March 16, 2020

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

rule-comments@sec.gov

Re: File Number S7– 24–19

Public Citizen Comments on Proposed Rule for Disclosure of Payments by Resource Extraction Issuers—Section 1504 of The Dodd-Frank Wall Street Reform and Consumer Protection Act

Public Citizen is one of America’s largest research and advocacy organizations representing the interests of household consumers. We promote transparent energy and financial markets on behalf of our over 500,000 members and supporters across the U.S.

Congress enacted Section 1504 of The Dodd-Frank Wall Street Reform and Consumer Protection Act to require public disclosure of certain foreign payments by oil companies. The clear objective of this law is to provide civil society organizations, policy makers, a free press and other stakeholders with public access to certain financial payments made by oil companies to foreign governments in an effort to combat corruption. This requirement creates a more trustworthy and accountable relationship between oil companies, governments, and stakeholders.

Per the House conference report on Dodd-Frank, Section 1504 mandates public disclosure of any payment relating to the commercial development of oil, natural gas, and minerals. The SEC defines payments as taxes, royalties, fees, licenses, production entitlements, bonuses, dividend payments, infrastructure payments, community and social responsibility payments, in-kind payments, and other material benefits.

Issuers are required to report these payments in the form of an annual report. This report must include total payments related to the commercial development of oil, natural gas, and minerals, made by the issuer, subsidiaries or partners, or entities under the control of the issuer to the U.S. or a foreign government.

After a decade of the SEC failing implement the rule, due to various obstacles in the form of lawsuits by the American Petroleum Institute and the U.S. Chamber of Commerce; agency inaction; and congressional action under the Congressional Review Act, this latest proposed rule falls far short of Congressional intent as reflected in Dodd-Frank. The SEC must make improvements to this proposed rule, so the U.S. can ensure publicly traded oil companies conform to needed transparency measures.
Exemptions for SRCs and EGCs Weaken The Rule’s Effectiveness

The SEC’s 2019 version of implementing Section 1504 grants broader exemptions to certain companies from disclosure requirements. In this iteration, Smaller Reporting Companies (SRCs) and Emerging Growth Companies (EGCs) are exempt from providing any of the payment information required by Section 13(q). In the Jumpstart Our Business Startup Act subsection of the Securities Exchange Act, an emerging growth company is defined as an issuer yielding total annual gross revenues of less than $1 billion during its most recently completed fiscal year. “Total annual gross revenues” is defined as total revenues as presented on the income statement presentation under U.S. Generally Accepted Accounting Principles (GAAP) (or International Finance Reporting Standards (IFRS) as issued by the International Accounting Standards Board (IASB), if used as the basis of reporting by a foreign private issuer). Newly public companies would be allowed a grace period of an entire fiscal year before being required to follow the disclosure procedures. Lastly, reporting payments are not mandated when foreign law or a pre-existing contract has prohibited disclosure. These exemptions will “eliminat[e] the compliance burden for those companies that are less able to afford it and would reduce the overall cost of the proposed rules and address the related Congressional concerns.”

Categorial exemptions to disclosure requirements thwart the entire original congressional intent of creating Section 1504: to necessitate public reporting by the oil and gas industry. SRCs and EGCs should not be exempt from disclosing their total payments as they are involved in the same industry practices that have enabled corruption and misappropriation in the past. Their size or income status should not preclude them from taking part in dubious financial or extraction related activity. Moreover, smaller issuers are generally more susceptible to equity risks than larger issuers, as they take more operational risks (PYP 2018).

Each time these exemptions have been proposed before, public interest groups and the SEC itself have rejected them on the grounds that they defy the central intention of Section 1504. In most recent memory, the 2016 version of Section 1504 did not ultimately include these exemptions after receiving public comments of which none supported reporting exemptions for smaller issuers or emerging growth entities. The SEC went on record claiming, “exempting such issuers from the final rules could create a significant gap in the intended transparency.”

