



April 15, 2014

Elizabeth M. Murphy
Office of the Secretary
U.S. Securities and Exchange Commission
100 F Street, NE
Washington, DC 20549-1090

Subject: Rulemaking under Section 1504 of the Dodd-Frank Wall Street Reform and Consumer Protection Act

Dear Ms. Murphy:

The American Petroleum Institute (“API”) submits this comment letter regarding the Commission’s rulemaking under Section 1504 of the Dodd-Frank Wall Street Reform and Consumer Protection Act (“Dodd-Frank Act”).¹ This letter supplements our letter dated November 7, 2013, and addresses arguments raised by some commenters that Section 1504 is intended to protect investors.

1. Background

API is a national trade organization representing more than 580 companies involved in all aspects of the domestic and international oil and natural gas industry, including exploration, production, refining, marketing, distribution and marine activities. API’s member companies participate in an industry that is essential to the economic health of the United States and its citizens, who depend on ready access to reliable and affordable energy. In addition to supporting hundreds of thousands of U.S. jobs, millions of U.S. citizens invest in our companies through retirement and pension plans, mutual funds, and individual investments.

As API has made clear in prior comments—including our most recent letter dated November 7, 2013—API supports transparency. Many of our member companies are long-time, active supporters of voluntary transparency efforts such as the Extractive Industries Transparency Initiative (“EITI”). Many of our companies, and API itself, are also active stakeholders in the United States’ implementation of EITI. As explained in more detail in our prior letters, API strongly believes that transparency can be achieved in a manner that fulfills the Commission’s core mission to protect investors and promote efficient capital markets.

¹ Pub. L. No. 111-203, 124 Stat. 1376, 2220 (2010).

The United States has the deepest and most liquid capital markets in the world, thanks in large part to the soundness of the U.S. securities laws and the work of the Commission in administering and enforcing those laws. For over 70 years the Commission has carried out its mission to protect investors; maintain fair, orderly, and efficient markets; and facilitate capital formation. A Commission rulemaking requiring company-specific public payment disclosures would upend the Commission's traditional role, to the detriment of listed issuers, their shareholders, and the U.S. capital markets.

2. Section 1504 Is Not An Investor Protection Measure

Section 1504 is not intended to protect investors. Rather, it is socio-political legislation intended to inform citizens of the revenues their governments receive in return for natural resource development. Indeed, the sponsors of Section 1504 expressly claimed that it was intended to address a phenomenon known as the "resource curse," whereby "oil, gas reserves, and minerals . . . can be a bane, not a blessing, for poor countries, leading to corruption, wasteful spending, military adventurism, and instability"² when "oil money intended for a nation's poor ends up lining the pockets of the rich or is squandered on showcase projects instead of productive investments."³

The Commission has repeatedly confirmed the foreign policy purpose of Section 1504. In the preamble to its initial rule implementing Section 1504, the Commission expressly observed that the objectives of Section 1504 "do not appear to be ones that will necessarily generate measurable, direct economic benefits to investors or issuers."⁴ Indeed, the Commission acknowledged that the provision's purported "*social benefit differs from the investor protection benefits that [the Commission's] rules typically strive to achieve.*"⁵ The Commission further acknowledged that the provision could in fact harm investors, noting that "the cost of compliance for [Section 1504] will be borne by the shareholders of the company[,] thus potentially diverting capital away from other productive opportunities which may result in a loss of allocative efficiency."⁶ The Commission reiterated this view during oral argument before the D.C. Circuit, in which it described Congress's goal as "promoting the Federal Government's foreign policy objective to promote payment transparency."⁷ To adopt a contrary position in any future extractive industries rulemaking would be a dramatic course reversal without any reasoned basis.⁸

² 156 Cong. Rec. S3816 (May 17, 2010) (statement of Sen. Lugar), *quoted in Am. Petroleum Inst. v. SEC*, 714 F.3d 1329, 1331 (D.C. Cir. 2013).

