position;

  (ii) did not take sufficient steps until December 2003 to address this issue; and

  (iii) did not notify the market of its misstatements until 9 January 2004.

(d) Shell failed to maintain adequate internal controls over its reserves estimation and reporting processes. Shell also failed in several respects to implement and maintain internal controls sufficient to provide reasonable assurance that it was estimating and reporting proved reserves accurately and in compliance with applicable requirements. These failures arose from (i) inadequate training and supervision of the operating unit personnel responsible for estimating and reporting proved reserves in the first instance, and (ii) deficiencies in the internal reserves audit function.

  (i) Inadequate operating unit controls

  Shell's reserve estimation and reporting practices were largely decentralised in that they required operating unit personnel initially to determine resource volume categorisation, including estimating volumes of proved reserves for Shell's SEC filings and other public reporting. Shell, however, failed to ensure that its personnel were adequately trained with respect to the SEC's reporting requirements. Indeed, the GRA observed in January 2003 that operating unit comprehension of both Group guidelines and Rule 4-10 regarding proved reserves was generally lacking.

  (ii) The Group Reserve Auditing function was deficient and ineffective

  Shell's decentralised system required an effective internal reserves audit function. To perform this function, Shell had engaged as GRA a petroleum engineer – who worked only part-time and was provided limited resources and no staff – to audit its worldwide operations. Shell provided scant, if any, training on such important matters as how the role should be performed and the rules and standards on which opinions should be based. The nature of the GRA's appointment meant that he lacked authority to enforce either Rule 4-10 or Group reserves guidelines.

  To fulfil his duties, the GRA made visits to a handful of operating units per year. He then issued reports rating the operating unit's systems, compliance

with Group guidelines and audit response as *"good"*, *"satisfactory"* or *"poor"* and giving his opinion as to whether the operating unit's reported reserves met Group guidelines. The GRA's visits to operating units occurred only once every four or more years.

Critically, the position of GRA was not an independent role. The GRA reported to the management of Shell's EP business, meaning he was answerable to the same people he audited.

(e) The GRA issued an annual report on the reasonableness of Shell's year-end total reserves summary. The GRA stated that Shell's "[proved reserves] *statements fairly represent the Group entitlement to Proved reserves at the end of*" the relevant year. His report was reviewed by Shell's external auditors who sent a letter each year saying that they had performed a review in accordance with SAS 52. This review did not constitute an audit of Shell's proved reserves. The FSA has formed no view as to the reasonableness of any reliance placed on that review.

76. Shell's overstatement of proved reserves, and its delay in correcting the overstatement, resulted from:

(a) its desire to create and maintain the appearance of a strong RRR, a key performance indicator in the oil and gas industry;

(b) the failure of its internal reserves estimation reporting guidelines to conform to the requirements of Rule 4-10; and

(c) the lack of effective internal controls over the reserves estimation and reporting process.

77. The imposition of a penalty for market abuse is a very serious measure but the seriousness of the abuse in this case is such that the FSA considers the level of penalty is appropriate. The FSA's finding of market abuse, and the penalty imposed for that market abuse, covers the period from 1 December 2001, being the date on which the Act came into force and the market abuse regime became effective.

Shell's remedial action

78. Shell has undertaken substantial remedial efforts in connection with the reserves recategorisation as well as corporate governance issues raised following the recategorisation announcement, including the following:

- a determination to self-report the need for a recategorisation to both the public and the SEC prior to the involvement of any external governmental agency or public release of the reserves overstatement;

- an independent investigation into the facts and circumstances ordered by the GAC, the results of which have been provided to the FSA;

- retention of an independent reserves engineering firm to assist in a review of Shell's proved reserves, which led to the 18 March and 19 April 2004 announcements of additional recategorisations;

- formal review and approval of all reported reserves by Shell's Committee of Managing Directors and review by the GAC on an annual basis;

- enhancements to the resources of the GRA, including the provision for systematic and consistent use of external reserves experts in the audit process;

- a restructuring of the Group Reserves Audit function to report through the Group Internal Audit function, with direct access to the GAC;

- expansion of the Group Reserves Audit program to include more frequent and detailed audits, including annual audits of every major operating unit;

- implementation of a Global Reserves Committee within EP, including an approval process for all reserves through regional peer challenges on reserves decisions;

- a restructuring of the EP business to place reserves reporting within the technical reserves function rather than the planning function;

- strengthening of the line responsibilities for reserve reporting within EP to ensure that appropriate levels of authority and responsibility for reserves booking and de-booking decisions are assigned to local Chief Reservoir Engineers, local management and EP management;

- inclusion of reserves reporting in the existing Group assurance and disclosure controls review processes;

- focused and enhanced training of EP reserves staff worldwide to ensure that the SEC's rules, guidance and compliance requirements are communicated to and understood by all involved in the reserves estimation and reporting process;

- significant revision to the Shell guidelines to ensure that they provide clear direction compliant with the requirements of Rule 4-10 on the reporting of proved reserves;

- a restructuring of the Group finance function to make business unit chief financial officers report directly to the Group Chief Financial Officer;

- enhancement of the Group legal function to improve the ability of Group management to benefit from appropriate legal advice concerning potential corporate governance, reporting and disclosure issues;

- appointment of a non-executive chairman of STT and a non-executive chairman of the Conference of the boards of RDP and STT;

- creation of a committee of members of RDP and STT boards to study issues relating to the structure and governance of Shell, including consultation with shareholders and a public report of the results of the study; and

- a public commitment by the board of RDP to submit a proposal to shareholders at RDP's 2005 Annual General Meeting to abolish the *"priority shares"* in RDP.

IMPORTANT NOTICES

This Final Notice is given to you in accordance with Section 390 of the Act.

Manner of Payment

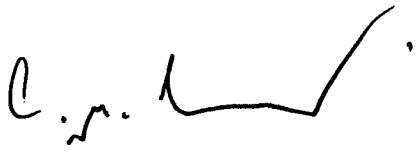
The financial penalty of £17,000,000 has been paid to the FSA in full.

Publicity

Sections 391(4), 391(6) and 391(7) of the Act apply to the publication of information about the matter to which this Final Notice relates. Under those provisions, the FSA must publish such information about the matter to which this Notice relates as the FSA considers appropriate. The information may be published in such manner as the FSA considers appropriate. However, the FSA may not publish information if such information would, in the opinion of the FSA, be unfair to Shell or prejudicial to the interests of consumers.

FSA contacts

For more information concerning this matter generally, you should contact David Blunt at the FSA (direct line: 020 7066 1608/fax: 020 7066 1609).



Carlos Conceicao
Head of Market Integrity
FSA Enforcement Division