Stacy Linden
Vice President, General Counsel
& Corporate Secretary

Office of the General Counsel

1220 L Street, NW
Washington, DC 20005-4070
USA

February 16, 2016

Brent J. Fields
Secretary
U.S. Securities and Exchange Commission
100 F Street, NE
Washington, DC 20549-1090

Re: Rulemaking under Section 13(q) of the Securities Exchange Act of 1934, File No. S7-25-15

Dear Secretary Fields:

The American Petroleum Institute ("API") is pleased to provide comments addressing the Commission's proposed rule implementing Section 13(q) of the Securities Exchange Act of 1934.[1] API is a national trade organization representing over 650 companies involved in all aspects of the domestic and international oil and natural gas industry, including exploration, production, refining, marketing, distribution and marine activities. Our highly competitive industry is essential to the economic health of the United States and the prosperity of our fellow citizens, who depend on ready access to reliable and affordable energy that our members strive to provide. In addition to supporting hundreds of thousands of American jobs, millions of Americans invest in our companies through retirement and pension plans, mutual funds, and individual investments.

API supports transparency. Many of our member companies are longstanding supporters of voluntary transparency initiatives such as the Extractive Industries Transparency Initiative ("EITI"). API itself has been heavily involved in the implementation of U.S. EITI through our membership on the U.S. EITI's multi-stakeholder group. API also believes that the Commission can promote transparency via Section 13(q), while remaining true to the Commission's core mission to protect investors, competition, and the efficiency of capital markets.

To achieve the objectives of Section 13(q), while adhering to the Commission's other statutory obligations under the Exchange Act, API offers the recommendations set forth

[1] *See* 15 U.S.C. § 78m(q).

below. These recommendations reflect API's industry expertise and the experience gained by our member companies in preparing for compliance with the original Rule 13q-1.[2]

[2] API has submitted other comments to the Commission and hereby incorporates those portions of the prior comments relevant to the SEC's December 23, 2015, proposed rule. *See* Letter from API (Oct. 12, 2010); Letter from API (Dec. 9, 2010); Letter from API (Jan. 28, 2011) at 1-4 (cover letter), 1-22, 24-47 (responses to the Commission's request for comments); Letter from API (Aug. 11, 2011); Letter from API (Feb. 13, 2012); Letter from API (May 18, 2012); Letter from API (Jan. 19, 2012); Letter from API (Nov. 7, 2013); Letter from API (April 15, 2014).

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I. Background

Congress enacted Section 13(q) to increase the transparency of payments made to the U.S. and foreign governments for the commercial development of natural resources so that interested constituencies can determine how much money a government is receiving and has available to spend and otherwise distribute to the population.[3] To that end, Section 13(q) directs the Commission to adopt a rule compelling resource-extraction issuers to report payments made to the U.S. and foreign governments for the commercial development of oil, gas, and minerals,[4] and then, "[t]o the extent practicable," "make available online, to the public, a compilation of th[at] information."[5]

The Commission's recent proposal is its second attempt to comply with this directive. As the Commission is aware, its prior rule was vacated by the U.S. District Court for the District of Columbia in July 2013, due to "two substantial errors."[6] Specifically, the Commission had "misread [Section 13(q)] to mandate public disclosure of the reports," and had arbitrarily and capriciously declined to provide an exemption for countries that prohibit disclosure.[7] The court admonished the Commission for "abdicat[ing] its statutory responsibility to investors" by pursuing an overly broad view of Section 13(q)'s purpose "no matter the cost" to issuers.[8]

With this background in mind, API encourages the Commission to adhere to three core principles in implementing Section 13(q):

> *First*, the Commission must adopt a rule that complies with the district court's decision in *American Petroleum Institute v. SEC*, 953 F. Supp. 2d 5 (D.D.C. 2013).

