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January 25, 2016

Chair Mary Jo White
Commissioner Michael Piwowar
Commissioner Kara Stein
U.S. Securities and Exchange Commission
100 F Street, NE
Washington, DC 20459-1090

Email: rule-comments@sec.gov

Re: Comment to Proposed Rule on Disclosure of Payments by Resource Extraction Issuers (File Number S7-25-15)

Dear Chair and Commissioners:

We the undersigned, an economist and a lawyer who bring deep private sector transactional experience as well as extensive policy-making expertise in the interrelationships between commercial investment, governance and transparency, and economic development in emerging markets, especially in the context of the natural resources extractive sector, urge the U.S. Securities and Exchange Commission ("Commission") to adopt a robust rule on disclosure of payments by resource extraction issuers — *one that includes "social or community payments"* — to implement Section 1504 of the Dodd-Frank Wall Street Reform and Consumer Protection Act (15 U.S.C. § 78m(q), "Section 1504") in its proposed Rule 13q-1 and amendment to Form SD.

Introduction

The Commission has drafted what is in many ways a splendid and sophisticated disclosure structure for issuers in the extractive industries, around which good corporate citizens, local populations, civil society, and governments can rally to defend against corruption and to plan for sustainable, equitable resource development. However, this structure is currently fashioned with an exposed flank; and worse still, it incorporates road signs pointing the way to that exposed flank.

Indeed, in its Summary of the proposed rule, the Commission acknowledges that its rule does not require disclosure of "social or community payments, such as payments to build a hospital or school . . . ."[1] Yet these activities increasingly epitomize the types of initiatives that businesses are gravitating towards — in the name of investment in "corporate social responsibility" ("CSR") — where the absence of sound governance and transparency has been posing the greatest risks

[1] U.S. Securities and Exchange Commission, "Summary of Proposed Rule on Disclosure of Payments by Resource Extraction Issuers," File Number S7-25-15 (December 11, 2015) ("Summary"), at 51, 54.

both for the private and the public sectors.

As we will contend below, disclosure of social and community payments is crucial to enhance the value that both companies and local stakeholders can legitimately receive from projects, and to mitigate the risk of corruption that can destroy such value altogether. We will note several cases that have already come to the attention of the Commission that illustrate the risks of harm from these types of payments, not to mention the lost opportunities they often represent. Failure to require disclosure of these types of payments will create perverse incentives that will undermine the Commission's entire resource extraction disclosure structure, as well as set back the corporate compliance efforts in this area that have occurred to date. Each of the arguments marshaled in the Summary against mandated disclosure of social and community payments falls short empirically and logically.

The Commission should demonstrate to the global marketplace and its diverse stakeholders its policy and enforcement leadership by explicitly including these payments in the required disclosures, rather than trying to lead from behind and follow the European Union and other jurisdictions in a "least common denominator" approach.

We offer our observations in light of our professional experience, which is summarized as follows:

Dr. Harry G. Broadman

- Johns Hopkins University Faculty: Director of the Council on Global Business and Emerging Markets; and Senior Fellow, Foreign Policy Institute.
- Former Senior Managing Director and Chief Economist, PricewaterhouseCoopers (PwC): Founded and led PwC's emerging markets business strategy management consulting practice; co-led PwC's governance and anti-corruption practice.
- Former World Bank Senior Official: Oversaw lending and policy operations throughout China; Russia and the CIS; East and South Asia; and Africa.
- Former Chief of Staff, President's Council of Economic Advisers.
- Former U.S. Assistant Trade Representative.
- Former Senior Professional Staff Member, U.S. Senate Governmental Affairs Committee.
- Current: Member, Board of Directors, Partners for Democratic Change; Member, Council on Foreign Relations; Member, Bretton Woods Committee.

Bruce H. Searby

- Former Assistant United States Attorney for the Central District of California, prosecuting offenses under the U.S. Foreign Corrupt Practices Act of 1977 ("FCPA") and other corruption, fraud, and money-laundering laws.
- Current: Attorney in private practice representing diverse companies in anti-corruption and FCPA matters, including in investigations, enforcement proceedings, M&A transactions, anti-corruption compliance policy, and agreements/controls for CSR investments.

Our various undertakings in these two different disciplines have often called on us to assist clients, whether corporate or governmental, with projects in the extractive industries and with "social and community payments." Our experiences have instilled in both of us strongly-held convictions that such payments can and should be "win-win" for all, and that there is unlikely to be a more forceful incentive for such an outcome as when such activity is compelled to be conducted in the light of day.