The SEC is prioritizing the financial interests of SRCs and EGCs over the transparency and anti-corruption efforts of the original version of Section 1504, despite the overwhelming public benefits of mandating transparency. These types of reporting exemptions have been proposed and subsequently rejected in other countries addressing the same issue of disclosure transparency in the extraction industry. Neither the European Union’s Transparency and Accounting Directives (EU Directives) nor Canada’s Extractive Sector Transparency Measures Act (ESTMA) make categorical exceptions for public companies regardless of size or status. Neither has reported competitive or capital losses consequentially.

If passed, the scope of these exemptions will be huge. Almost half of all extractive resource issuers fall under the category of SRC, EGC, or both, thus excluding nearly half of the relevant information on foreign extraction payments (PYP 2018). Specifically, 318 of the now 677 potentially obligated resource issuers would be given a free pass from reporting their total
payments. Conversely to what the SEC now claims, this creates a competitive advantage and uneven compliance cost on the larger issuers and those that do not qualify as Emerging Growth Companies, all for following the rules meant to be applied categorically throughout the extractive resource industry.

**Redefinition of “Project” & Aggregation of Payments**

The 2016 and previous versions of Section 1504 required disclosure for the type and total amount of payments to a government for each individual project. In these previous versions, Project was defined by being governed/documeted by a single legal contract or similar agreement (“Contract-Level Project Definition”). Its new proposed definition, the “Modified Project Definition” distinguishes projects by three broad factors: the type of resource, the method of extraction, and the major subnational political jurisdiction where the commercial development took place. This rule change will allow issuers to aggregate their payments across multiple projects within the same major subnational or lower government level in their reports, whereas in the past, companies were only permitted to aggregate payments directly related by more intuitive categories, operation and geography. In other words, previous iterations of Section 1504 have required issuers to report their payments discretely for each individual project in which they participated (as defined by having a contract or agreement). Under the new version, issuers will be able to group together their payments in reports distinguished not by contract but rather vague, broader categories within a state or subnational jurisdiction. This creates a lower reporting standard in that far less clarity and transparency would be mandated in these reports. If the audience of the reports is not able to easily distinguish which payments correspond to each project, they cannot determine how much money is being funneled into a certain project.

The Commission claimed the Contract-Level Project Definition posed a risk to issuers by forcing them to disclose sensitive proprietary commercial information and the potential to have that information reverse-engineered. The SEC purports that the Modified Project Definition strikes an appropriate balance between demanding transparency from issuers and assuaging issuers’ concerns about competitive harm, though it clearly favors the issuers’ agenda. In its discussion of implementing the new definition, the Commission states “the Contract-Level Project Definition, by providing transparency about the revenues generated from each contract, license, and concession, could serve to reduce the potential for corruption in connection with the negotiation and implementation of a resource-extraction contract. In this way . . . [it] could minimize instances of corruption that may occur before resource-extraction revenue is paid to the government” (Federal Register 2537). Clearly, there are great threats to transparency and accountability at stake with the implementation of a new project definition. The SEC needs to enforce a much stricter definition, preventing the possibility of widespread payment aggregation and ensuring useful, complete information is reported, to maintain consistency with the standard industry definition upheld in Canada, the EU, and other countries.
Timeline

Under this version of Section 1504, the SEC has eased issuers’ responsibility of filing their reports in a timely manner of 150 days after fiscal year end (per the 2016 version). This iteration has relaxed this deadline such that an issuer whose fiscal year ends on or before June 30 has until March 31 of the following year to submit its Form SD and an issuer whose fiscal year ends after June 30 will have until March 31 the second following year. This allows and exorbitant amount of time for companies to delay their disclosure.