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3 Disclosure of Payments by Resource Extraction Issuers, 80 Fed. Reg. 80,058, 80,059 & n.7 (Dec. 23, 2015); 156 Cong. Rec. S3816 (daily ed. May 17, 2010) (Statement of Senator Lugar) ("The essential issue at stake is a citizen's right to hold its government to account. Americans would not tolerate the Congress denying them access to revenues our Treasury collects."); 156 Cong. Rec. S5872 (daily ed. July 15, 2010) (Statement of Senator Cardin) ("[W]e are helping to alleviate poverty internationally by allowing the people of the countries that have mineral wealth to hold their officials accountable, to use those payments to help the people of that nation.").

4 Exchange Act § 13(q)(2)(A), 15 U.S.C. § 78m(q)(2)(A).

5 *Id.* at § 78m(q)(3).

6 *API v. SEC*, 953 F. Supp. 2d 5, 11 (D.D.C. 2013).

7 *Id.*

8 *Id.* at 23.

> *Second*, under the doctrine of constitutional avoidance—which precludes an agency from applying a statute in a manner that raises serious constitutional concerns if another reasonable interpretation is available and avoids those concerns—the Commission must craft the rule to avoid conflict with the First Amendment's limitation on compelled speech. API's proposed definition of "project" and compilation approach is one such reasonable interpretation that reduces the burden on First Amendment rights.
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> *Third*, the Commission should exercise its discretion to serve the transparency objectives of Section 13(q), while faithfully complying with its other statutory obligations. In enacting Section 13(q), Congress expressly provided that the Commission "shall" pursue the "[p]ublic availability of information" "[t]o the extent practicable" by "mak[ing] available online, to the public, a compilation of the information required to be submitted under the [Commission's] rules."[9] By not expressly mandating that issuers disclose payment information publicly and emphasizing the Commission's discretion to make information publicly available "*to the extent practicable*," Congress signaled its intent that the Commission continue to adhere to its statutory obligations to protect investors by promoting competitive and efficient capital markets and minimizing discretionary costs.[10]

With these principles in mind, the Commission should make at least four important changes to the proposed rule. These changes would substantially reduce the rule's costs while more effectively promoting Section 1504's statutory purposes: *First*, the Commission should "make available online, to the public, a compilation of" payment information, instead of requiring issuers to disclose publicly payments made to the U.S. and foreign governmental entities in the first instance. *Second*, the Commission should adopt API's proposed definition of "project" and thereby reduce the risks and harms associated with forcing companies to disclose sensitive, contract-level information that can be exploited by competitors. *Third*, the Commission should adopt a rule that exempts disclosures that would violate a host country's laws and existing contracts, reveal commercially sensitive information, or jeopardize the safety of an issuer's personnel. *Finally*, the Commission should adopt API's proposed definition of "control," requiring only the operator of a joint venture to report the payments the operator made to the host government for the project.

[9] Exchange Act § 13(q)(3)(A), 15 U.S.C. § 78m(q)(3)(A).

[10] Exchange Act §§ 3(f), 23(a)(2), 15 U.S.C. §§ 78c(f), 78w(a)(2).

II. Requiring Public Disclosure Of Companies' Reports Imposes Unnecessary Competitive Harms On Companies Subject To The Rule And Violates The First Amendment. [*Responding to Questions 40, 41, 42, 46, 66, 78*]

The Commission's decision to require companies to disclose publicly their payments to governments is inconsistent with the Commission's statutory obligations, is unnecessary in light of the Commission's obvious alternative (a public compilation), imposes substantial competitive harms on U.S. listed companies, and violates the First Amendment. The Commission should adopt a rule that permits companies to submit their payment information confidentially, followed by the Commission's creation of a public compilation of that information.

A. Section 13(q) Does Not Mandate Public Disclosure By Companies And Provides That The Commission "Shall" Make Available A Public "Compilation."

As the district court held in vacating the Commission's original extractive industries rule, Section 13(q) does not mandate company-specific, public disclosure.[11] Despite that determination, the Commission again opts to require issuers to disclose publicly payments made to the U.S. and foreign governmental entities.