Reasons for Disclosure of Social and Community Payments

The reasons for disclosure of social and community payments lie in understanding certain indisputable trends in overseas corporate investment,[2] which call for this common-sense regulatory strategy in response. Disclosure would incentivize best practices that achieve maximum economic and social value for all, while deterring official and corporate wrongdoing that has been on the rise in this area.

Over the last several decades, social and community payments negotiated with local governments, communities, or state-owned enterprises in the name of CSR have become commonplace within many large companies and financial institutions, particularly those who have investments abroad. This is especially the case for sizeable private foreign firms operating in emerging markets, where enterprise-sponsored initiatives aimed at facilitating economic development are seen as avenues for business to "do well by doing good." However, in an increasing number of cases, on balance the intended beneficiaries are not made better off; in fact, sometimes they actually are made worse off. Sometimes social and community investment projects are designed, indeed even implemented, without fulsome consultation with *representative* groups of the local stakeholders. Discussing the priorities of a proposed initiative only with the community leadership — usually government officials, and not elements of the broader society, including the poor, minority groups, women, religious leaders, educators, and local businesses and workers — may result in a project that only serves to validate, if not embolden, the objectives of the most powerful vested interests. And this may come at the expense of the rest of the community that is already disadvantaged. At worst, the initiative can introduce *wholly new distortions* within the local socioeconomic and political fabric. Indeed, there have been cases where a sponsor, eager to garner local support for its investment plans, has given gifts or donations to the most significant influencers of the government, or directly to government officials themselves.

Social and community payments can not only exacerbate *status quo ante* societal problems, but also expose the sponsor to criminal or civil charges under various anti-corruption laws. The Commission's own investigations under the FCPA have included several instances of CSR social and community investments suspected or

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[2] These trends were the subject of one of the undersigned's recent article in *Forbes* magazine, *see* Harry G. Broadman, "Time To Hit The Corporate Social Responsibility 'Reset Button'," *Forbes* (May 31, 2015), from which some of the analysis below for this comment is adapted.

even proven to have gone awry — enriching officials who deal with or oversee the foreign firm, diverting resources from the community's needs, and resulting in poorly-executed or even fictitious deliverables. In the extractive industries, there have been multiple cases like this.

In one instance investigated by the Commission, the energy company BP plc could not account for any results three years after paying a project signing bonus of many tens of millions of dollars supposedly to be spent on a training facility where Angolans could learn skills needed for work in the oil and gas sector. A representative of BP commented: "Having the right relationship with the state oil company is important to us, but as far as the signature bonus goes, it's like paying taxes — once you've paid your tax, you can't tell your government what to do with it."[3] While the Commission has not filed charges in connection with its investigation, the litigation-related costs of the scandal to the investors in the Angolan project are going to be formidable by themselves. The case crisply illustrates why social and community payments *ought* to be disclosed pursuant to the new rule, just like corporate taxes paid to a local government, so that the public can track them even if the resource extraction company washes it hands.

Similarly, the energy company Hyperdynamics Corporation has disclosed that an FCPA investigation by the Commission focused on whether its activities in obtaining and retaining concession rights in Guinea and its relationships with charitable organizations potentially violated the FCPA and anti-money laundering statutes. Last year, Hyperdynamics settled with the Commission, accepting a civil money penalty for FCPA violations and a cease-and-desist order, after having incurred $12,000,000 in legal costs.[4]

Various cases outside the extractive industries suggest just how often these issues of corruption risk rear themselves in CSR-related corporate expenditures. In recent years, as you well know, the Commission has publically settled FCPA charges related to these payments against ADM (agribusiness), Stryker Corp. (health care products), Eli Lilly (same), Schering-Plough (same), Titan (defense technology), Alstom (infrastructure), and Louis Berger (same). The Commission has rightly sought to draw attention to the risk of such violations in its widely-praised FCPA Resource Guide.[5] White-collar criminal lawyers from one of the leading firms in the FCPA practice area have compiled data on what amounts to a discernible trend of coerced extraction by local officials of CSR payments.[6]

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[3] Tim Fernholz, "The absence of a mysterious research center in Angola could be evidence of oil corruption," *Quartz* (August 12, 2014).

[4] Hyperdynamics Corporation, SEC Form 8-K and Current Report filed January 19, 2016, Ex. 99-1.

