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Iraqi Transparency Alliance for Extractive Industries (ITAEI)

10 March 2020

Vanessa A. Countryman
Secretary, Securities and Exchange Commission
100 F Street NE, Washington, DC 20549-1090.

CC:
Mr. William Hinman, Director, Division of Corporate Finance
Mr. Barry Summer, Associate Director, Division of Corporation Finance
Ms. Elizabeth Murphy, Associate Director, Division of Corporate Finance
Mr. Elliot Staffin, Special Counsel, Division of Corporation Finance

RE: Dodd-Frank 1504, File No. S7-24-19

Dear Chair and Commissioners:

We value your effort and thank you for your cooperation. On behalf of the Iraqi Transparency Alliance for Extractive Industries (ITAEI), I write in support of a strong implementing rule under Section 1504 of the Dodd-Frank Wall Street Reform and Consumer Protection Act. A strong rule that requires project-level reporting could drastically enhance Iraq's ability to tamper down corruption and ensure that its resource revenues are used to benefit the country's development and its people.

ABOUT THE IRAQI TRANSPARENCY ALLIANCE FOR EXTRACTIVE INDUSTRIES

ITAEI is a coalition of more than 52 activists from non-governmental organizations, trade unions, media institutions, academics, and experts in law, oil, and economy. It is an independent voluntary coalition that works on transparency, accountability, and good governance of extractive industries. Oil and gas revenues are the main artery of the Iraqi economy and its way towards development and economic well-being. Our coalition aims at maximizing the returns from natural resources and guaranteeing their optimal investment for enhanced development.

We also believe that transparency and accountability are key components in the fight against the resource curse and corruption in Iraq's extractives sector. These efforts are critical in curtailing

public unrest and potential conflict that can arise from suspected corruption and misconduct within the government. In this way, we believe that greater transparency and accountability in Iraq's oil and gas sector is paramount to ensure lasting peace in our country.

THE OPPORTUNITY

American Senator John Cornyn once argued that building the rule of law in Iraq was key to the United States' interests in our country. He said, "In order for Iraq to grow and blossom from the rubble, it requires security; it requires order; it requires the rule of law. No system of justice can survive in the absence of law and order. And there can be no democratic Iraqi state as long as lawlessness reigns."[1] To this day, we continue to struggle with building the rule of law and citizens' faith in institutions. When stability and predictability exist, citizens are incentivized to act within accepted laws and norms. Without the rule of law, even ethically and morally conscious citizens must pursue corrupt practices because of an absence of trust, opportunity, and predictable legal consequences. Research shows that transparent, intelligible, and enforceable contracts are a key component in establishing the rule of law and that it is critical for a country to build a "rule-of-law culture."[2] A strong Dodd-Frank 1504 rule would give the United States the opportunity to lead by example in establishing rule-of-law culture in Iraq's oil and gas sector and modeling transparency in its contracts.

Iraq is endowed with tremendous natural resources, which should allow for its citizens to enjoy a remarkably high level of economic and social well-being if these resources, primarily oil and gas, are well governed. In the past ten years, revenues from oil and gas have comprised two thirds of Iraq's GDP and over 95 percent of its public revenues. Extractive companies operating in Iraq include many that are listed on the New York Stock Exchange, such as Chevron, ExxonMobil, and Royal Dutch Shell.

Oil and gas revenues represent 96 percent of revenue for Iraq's 2020 budget. The industry truly is the backbone of our national economy. Despite our tremendous resource wealth, Iraq is ranked 176 of 182 countries on the 2019 Human Development Index, which is based on international standards for development. Moreover, Iraq is one of the world's most corrupt countries: in its 2019 Corruption Perceptions Index, Transparency International has ranked Iraq as the 162nd most corrupt out of 180 countries. Iraq is the sixth most corrupt country in the world according to the World Bank's composite Governance Indicator, which scored us at 7.6/100 for "Control of Corruption."