³ *Id.*; *see also* 156 Cong. Rec. S5872 (July 15, 2010) (statement of Sen. Cardin, asserting that many of the world's "most wealthy mineral countries are the poorest countries" in terms of their citizens' quality of life).

⁴ Disclosure of Payments by Resource Extraction Issuers, Final Rule, 77 Fed. Reg. 56,365, 56,398/2 (Sept. 12, 2012).

⁵ *Id.* at 56,397/3.

⁶ *Id.* at 56,403/2.

⁷ *See* Transcript of Oral Argument at 32:21-25, 33:11-12, *Am. Petroleum Inst. v. SEC*, 714 F.3d 1329 (D.C. Cir. 2013) (No. 12-1398).

⁸ *See FCC v. Fox Television Stations*, 556 U.S. 502, 515 (2009) (agency must provide detailed explanation when "its new policy rests upon factual findings that contradict those which underlay its prior policy; or when its prior policy has engendered serious reliance interests that must be taken into account.").

The plain language of Section 1504 makes clear that it was not intended for the protection of investors. Had the provision been intended as an investor protection measure, Congress would have required in Section 1504 itself that individual company payment information be made public. Instead, in the version ultimately adopted, Section 1504 mandates only that the Commission make publicly available a “compilation of the information” submitted by issuers, and only “[t]o the extent practicable.”⁹ As noted by the U.S. District Court for the District of Columbia, “[a] natural reading of this provision is that . . . the Commission may selectively omit . . . from the public compilation” any information that would “impose high costs on shareholders and investors.”¹⁰ Congress’s past actions also support this view. Congress rejected a prior version of the provision that would have explicitly required companies to disclose payment information in an annual report filed with the Commission via its online “EDGAR system.”¹¹ It also declined to require that Section 1504 reports be part of the filings companies make for shareholder disclosure purposes, e.g., the 10K or 10Q.

Companion disclosure requirements enacted alongside Section 1504 as part of the Dodd-Frank Act further confirm that Congress’s aim was to address various foreign policy issues, not to protect investors. Section 1502, for example, mandates disclosures concerning whether certain conflict minerals used in a company’s products originated in the Democratic Republic of the Congo or any adjoining country, and if so, a detailed report describing the supply chain and custody due diligence measures undertaken by the company. Section 1503 similarly requires mining companies to include information about mine health and safety in their regular reports to the Commission. Such provisions, like Section 1504, were enacted to promote foreign policy objectives, not to protect investors.

In a widely reported speech earlier this year, the Commission’s Chair criticized Congress for saddling the Commission with duties that, in her words, “distract [the Commission] from other important rulemakings and initiatives that further [its] core mission” of investor protection. In referring to “the sometimes controversial nature of the Congressional mandates,” it is reasonable to infer that the Chair had in mind requirements such as Section 1504.¹² To now characterize Section 1504 as an investor protection measure would conflict with the Chair’s assessment of provisions such as these, and would invite Congress to enact more mandates of this nature that “distract” the Commission from its “core mission.”¹³

In the prior rulemaking under Section 1504, the Commission noted claims by certain commenters that the rule could “materially and substantially improve investment decision making.” The Commission studiously avoided adopting those dubious assertions as its own, however.¹⁴ And the D.C. Circuit has made clear that benefits claimed by a handful of investors—even a substantial segment of influential investors, such as public union pension

⁹ 15 U.S.C. § 78m(q)(3)(A).

¹⁰ *Am. Petroleum Inst. v. SEC*, 953 F. Supp. 2d 5, 15 (D.D.C. 2013).

¹¹ H.R. 6066, 110th Cong. § 3(a), (c) (2008); S. 3389, 110th Cong. § 3(a), (c) (2008).

¹² Mary Jo White, Chair, U.S. Securities and Exchange Commission, Chair’s Address at SEC Speaks 2014 (Feb. 21, 2014), available at <http://www.sec.gov/News/Speech/Detail/Speech/1370540822127#U0L1MvldVyJ>.