In defending this position, the Commission repeats many of the arguments that the district court rejected in *American Petroleum Institute v. SEC*. For example, the Commission repeats its contention that Congress's use of the phrase "annual report" suggests that Congress intended for the report itself to be publicly available.[12] But, as the district court correctly held, Congress specifically addressed the "[p]ublic availability of information" in Section 13(q)(3)(A)—a provision that expressly requires the Commission to make a compilation available to the public—thus "eliminat[ing] any inference that Congress relied on (2)(A), the disclosure provision, to establish the information's public availability."[13] The Commission also insists that Section 13(q)'s placement in the Exchange Act suggests that Congress wanted issuers' disclosures to be publicly available.[14] But the district court dismissed that argument as well, noting that Section 13(q), "with its global political concern,

[11] *API v. SEC*, 953 F. Supp. 2d at 12-20.

[12] 80 Fed. Reg. at 80,080.

[13] *API v. SEC*, 953 F. Supp. 2d at 14.

[14] 80 Fed. Reg. at 80,080.

differs significantly from a typical provision of the Exchange Act that seeks to protect investors through public disclosure."[15]

Having elected not to appeal the district court's decision, the Commission is bound by it. Yet, in continuing to suggest that company-specific public disclosure is essential to advance Congress's transparency and anti-corruption objectives, the Commission runs roughshod over the district court's opinion, Section 13(q)'s structure, and the Commission's other Exchange Act obligations. The district court's opinion and the plain language of the statute confirm that the Commission should require companies to disclose payment information to the Commission confidentially and that the Commission "shall" then make a "compilation of" that information available to the public "to the extent practicable."[16] This two-step process is wholly consistent with Congress's statutory framework and serves Congress's interest in making publicly available information about the amount of money received by the U.S. and foreign governments from resource-extraction issuers. Indeed, by mandating only that a compilation be publicly available (and only "to the extent practicable"), Congress plainly signaled that the Commission was to balance the "public availability of information" against its other statutory and regulatory imperatives, including protecting investors and minimizing harm to competition, efficiency, and capital formation. Here, a public compilation of company-generated information strikes the proper balance between Congress's transparency interests and these other imperatives. By contrast, the Commission wholly abandons its obligation to create a compilation in the proposed rule, instead placing the burden on resource-extraction issuers to disclose contract-level information and on the public to translate that data into useful information.

B. Confidential Disclosure To The Commission, Followed By A Public Compilation, Would Achieve Congress's Objectives And Greatly Reduce The Burdens On Issuers.

Confidential, company-specific disclosures followed by a public "compilation" would not only satisfy the plain language of Section 13(q) but would substantially reduce the burdens imposed by the Commission's proposed rule. By permitting confidential, company-specific disclosures and then aggregating that information in a public "compilation," the Commission would fulfill its obligation to "make available online, to the public, a

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15 *API v. SEC*, 953 F. Supp. 2d at 16-17.

16 Section 13(q)(3)—titled "Public availability of information"—requires the Commission, "[t]o the extent practicable," to "make available online, to the public, a compilation of the information required to be submitted" by issuers "under the rules issued under [Section 13(q)](2)(A)." 15 U.S.C. § 78m(q)(3)(A); *see also API v. SEC*, 953 F. Supp. 2d at 18-19.

compilation," while also ensuring that companies are not required to make commercially sensitive information publicly available.[17] Moreover, because Section 13(q) requires the Commission to make information publicly available only "[t]o the extent practicable," the Commission has the ability to produce a compilation"—defined as "something that is a product of the putting together of two or more items"[18]—that minimizes the competitive harm to issuers by omitting the most sensitive data.

Moreover, a public compilation would better serve the purposes of Section 13(q). As Section 13(q)(3)(A)'s text makes clear, Congress provided that the Commission "shall" make a compilation and expected that the public would be able to access that compilation online. The proposed rule reads this command out of the statute, treating issuers' independent, public disclosure of disaggregated, contract-level information under Section 13(q)(2)(A) as the creation of a compilation sufficient to satisfy Section 13(q)(3)(A), and absolving the Commission of any role in that process. The Commission's failure to play any part in the compilation is contrary to Congress's unambiguous intent, while making the disclosures less useful to members of the public who will have to aggregate company-specific information themselves from each company's annual report in order to determine the revenue their government is receiving from resource extraction.[19] It also stands in stark contrast to the work that the Department of Interior has done in compiling and presenting information provided under U.S. EITI.[20] That the Department of Interior has successfully created and made available a compilation of EITI information underscores the practicability of the Commission complying with its obligation to assemble a compilation pursuant to Section 13(q).