Political scientist Michael Ross finds that in part because of its proclivity to corrupt practices, oil wealth breeds conflict, not only between countries, but also within them, as is the case with Iraq.[3]

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[1] John Cornyn, "Establishing a Rule of Law in Iraq," Website of US Senator John Cornyn, 2 May 2003, https://www.cornyn.senate.gov/content/establishing-rule-law-iraq.

[2] "Rule of Law." *The Beginner's Guide to Nation-Building*, by James Dobbins et al., RAND Corporation, Santa Monica, CA; Arlington, VA; Pittsburgh, PA, 2007, pp. 73–108. *JSTOR*, www.jstor.org/stable/10.7249/mg557srf.13. Accessed 4 Feb. 2020.

[3] Ross, 2008: file:///Users/aubreymenard/Downloads/Blood_Barrels_Why_Oil_Wealth_Fuels_Conflict.pdf

Specifically, developing countries that produce oil are twice as likely to suffer internal rebellions than non-oil producing ones. Oil wealth can also extend the length of conflicts: in non-wealthy states, rebellions often end when the rebels run out of money. However, in states like Iraq, rebellions can continue funding themselves by stealing oil and selling it on the black market. Because oil wealth often favors the economic development of some regions over others, it increases separatism, as some people in petroleum-rich regions seek autonomy from the federal government. While the political motivations surrounding Kurdistan Regional Government's autonomy are more complex, we've repeatedly seen how lack of transparency around oil revenues fuels conflict as it relates to the region (we discuss these payment systems in detail below).

It is because of this dire corruption that we so desperately need the SEC rule to require detailed, project-level disclosure. Currently, Iraq's enabling environment allows for this ubiquitous corruption. We lack an open budgeting process, have low levels of accountability, high levels of government ineffectiveness, and the absence of the rule of law. Combined, these problems mean that a huge proportion of oil revenues are lost and cannot benefit the Iraqi people. Our oil and gas revenues should be used to provide public services and to help our country achieve its development goals.

Instead, around $65 billion in illicit funds left Iraq between 2001 and 2010, as estimated by US-based NGO Global Financial Integrity. Iraq's Board of Supreme Audit confirms that up to $40 billion may leave the country annually because of corruption. The OECD estimates that oil smuggling cost Iraq nearly $7 billion between 2005 and 2008 alone and has not since abated. These revenues could have placed our country amongst the world's richest and aided our post-war reconstruction and development. Instead they ended up in the pockets of corrupt elites. A strong Dodd Frank 1504 rule could help Iraqi civil society to ensure that such staggering losses do not continue to occur.

IRAQI OIL AND GAS FINANCIAL FLOWS

Iraq's oil and gas financial system operates differently than most other countries: international oil companies deposit their payments for Iraqi oil in the Development Fund for Iraq (DFI), a trust fund held in the Federal Bank of New York. After 5 percent is deducted to pay Kuwait for war reparations, the DFI sends the remainder of these revenues to Iraq's Ministry of Finance. The Ministry then creates a budget, allocating funds to provinces and ministries. Three criteria determine how the Ministry distributes these revenues to each province:

1. Population size of the province
2. Size of areas affected by extraction
3. Petrodollars allocated to oil and gas producing provinces or to provinces hosting oil refineries.

According to the 2010 Budget Law, which is currently in force, every province receives $1 per barrel of oil it produces, exports, or refines. This means that the subnational resource revenue sharing scheme in Iraq is derivation-based—revenue is shared based on the amount of oil produced or refined in a specific geographic area. The provinces have called for an increase of this amount;

however, given the country's economic and security situation due to the war against ISIS and the international drop of oil prices, the amount has remained the same.