¹³ *Id.*

¹⁴ 77 Fed. Reg. at 56,398/2.

funds—cannot substitute for the Commission’s obligations to determine for itself the consequences of its rules. In the “proxy access” rulemaking, a substantial number of large investors claimed that a proxy access mechanism would bring significant benefits to shareholders generally. The court of appeals dismissed these claims, observing that “investors with a special interest . . . can be expected to pursue self-interested objectives rather than the goal of maximizing shareholder value.”¹⁵ So, here, the fact that a small number of investors with a special interest in extractive disclosure claim benefits from a highly granular disclosure regime is entirely insufficient for the Commission to find that disclosures of that nature would indeed benefit investors.

Even though Congress did not enact Section 1504 to protect investors, the Commission must adopt a rule that, to the extent possible, is consistent with the Commission’s “central purpose[.]” of investor protection.¹⁶ And the Commission must take care that its rule does not harm investors in ways that would conflict with the Commission’s other statutory obligations under the Exchange Act. For example, the Commission is obligated to exercise its judgment to determine its rules’ effects on “efficiency, competition, and capital formation” and “the protection of investors,” and it is prohibited from imposing burdens on competition that are unnecessary to further the purposes of the Exchange Act.¹⁷ These obligations must inform the Commission’s decisions in *every* rulemaking—including under Section 1504.

Under these provisions, the Commission must “determine as best it can” the costs and benefits of its proposals,¹⁸ and then “consider” those costs and benefits when writing a rule.¹⁹ In so doing, the Commission is responsible for “*weighing* the rule’s costs and benefits”—including any “cost[s] at the margin”—in order to determine its “net benefit.”²⁰ It is not sufficient to rely upon scant empirical data to conclude that the rule will certainly produce the claimed benefits.²¹ Applying this standard, commenters advocating for company-specific public disclosures have not come close to establishing that the Commission must adopt an onerous, company-specific disclosure regime to satisfy its obligations under Section 1504.

3. The Information Covered By Section 1504 Is Immaterial And Risks Harming Investors By Inundating Them With Unhelpful Information

Public companies in the extractive industry sectors are already subject to a host of statutory and regulatory requirements under the securities laws that give shareholders ample information to make informed investment decisions. The Commission must consider this baseline of available information in determining what additional disclosures are required under

¹⁵ *Bus. Roundtable v. SEC*, 647 F.3d 1144, 1152 (D.C. Cir. 2011).

¹⁶ *Tcherepnin v. Knight*, 389 U.S. 332, 336 (1967).

¹⁷ 15 U.S.C. §§ 78c(f), 78w(a)(2), 80a-2(c).

¹⁸ *Chamber of Commerce v. SEC* (“*Chamber I*”), 412 F.3d 133, 143 (D.C. Cir. 2005).

¹⁹ 15 U.S.C. §§ 78c(f); 80a-2(c).

²⁰ *Bus. Roundtable*, 647 F.3d at 1151, 1153 (emphasis added).

²¹ *See id.* at 1150-51 (insufficient for Commission to rely on “two relatively unpersuasive studies” when it concluded that a rule would improve board performance and increase shareholder value).

Section 1504, and it should not promulgate a rule that would force investors to bear the cost of unnecessary, immaterial company-specific disclosures.

Under the Supreme Court’s familiar formulation of materiality,

[a]n omitted fact is material if there is a substantial likelihood that a reasonable shareholder would consider it important in deciding how to vote What the [materiality] standard does contemplate is a showing of a substantial likelihood that, under all the circumstances, the omitted fact would have assumed actual significance in the deliberation of the reasonable shareholder. Put another way, there must be a substantial likelihood that the disclosure of the omitted fact would have been viewed by the reasonable investor as having significantly altered the ‘total mix’ of information made available.²²

As the Supreme Court added:

Some information is of such dubious significance that insistence on its disclosure may accomplish more harm than good. The potential liability for a Rule 14a-9 violation can be great indeed, and if the standard of materiality is unnecessarily low, not only may the corporation and its management be subjected to liability for insignificant omissions or misstatements, but also management’s fear of exposing itself to substantial liability may cause it simply to bury the shareholders in an avalanche of trivial information—a result that is hardly conducive to informed decisionmaking.²³