Transitional relief

This suggested rule change would grant a period of transitional relief to issuers that have recently completed their initial public offerings in the United States. Specifically, an issuer would not have to comply with the disclosure requirements until the first fiscal year following the fiscal year in which it completed its IPO. Hereby, the SEC allows potentially corrupt issuers a sizeable grace period before having to disclose their payments and revenue, during which irreparable damage with foreign governments could be done.

Disclosure Treatment

The new proposed version of Section 1504 would allow disclosure of total payments to be treated as furnished to, not filed with, the SEC, effectively letting companies shirk the risk of liability for these reports under Section 18 of the Exchange Act and the risk of incorporation by reference in a company’s registration statements filed under the Securities Act. Herein, the SEC provides another layer of protection for oil companies, in easing the level of accountability to which resource extraction issuers are held when reporting payments.

De minimis payment

Whereas the 2016 version of the rule defined a de minimis payment as $100,000 at project level, the new version of the rule significantly increased the threshold of de minimis. In this proposed version, issuers will only have to report individual payments or a series of related payments of the same type for one project that equal or exceed $150,000. Additionally, issuers will only have to report aggregate payments for one project that exceed or equal $750,000. This change works in tandem with the changed definition of project, which allows for a higher level of payment aggregation, therefore increasing what the value of what the SEC believes is the minimum threshold for reporting. Again, the SEC justifies this suggested change by claiming it will reduce the competitive harm of more payment disclosure imposed upon issuers. The Commission also ensures that this minimum does not create a competitive advantage for SRCs and EGCs, whose payments generally do not equal or exceed this new standard, as they will be exempted from disclosure requirements. In effect, the SEC is granting larger leeway for issuers to engage in corruption and collusion with less than $150,000 on individual payments and $750,000 on aggregated payments.

New Conditional Exemptions

This change would add two new conditional exemptions: issuers whose pre-existing contracts
with foreign governments or whose host country’s law prohibit this type of required disclosure will be exempt from compliance. It is unclear whether the proposed rule puts into place measures to independently verify whether these exemptions are justified. This change yet again prioritizes resource issuers over the public’s right to full transparency.

Redefinition of “Control”

The new proposed definition of control would exclude from reporting entities or operations only proportionately consolidated by the issuer, thereby allowing extraction issuers to omit payment information on joint ventures. As a result, the proposed rule will likely incentivize extraction issuers to structure payments through such ventures and effectively evade disclosure almost entirely.

Conclusion

The consistent justification for these rule changes are that they lower the compliance cost of resource extraction issuers. However, Congress’ concern in creating Section 1504 was not to provide short cuts for extraction issuers, but to demand their accountability in their extraction activity. Enforcement of the more stringent Section 1504 rule changes would probably result in better governance by developing countries with rich natural resource reserves. When governments and corporations are mandated to disclose their total payments, the likelihood of corruption shrinks, as corporations and regimes are unable to obscure the legally and morally questionable decisions they make regarding extraction finances. Reduced corruption also helps to stabilize the market. Mandated transparency lessens the possibility of political risks associated with corrupt regimes pursuing their own interests. Additionally, the disclosure of payment related information and decisions will disincentivize issuers from taking part in nepotism or awarding projects to companies for personal gain, enhancing market efficiency by appointing the most qualified companies to economic ventures. Awarding ill-equipped or unqualified parties to these industries takes away investment opportunity from merited parties. This generally hurts the financial prowess of US issuers and the entire economies and GDPs of the developing states in which these profitable natural resources are found. When the U.S. stands up to corruption in the extractive industries, powerful allies follow suit. Both the European Union and Canada have adopted transparency agreements of their own since 2018. The SEC needs to revert back to many of the proposals found in the 2016 rule or alter these proposed changes such that they reflect Congressional intent in securing transparency, fighting corruption, and ensuring justice.

Respectfully submitted,

Claudia Steiner, Research Intern
Tyson Slocum, Energy Program Director
Public Citizen, Inc.
215 Pennsylvania Ave SE
Washington, DC 20003
(202) 588-1000
tslocum@citizen.org