The Ministry of Oil is responsible for providing the Ministry of Finance with all the data on extraction, exportation, and refining, so that it may calculate the petrodollar value for every province, and include it in a special clause in each year's budget. The abovementioned law stipulates that petrodollar allocations shall be solely and exclusively spent for two purposes: 1) to repair infrastructure damage caused by extraction, 2) to minimize environmental damage caused by extraction that affects both citizens and society. Reality has shown that these sums, which were estimated to have been hundreds of millions of dollars, were not spent as prescribed due to entrenched corruption. Their misuse has resulted in uneven amounts allocated for development for every province, which has in turn caused a discrepancy in development and a dangerously staggering difference in poverty levels amongst all Iraqi provinces.

CORRUPTION HAS EXACERBATED DEVELOPMENT CHALLENGES

Widespread corruption, sectarianism, and political quotas, alongside the absence of oversight and accountability of any sort, have brought all economic, agricultural, industrial, and investment activities beyond the oil sector to a halt. Consequently, unemployment rates have skyrocketed reaching 21 percent in Baghdad, Basra, Salaheddin and Anbar, 30 percent in Babel, Al-Qadisiyah, Dhi Qar, Maysan, Mosul, 48 percent in Erbil and Sulaymaniah, and finally 6 to 10 percent in Dohuk northern Iraq. Furthermore, the utter absence of sustainable development led to a 30 percent increase in the housing crisis and a 40 percent decrease in health care and hospitalization. Private sector participation in the gross national product plummeted from 39 percent to less than 9 percent. In the field of education, the shortage of school buildings has reached 40 percent. Unemployment, lack of job opportunities, and poor wealth distribution have caused a 20 percent poverty rate amongst all Iraqis, an illiteracy rate of more than 23 percent, and a flagrant regression of women's social and public roles.

According to open budget surveys conducted in previous years, Iraq's budget has been amongst the worst organized, scoring only 10 out of 100 possible points because it presents little information on calculations and was not prepared with public consultations or citizens' participation. These contribute to a lack of government accountability for decisions pertaining to resource allocations, expenditures, and budget disclosures. For instance, it remains unclear how Iraq's 138-billion-dollar budget was spent, and why the 2020 budget deficit reached 48 percent (with a budget of $132 billion) with no clear plans to reduce it. The Iraqi budget is inextricably linked to our country's oil and gas revenues. As a result, any sort of corruption in the oil sector will affect every financial aspect in the State. A strong Dodd-Frank 1504 rule presents an opportunity to enshrine transparency and accountability at the highest level of the budgeting process, which could serve as precedent for establishing greater clarity throughout the budgeting process and allow citizens to monitor revenue flows.

Iraqi citizens have repeatedly voiced their desire for a more transparent government that uses the country's fiscal resources to advance development objectives. In October 2019, mass protests erupted across Iraq as citizens voiced their frustration with corruption, high unemployment, and inefficient public services. Iraqis called for the end of the political system that was created by the US-led invasion of Iraq, which they perceive as being rife with corruption. With Dodd Frank 1504, the US can make progress towards helping the system that it helped create be more transparent, democratic, and accountable to its people.

THE NEED FOR PROJECT-LEVEL DATA

Citizens most impacted by extraction, such as communities located near extraction sites, will require project-level data in order to determine whether they are receiving a fair share of services from their local governments and social benefits from companies operating in their areas based on contracts signed between these companies and the federal government. Since Iraq uses a derivation-based formula for oil revenue sharing, citizens must have access to payment data for each separate project to verify that the revenues being remitted by central government for the oil produced or refined from projects in their locality are accurate. These funds are necessary for providing services, implementing projects to minimize environmental and social damages caused by extractive industries, and compensating for any damages to these communities' properties, livelihoods, professions, and tribal traditions. Knowing whether and with what funds companies intend to address damages can be crucial knowledge for local communities to have when deciding whether to extract their natural resources and to give extraction companies social license to operate on their lands. For example, a village located near an extraction site might draw on project level data to discover that the provincial government is generating huge sums of money from a nearby project, yet providing relatively paltry services to the affected village. In such a case, project-level payment information could be used by civil society organizations to effectively lobby for additional expenditures.