The Commission has expressed similar concerns. For example, in its December 29, 2003 guidance regarding Management’s Discussion and Analysis, the Commission warned that “companies must evaluate an increased amount of information to determine which information they must disclose. In doing so, companies should avoid the unnecessary information overload for investors that can result from disclosure of information that is not required, is immaterial and does not promote understanding” The UK Financial Reporting Council commented similarly in its 2009 publication *Louder than Words*, stating that “preparers should remember that immaterial disclosures undermine the quality of reports and make a concerted effort to cut clutter.”²⁴ More recently, the Commission’s Chair commented in an October 2013 speech that “[w]hen disclosure gets to be ‘too much’ or strays from its core purpose, it could lead to what some have called ‘information overload’—a phenomenon in which ever-increasing amounts of

²² *TSC Industries, Inc. v. Northway, Inc.*, 426 U.S. 438, 449 (1976); see also *Basic v. Levinson*, 485 U.S. 224 (1988).

²³ *TSC Industries*, 426 U.S. at 448.

²⁴ Available at <https://frc.org.uk/getattachment/7d952925-74ea-4deb-b659-e9242b09f2fa/Louder-than-words.aspx>; see also *In re Time Warner Sec. Litigation*, 9 F.3d 259, 267 (2d Cir. 1993) (“a corporation is not required to disclose a fact merely because a reasonable investor would very much like to know the fact”).

disclosure make it difficult for an investor to wade through the volume of information she receives to ferret out the information that is most relevant.”²⁵

Against this standard, the company-specific public payment disclosures advocated by some commenters would not add any new *material* information to the total mix of information which SEC registrants already disclose. These disclosures would, however, increase the volume of unnecessary, unhelpful, and potentially confusing information presented to investors that Chair White has criticized. Detailed company-by-company public disclosure of payment information under Section 1504 is not information that a *reasonable investor* would deem important in making a voting or investment decision.

U.S.-listed companies, and oil and gas companies specifically, already are subject to a host of disclosure requirements that provide investors ample information about potential risks in the company’s operations, including those overseas. Regulation S-K requires the following extensive and detailed disclosures, among others:

- Item 101(c)(vii): Requires disclosure of the dependence of any business segment upon a single customer or a few customers;
- Item 101(c)(ix): Requires disclosure of any material portion of the business that may be subject to renegotiation of profits or termination of contracts or subcontracts at the election of the government;²⁶
- Item 101(d): Requires disclosure of financial information about geographic areas where the registrant engaged in business, including revenues from foreign customers and certain long-lived assets located in foreign countries—reported on an individual-country basis, if material; also requires disclosure of any risks attendant to foreign operations, and any dependence of a segment upon such foreign operations;
- Item 303: Requires a detailed discussion of known trends or uncertainties that have had, or that the registrant reasonably expects will have, a material favorable or unfavorable impact on the registrant’s liquidity, capital resources, or results of operations, and other events or uncertainties necessary to enable investors to assess the financial condition and results of operations of the registrant or that could cause reported financial information not to be necessarily indicative of future operating results or financial condition;²⁷ and
- Item 503(c): Requires disclosure in registration statements and prospectus documents of the most significant specific factors that make an investment speculative or risky.

²⁵ Mary Jo White, Chair, U.S. Securities and Exchange Commission, The Path Forward on Disclosure, Remarks at the National Association of Corporate Directors Leadership Conference (Oct. 15, 2013), *available at* <http://www.sec.gov/News/Speech/Detail/Speech/1370539878806#.UzylDfldVyI>.

²⁶ While the regulation does not specify what “government” is being referred to, it is plain that the purpose of the provision is for companies to disclose all material risks resulting from government modification or termination of contracts—whether foreign, federal, state, or local.