[5] U.S. Securities and Exchange Commission & U.S. Department of Justice, *A Resource Guide to the U.S. Foreign Corrupt Practices Act* (November 2012), at 16, 18-19.

[6] Joel M. Cohen & Daniel P. Harris of Gibson, Dunn & Crutcher LLP, "Coerced Corporate Social Responsibility and the FCPA,"in *The International Comparative Legal Guide to Business Crime 2016*, Chapter 5 (6th ed., January 2016).

Because in-country legal and policy regimes regarding these social and community payments are nascent or even non-existent, whether with respect to their content "on the books" or the effectiveness of their implementation, the environment is overripe for "leakages." Corporate managers often lack for sufficient incentives to ensure there exists a sound administrative and organizational framework that helps drive a CSR program towards the desired performance and avoid corruption. But corporate shareholders would surely want to see their companies achieve these goals. As the non-governmental organization Global Witness stated previously in connection with the proposed rule, a "strong disclosure rule is necessary to provide investors important information required to assess and mitigate risk; [and] to combat and deter resource-related corruption."[7] Companies that fail to confront these risks and mislead investors as to them face punishing derivative and class action lawsuits.

The Commission can and should make easier the issuers' job of keeping this activity clean by giving them new arguments with local powerbrokers based on the transparency of the social and community payments and the prospect of being held accountable for how they manage resource wealth. The transparency would also foster the inclusion of new, more representative stakeholders with worthier social and community investment project concepts, and with their own reasons to closely monitor the development and implementation of such projects.

Until a disclosure rule starts to re-define the norms for social and community payments in the extractives industry, the lack of transparency will favor unethical companies competing for market access and concessions, to the detriment of honest issuers.

Finally, as the Commission's new rule spreads the norm of disclosing various other types of payments from resource extraction issuers, it would be important not to open a loophole for social and community payments, to be exploited as never before by local officials playing a game of cat-and-mouse with those scrutinizing their use and abuse of public funds.

<u>Arguments Against Disclosure of Social and Community Payments</u>

We will now address the Commission's unconvincing arguments in the Summary attempting to explain its omission of social and community payments from the resource extraction issuer disclosure regime.

First, the Summary states: "[I]t remains unclear whether these types of payments are part of the commonly recognized revenue stream." This lack of clarity can

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[7] Corinna Gilfillan & Simon Taylor of Global Witness, Letter to the Commission re: Dodd-Frank Section 1504 Rule and International Transparency Efforts, dated December 18, 2013, at 1.

perhaps be explained by a lack of empirical research, but it is in any event not reflective of our experience and understanding. Our engagements have often involved negotiations with local communities over CSR-type payments as part of the expected revenue stream from extraction, and sometimes involve non-contractual social and community payments that are suggested or required as a practical matter by officials. Public manifestations of how common in this industry CSR payments have become include prolific conferences, studies, guidance, and compliance manuals emanating from groups such as the International Petroleum Industry Environmental Conservation Association ("IPIECA"),[8] non-profit consulting groups such as Businesses for Social Responsibility ("BSR"),[9] and industry leaders such as the South African mining company Anglo-American plc,[10] to name but a few. In one of its studies of CSR in the extractive industries, the nonprofit FSG, Inc. has stated that CSR and charitable payments have been "dominant approaches" by business to community and social engagement.[11] Merely surfing the official websites of publically-listed companies in the extractive industries will yield many high-level descriptions of how those companies give back, so to speak, to the communities they are in.[12] Commercial secrecy may shroud the proportions, but the Commission should have no doubt that social and community payments are, formally or informally, indeed part of the commonly recognized revenue stream.

The second, even more puzzling basis of the Commission's tentative position is a misguided search for consensus. The Commission states that it is inclined "to follow the approach of the European Union and Canada in not proposing to require the disclosure of social or community payments," versus the current requirement of the Extractive Industries Transparency Initiative ("EITI") that includes the disclosure of material "social expenditures" in an EITI report when those expenditures are required by law or contract.[13] However, as the Commission then concedes in a footnote, Canada's guidance states that "payments made for corporate social responsibility purposes" may be required to be disclosed if "made in lieu of one of the payment categories that would need to be reported . . . ."[14] Thus, there is no consistency after all between Europe's and Canada's regimes to which the Commission should adhere for the sake of equalizing standards and reporting burdens. No reason is given for preferring Europe's inaction on these payments

[8] IPIECA, *Creating Successful, Sustainable Social Investment: Guidance document for the oil and gas industry* (2008).