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[17] 15 U.S.C. § 78m(q)(3)(A); *see also Bus. Roundtable v. SEC*, 647 F.3d 1144, 1151-53 (D.C. Cir. 2011) (the Commission must consider whether lower-cost alternatives will be equally effective).

[18] Webster's Third Int'l Dictionary 464 (1976); *see also* Black's Law Dictionary 344 (10th ed. 2014) (defining "compilation" as a collection of materials "arranged in an original way," such that "the resulting product constitutes an original work of authorship").

[19] It should be noted that EITI uses the compilation approach. To see USEITI's compilation, visit https://useiti.doi.gov/explore/#revenue. For more information about what the compilation would look like under API's suggested approach, see *infra* at 31-36.

[20] The Department of Interior's compilation of EITI information is available here: https://useiti.doi.gov/explore/federal-revenue-by-location/. Notably, in the context of the United States' own EITI candidacy, the U.S. Department of the Interior has recognized that it would likely violate the Trade Secrets Act, 18 U.S.C. §1905, for the government to disclose payment information in such detail that a firm's competitors would be able to determine specific contract terms. *See* USEITI Candidacy Application Form at 10, http://www.doi.gov/eiti/FACA/upload/USEITI-CanApp.pdf.

The Commission's explanation for its continued refusal to make a compilation lacks merit. The Commission contends that simply requiring issuers to file the disclosures on EDGAR satisfies its duty to "make available online, to the public, a compilation," because the XBRL standard would allow "users to create their own compilations and analyses."[21] But the Commission does not "make" a compilation by requiring a citizen to make the compilation for herself. The Commission's interpretation also renders Section 13(q)(3) meaningless by conflating an issuer's "annual report" with the Commission's "compilation." Congress required both, however, and made them separate requirements. If the reports under Section 13(q)(2)(A) could satisfy both requirements by themselves, then Section 13(q)(3) would serve no purpose. The Commission may not interpret Section 13(q) in a manner that renders one of its provisions mere surplusage.[22]

The Commission also contends that a "periodically released" compilation would be outdated in comparison to real-time public disclosures filed annually by issuers on EDGAR.[23] But an issuer's "annual report"[24] is just that—annual—so by the Commission's reasoning public disclosure by issuers would be just as dated as a yearly compilation. Congress decided that annual reporting—*i.e.*, periodically released information—is timely enough, and the Commission may not second-guess that decision.

C. Public Disclosure Of Issuer-Specific Information Is Not Necessary To Achieve Transparency.

The Commission gains no perceptible benefit from forcing issuers to disclose their payment information directly to the public, rather than aggregating that information and making a compilation available to the public.[25] The Commission's purpose of enabling people to hold their governments accountable for the revenues generated from resource development is achieved so long as citizens know the amount of money the government receives, not the companies that make each individual payment. In the proposing release, the Commission asserts Section 13(q)'s general interest in transparency and Congress's mandate to enact a rule, but does little to connect those objectives to the specific approach in the

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[21] 80 Fed. Reg. at 80,085.

[22] *See, e.g.*, *Duncan v. Walker*, 533 U.S. 167, 174 (2001) (avoiding an interpretation of a statue that would have rendered part of the statute "insignificant, if not wholly superfluous").

[23] 80 Fed. Reg. at 80,085.

[24] 15 U.S.C. § 78m(q)(2)(A).

[25] *See Pub. Citizen v. Fed. Motor Carrier Safety Admin.*, 374 F.3d 1209, 1218 (D.C. Cir. 2004) (imposing massive costs without a discernible benefit violated the Administrative Procedure Act).

proposed rule—mandatory public disclosures by issuers in their annual reports, as opposed to confidential disclosure by issuers followed by a public compilation produced by the Commission.[26] Moreover, the Commission concedes that the benefits of compelled public disclosure are impossible to quantify, and that it has no data to back its assertion that compelled public disclosure will improve government accountability.[27]

To the extent the Commission contends that disclosing information about *issuers*, as opposed to *governments*, furthers the purpose of Section 13(q), that argument misunderstands the purpose of the statute.[28] Section 13(q) was passed to increase the accountability of governments, not to force public companies to pay more to develop natural resources, or to expose them to activism by special interest groups.