²⁷ In this regard, the Commission, in its September 17, 2010 guidance on Presentation of Liquidity and Capital Resources Disclosures in Management’s Discussion and Analysis, reminded companies that “disclosure is required in MD&A where a known commitment, event or uncertainty will result in (or is reasonably likely to result in) the registrant’s liquidity increasing or decreasing in a material way.”

Additionally, under Rule 12b-20, a company must disclose any further information that is necessary to ensure that the required statements are not misleading, in light of the circumstances in which they are made.

On top of these general disclosure requirements, Subpart 1200 of Regulation S-K was adopted (and recently revised) specifically to ensure that material information unique to the oil and gas industry is disclosed to investors. Those disclosures include:

- Item 1202: Requires disclosure of proved reserves for any country containing more than 15% of registrant's total reserves;
- Item 1204: Requires disclosure of production, production prices, and production costs on a similar basis as in Item 1202;
- Item 1205: Requires disclosure of drilling and other exploratory and development activities by geographical area, as defined under Item 1201 to include individual countries as appropriate;
- Item 1206: Requires disclosure of wells being drilled and other present activities by geographical area, defined to include individual countries as appropriate;
- Item 1207: Requires disclosure of delivery commitments by geographical area, defined to include individual countries as appropriate; and
- Item 1208: Requires disclosure of wells and acreage by geographical area, defined to include individual countries as appropriate.

Finally, the Commission has made clear that, even if disclosure rules do not expressly require a registrant to identify operations or results relating to a particular country, the registrant is obligated to make such disclosure if necessary to ensure that the information provided is not misleading.²⁸

In light of the Commission's comprehensive regulation of disclosures in the extractive industries, any attempt to supplement these disclosures must include an assessment of the degree and efficacy of existing regulation. In *American Equity Investment Life Insurance Co. v. SEC*, for example, the D.C. Circuit invalidated a Commission rule that provided for federal regulation of fixed index annuities, a product already comprehensively regulated by state insurance agencies.²⁹ The Commission had said the rule was beneficial because it would increase price transparency, information disclosure, and competition.³⁰ But the Court rejected that explanation, holding that the Commission had given insufficient consideration to the price transparency and information disclosure that already resulted from state insurance regulation, as well as the effects of state regulation on competition in the fixed index annuity market.³¹ So too, here, a comprehensive assessment of existing material disclosure regulations is necessary.

²⁸ See *In the Matter of Caterpillar Inc.*, Exchange Act Release No. 30532, 50 S.E.C. 903 (Mar. 31, 1992).

²⁹ 613 F.3d 166, 178 (D.C. Cir. 2010).

³⁰ *Id.* at 177-78.

³¹ *Id.* at 178.

Under existing disclosure rules, companies will in many cases have to disclose their proved reserves in foreign countries, as well as the location of any drilling, wells, and other exploratory and development activities, among other things. Under API's proposed approach to Section 1504, investors would also receive aggregated payment information reflecting U.S. listed companies' collective investments in foreign countries by type of payment, government payee, and project.³² Thus, the commenters who advocate company-specific public payment disclosures bear the heavy burden of showing that investors who are *already aware* of a company's investment in a foreign county also need to see company-specific payment streams to make an informed investment decision—at the cost of *billions* of dollars to American businesses. This burden simply cannot be met.

Some commenters have recommended that the Commission adopt the European Union ("EU") definition of "project." However, as noted in our letter of November 7, 2013, implementation of such a definition would likely overwhelm investors with immaterial information. Some companies are party to tens of thousands of contracts and leases. Individual payments under these contracts could number in the hundreds of thousands. This disclosure would clearly obfuscate any material information. At the same time, the disclosure would be difficult for citizens of resource-producing countries to utilize for purposes of holding their governments accountable because—unlike API's proposal for project-level reporting—the payment information could not be readily compiled by type of resource, type of development, or location of the extraction activity.³³

4. Company-Specific Disclosures Will Harm Investors, Rather Than Protecting Them

The company-specific public disclosures demanded by some commenters will harm rather than protect investors by inundating them with immaterial information that is potentially misleading, and by subjecting the companies in which they are invested to exorbitant disclosure costs.