Contract-based project level disclosures provided to the SEC by companies are especially important in our context given the opacity of our national budgeting processes and rampant corruption. Provincial governments must have better ways to validate the revenues remitted to them by the central government since they cannot be assured of proper conduct and fair dealing within the central government. Without the tools to hold the central government accountable, localities become suspicious.

The Kurdistan Regional Government (KRG) uses a different system than the rest of Iraq to govern its extraction contracts. Public, project-level reporting under Dodd-Frank 1504 would be especially useful considering the production sharing agreement (PSA) model used in the region. The Kurdistan region is a federal autonomous region of about 10,000 km^2 in the north of Iraq that contains three governorates (Erbil, Sulaymania, Dhok). In principle, KRG must follow the Iraqi central government in Baghdad's oil and gas polices as this wealth is considered sovereign wealth. Unfortunately, KRG is not compliant with Iraqi EITI, and since 2010 has refused to provide any information for the Iraqi

central government about oil companies, contracts, oil and gas exports, and the revenues it has received to the Iraqi government and its Finance and Oil Ministry.

This has been a pending issue and a main point of contention between the central federal government of Iraq and the KRG since 2005. Three years ago, the KRG agreed to give the federal government revenue generated by export of "550 thousand barrels per day" from oil fields in the KRG, as well as some oil fields in Kirkuk through Turkey's Jihan port. In return, the federal government would allocate its entire share of 12.7 percent of the federal budget to the KRG. However, as of now, this agreement is yet to be honored by the KRG, though it was supposed to enter into force as of 1 January 2020. It is the KRG's non-disclosure of the real oil volumes exported that has prevented the agreement from progressing. Without the export revenue data, it's impossible to accurately assess how much the KRG should be paying the central government. Absent this, the central government is not inclined to share federal budget revenue with the KRG. The extraction companies, which do not disclose the volumes that they produce or export from the region, are complicit in the country's inability to appropriately assess and allocate this wealth.

In Kurdistan, project-level reporting will help us identify payments made by companies such as ExxonMobil, which have signed separate PSAs with the KRG, and without approval from the central federal government in Baghdad. If the companies disclose their payments, we can compare the company's payments data with the figures the KRG is required to disclose (but is not disclosing). This comparison will be very useful to fairly estimate the sums allocated to the three KRG provinces (Erbil, Sulaymania, Dhok) in the annual budget with the petro-dollar amounts for the oil-producing governorates. A transparent system will help ease tension between the KRG and the Iraqi central government.

IRAQ'S TRANSPARENCY EFFORTS

In 2009, the Iraqi government voiced its intention to join the Extractive Industries Transparency Initiative, a global standard to promote accountable management of oil, gas, and mining resources. In the ensuing years, Iraq took the necessary steps to be accepted as a candidate country and submitted its first report. While the international community heralded this initial progress, the intervening years have offered little progress.

Before EITI reports were published, there was no public information on what revenues went to the Development Fund for Iraq (DFI). Now, information regarding the volumes and values of oil produced by companies is available in Iraq's EITI reports, and is disaggregated by producing fields. A shortcoming of our current EITI is that it does not yet require more disaggregated info, which minimizes the information's utility. Project-level information for every field is necessary, albeit currently unavailable. Because some of Iraq's oil fields are so large, in some cases, many companies operate in a single field. It is therefore necessary that information is also disclosed at a project level so that we can see what each company is contributing.

Despite the limited data available, civil society has already been able to use the EITI data to monitor the revenues going to the Development Fund for Iraq (DFI) and compare them to the revenues reported in the Iraqi budget, in order to establish whether or not the numbers are the same. For example, in discussing the 2016 EITI report with the Wasit Governorate Council and Governorate Court, it became clear that there was a major discrepancy between the petro-dollars that the general budget allocated to the Governorate and what they actually received. Following this discovery, the Wasit Governorate requested that the central government disburse the rest of the amount their governorate was owed.