[9] Alison Colwell of BSR, *Driving Business and Social Benefits Through Inclusive Community Investment* (July 2015).

[10] Anglo American Corp., *Socio-Economic Assessment Toolbox, Version 3* (2013); *see also* Official Website Homepage, http://southafrica.angloamerican.com (link to Our Difference" re Corporate Social Investment and Community Development), accessed on January 25, 2016.

[11] FSG, "Shared Value In Extractives," prepared materials for the Next-Gen CSR and Shared Value Forum (February 2014); *see also* FSG, "Extracting with Purpose: Creating Shared Value in the Oil and Gas�and Mining Sectors' Companies and Communities" (October 2014).

[12] *See, e.g.* BHP Billiton plc, Official Website Homepage, http://www.bhpbilliton.com, accessed on January 23, 2016 (link to "Working with communities where we operate").

[13] Summary, at 51.

[14] *Id.*, at n. 147.

versus the EITI's requirement and even Canada's position. Under these circumstances, the Commission must surely decide what is the optimal policy and then encourage fellow regulators in other jurisdictions to catch up if necessary.

In addition, the Summary states there was "no clear consensus among the commenters on whether the proposed rules should include social or community payments as part of identified payments that are required to be disclosed."[15] Given that much of the extractives industries has been opposing the proposed disclosure rule as a whole, the lack of consensus on this point should come as no surprise and be given no weight.

Finally, as grounds for not including these social and community payments, the Commission references "our desire to minimize the additional compliance costs to issuers that would result from having to track and disaggregate such payments. . . ."[16] This argument is made in passing without citing any factual basis, and it is seriously flawed. First, issuers with good financial controls and anti-bribery compliance programs will already track these kinds of payments for approval and accounting purposes. Second, issuers that do not already track these payments surely ought to do so, but they are less likely ever to do so if the Commission passes the proposed rule with this express omission. In fact, by sending the unsubtle message that these costs do not matter enough to track for the sake of transparency, the Commission may actually encourage companies that already do so to become lax. The Commission thus threatens to create a perverse incentive structure that unravels compliance efforts in an important area where its FCPA enforcement program correctly recognizes considerable risk. Third, any effort needed to "disaggregate" the payments is not a compelling objection; as discussed below, there is a policy alternative to doing this already in the Commission's grasp.

<u>When and How Companies Should Disclose Social and Community Payments</u>

Assuming that social and community payments are, as a general matter, important enough to require disclosure, the issue arises of when and how issuers should do so. This question has at least two dimensions.

First, disclosure could be limited to only where social and community payments are required by contract or law, or could extend to where such payments are made in lieu of one of the payment categories that would need to be reported. We consider the latter position to be best, and we contend that social and community payments should be considered "in lieu of" reportable categories wherever the payments are made at the request or suggestion of government officials in a position of authority or influence over the business activities. The disclosure rule would simply be too easy to skirt if officials could reach informal understandings with companies to fund their favored social and community projects.

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[15] Summary, at 51.

[16] *Id.*

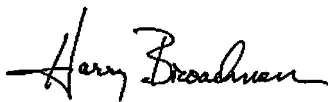
Second, we recognize that in some such instances companies may have difficulty allocating a social or community payment to any one resource extraction project for purposes of reporting. Indeed, some CSR activities may proceed at the request of regional or national government officials where a company has several existing or prospective projects. In these instances, we believe the disclosure could be made at the entity level (broken down by country), if inappropriate to do so at the project level, or if disaggregating such payments is too difficult. This is indeed only following the Commission's current approach in response to earlier concerns expressed about the difficulty of allocating certain payments, such as corporate taxes, to specific projects.[17]

Conclusion

We appreciate the Commission's invitation to comment on the proposed rule's omission of a disclosure requirement for social and community payments. So much work remains to be done to help make these types of expenditures fulfill their ostensible purposes, and to not become part of the "resource curse" problem. The Commission should use the opportunity presented by the proposed disclosure rule to lead in this area, rather than to erode the progress to date. The Commission therefore should reverse its current position and should require disclosure of social and community payments.

Thank you for your time and consideration.

Sincerely,



Dr. Harry G. Broadman
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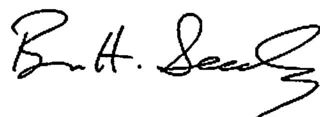

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[17] Summary, at 52-53.