Public disclosure of payments on a company-by-company basis poses a substantial risk of investor confusion, because payments to foreign governments are only a small part of the overall transactional relationship governed by any given extractive agreement. Information about the size of annual payments is of little use to investors without additional contextual information regarding other contract terms, such as the scope of activities and the extent of the underlying resources. At the same time, this contextual information is almost invariably commercially sensitive, and disclosure of such information would violate Section 23(a)(2) of the Exchange Act by unnecessarily burdening competition. By examining company-specific payment information alone, an investor might draw erroneous conclusions about a company's conduct. To avoid this, the company could well be forced to choose between: (1) disclosing sensitive information about

³² See API Comment 3 (Nov. 7, 2013).

³³ Some commenters also argue that project-level disclosure would help uncover corrupt payments. However, the Foreign Corrupt Payments Act proscribes illicit payments to foreign officials, not the legitimate payments to foreign governments that would be disclosed under Section 1504.

the contract, in an effort to defend or explain itself; or (2) declining to reveal such information, at the risk of being misperceived by investors or the public.

If the Commission were to promulgate a rule requiring company-specific public disclosures, the potential competitive harms for U.S.-listed companies would be manifold. More than 90% of the world's oil reserves are owned or controlled by state-owned oil companies,³⁴ many of which are not subject to either the Commission's jurisdiction or the EU's rigorous disclosure requirements. Competitors could examine the disclosures of U.S. issuers to discern commercially sensitive information, and countries wishing to avoid disclosure could divert their business to foreign competitors not subject to the U.S. disclosure rule.

Moreover, 46 of the top 100 oil and gas companies are listed only in the United States. Because many U.S.-listed companies have no reportable operations in Europe at all, or conduct only limited operations through European subsidiaries, they are not subject to the competitively harmful disclosure regime currently being developed in EU countries. A company-specific public payment disclosure regime would, therefore, subject many U.S. registrants for the first time to a costly, unjustifiable, and competitively harmful disclosure regime. As API has previously stated, we believe the best approach is for the United States to exercise leadership in global transparency by pursuing a collaborative and constructive rule-making along the lines outlined in API's November 7, 2013 submission, rather than following the approach currently under development in the EU, which would be both competitively harmful for companies and their shareholders and ineffective for citizens trying to hold their governments to account.

Were the Commission to conclude that company-specific payment information is material to investors, the Commission should examine whether such disclosures ought to be required for all industries—including financial, technology, and pharmaceutical companies, among others—via rulemaking under Regulation S-K. If such detailed disclosures are, in fact, material, there is no principled reason why they should be limited to resource extraction companies.

* * *

In conclusion, we ask the Commission, as other commenters have, to proceed with a new rulemaking under Section 1504 as part of its 2014 agenda. API reiterates, however, that Section 1504 is intended solely for broad social and foreign policy purposes associated with resource transparency, and urges the Commission to implement the provision with that end in mind. In the context of existing Commission requirements to disclose material information about a registrant's operations and activities in a particular country—including the extensive and highly detailed special disclosure requirements applicable to oil and gas companies under Part 1200 of Regulation S-K—any further mandated disclosures of company-specific payment information under Section 1504 would not be material to reasonable investors. To the contrary, as API has explained in more detail in prior comment letters, disclosure of company-specific payment

³⁴ <http://www.api.org/oil-and-natural-gas-overview/industry-economics/~media/Oil-and-Natural-Gas-images/Earnings-Perspective/Earnings-high-res/2012-Largest-Oil-Companies-Reserves.ashx>

information has the potential to cause grave harm to shareholders by revealing proprietary commercial information to the company's state-owned competitors.

API appreciates the opportunity to submit these comments, and welcomes the opportunity to meet with any of the Commissioners or their staff to discuss these issues or any other issues of interest. Please direct any questions about this letter to Peter Tolsdorf, Senior Counsel, API, at tolsdorfp@api.org or (202) 682-8074.

Sincerely,



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Chairman
API General Finance Committee



Stephen Comstock
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Cc:

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