Local civil society organizations (CSOs) are actively training journalists, economists and stakeholders throughout the country on how to analyze the data that is currently publicly available. We hope to see more examples of data generating accountability as it has in Wasit as more data becomes available and more people learn how to use it.

THE LIMITATIONS OF AVAILABLE DATA

EITI data is certainly an improvement upon what was previously available. While we have put the data to good use, there are some serious shortcomings in available data that prevent civil society organizations like mine from properly monitoring the flow of money in our oil sector. First, EITI data in Iraq is reported by field, but some fields are enormous, and therefore it is difficult to break down payment information for individual projects. For example, more than $300 million in payments have been made for extraction on the Rumaila field—a super-giant oil field, covering around 700 m2, with around 270 production wells in operation, producing around 1.3 m barrels per day and where British Petroleum (BP) and several other IOCs operate. Though in some cases, several wells are governed by a single contract, Rumaila is clearly not a single project. Without project-level information, we cannot see the detailed roles that individual companies are playing in the region, monitor revenue flows from company to government, and evaluate whether Iraqi citizens are seeing the appropriate benefits from the extraction. The EITI report has data that is disaggregated by field, but not by *company* by field. If, as is quite common, the field has more than one company operating on it, then the data provided by the EITI report does not indicate what each company is producing (by value or volume).

With a strong rule for Section 1504, the project-level reporting required of companies complying with Dodd Frank will allow the Iraqis to know these important details. Specifically, we request that the Dodd-Frank 1504 rule align with the project definition and requirement that each company publicly report disaggregated project payment that are already in the EU Accounting and Transparency Directives. To anonymize the information would make it impossible to discern which companies made which payments and render such obscure information useless. Similarly, to allow companies to compile information across many individual projects and report it as though for only one project, as the SEC would allow in the new rule, would be very confusing. It would make monitoring revenue flows substantially harder, and would be so different than how European and

other companies report, and how the government information we have is described, and thus would make it impossible to understand together.

Indeed, in 2013, the EITI recognized the need for project-level disclosure and changed the Standard to reflect that. However, the only detailed activity by company that was reported in Iraq's most recent EITI reports is that of SOMO, the national oil company. SOMO reports the value of the oil it distributes to each oil company (many oil companies receive in-kind payments of oil and gas itself). Yet Iraq's EITI report does not publicize oil production data by company. Therefore, there is no way to reconcile what is being produced by a company in the field with what is being distributed by SOMO to each company. A strong Dodd-Frank 1504 rule would provide this critical data.

Also not included in the EITI reports are payments made by companies to the KRG. No data from the KRG is currently included in the EITI reports, due to an adapted implementation clause that allows Iraq to publish its EITI reports without any data from the KRG. Though the KRG's Ministry of Natural Resources does publish figures, there is no way of reconciling these numbers, since international oil companies operating in the region do not currently publish their payments anywhere. This has recently changed since companies, including Talisman Energy, Perenco, and Gazprom, have started to report in line with the EU Accounting and Transparency Directives and Canada's Extractive Sector Transparency Measures Act (ESTMA). Once Dodd-Frank 1504 is implemented, companies like Chevron and Hess will be added to this list. The implementation of a strong rule will indeed be critical to preserving Iraq's unity and guaranteeing that all Iraqis benefit from the available resources, in an equal and transparent manner.

On behalf of ITAEI and of civil society in Iraq, I therefore strongly urge the SEC to issue a strict rule implementing Dodd-Frank 1504, at the earliest possible opportunity. We recommend that the SEC strongly consider a project definition that will be consistent with the way it is normally used by industry, and with how other companies already report payment information, so that it will yield clear and useful information that we can use to combat corruption, which will in turn help bring stability and the rule of law to Iraq. Iraqi civil society has already made extensive use of the data available through the EITI, and we look to you to assist us by ensuring that companies provide more complete data, which can be useful for all of Iraqi society.

Thank you for your consideration.

Sincerely,
Majid Abu Kelal
Coordinator, Iraqi Transparency Alliance for Extractive Industries