The Commission also asserts a vague interest in combatting corruption.[29] As an initial matter, it is unclear what "corruption" the Commission is referring to. Section 13(q) does not seek to limit illicit payments from companies to government officials; by definition, Section 13(q) applies only to payments to the governments themselves.[30] And in any event, the Commission is mistaken when it contends that the United States "may have few other means … to directly target governmental corruption associated with the extractive sector in foreign countries."[31] The Foreign Corrupt Practices Act, for example, has prohibited illicit payments to "foreign officials" since 1977.[32] Thus, to the extent that payments covered by Section 13(q) might be relevant to combatting bribery, the Commission can use confidential disclosures to investigate suspect payments under the FCPA, while avoiding company-specific public disclosure of legitimate payments.

The Commission also mentions corruption in the sense of the "unlawful misuse" of funds—*i.e.*, a government official spending the government's resource-extraction revenues to purchase goods for his or her personal use.[33] But to the extent Section 13(q) is concerned

26 *E.g.*, 80 Fed. Reg. at 80,088-89

27 *Id.*

28 *See* 80 Fed. Reg. at 80,066-67 & accompanying notes.

29 *E.g.*, 80 Fed. Reg. at 80,065-67.

30 15 U.S.C. § 78m(q)(2)(A).

31 80 Fed. Reg. at 80,067

32 15 U.S.C. §§ 78dd-1 *et seq.*

33 80 Fed. Reg. at 80,066, 80,077. The Commission cites several economic studies for the proposition that reducing corruption has positive economic effects and thus would increase long-term growth and

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with that kind of corruption, the identity of the company making the initial payment is irrelevant. All the public actually needs to know—and all the statute requires the Commission to provide—is the total amount of money the government received from resource-extraction issuers. And the Commission can put that information in a public compilation, without forcing companies to disclose publicly their individual payments.

D. Public Disclosure Imposes Competitive Harms On Issuers And Risks The Safety Of Their Employees.

Requiring public disclosure by companies is also unnecessarily harmful for at least two reasons. *First*, compelled public disclosure forces issuers to reveal highly confidential, commercially sensitive information. That puts American issuers at a competitive disadvantage relative to competitors, many of whom are not subject to similar disclosure requirements either because they are unlisted or because they are based in countries that do not require public disclosure.[34] To give just one example, if an issuer is forced to disclose publicly the details of its payments to a government, other governments could use that data to determine the rates of return that the issuer is willing to accept on future contracts, and could then use that information to negotiate for more favorable terms.[35]

The competitive harm imposed by compelled public disclosure is one critical difference between the proposed rule and the disclosures required under EITI.[36] Unlike the

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investment in some of the countries where issuers operate. *Id.* at 80,089-90. But most of the literature cited by the Commission discusses primarily the former form of corruption—bribes. *See, e.g.*, Pierre-Guillaume Méon & Khalid Sekkat, *Does Corruption Grease or Sand the Wheels of Growth*, 122 Public Choice 69 (2005); Isaac Ehrlick & Francis Lui, *Bureaucratic Corruption and Endogenous Economic Growth*, 107 J. of Political Econ. S270, S271-S273 (1999); Pranab Bardhan, *Corruption and Development: A Review of Issues*, 35 J. of Econ. Literature 1320 (1997). As shown above, Section 13(q) does not apply to bribes, and hence this literature does not support the Commission's assertion that the proposed rule might achieve economic benefits resulting from reduced corruption.

[34] As discussed below, the competitive harm imposed by the proposed rule may actually reduce overall transparency, both because the cost of the rule may encourage foreign issuers to delist from American exchanges, and because issuers who remain subject to the rule will lose market share. *See infra* at 28.

[35] For more examples of the competitive harm imposed by compelled public disclosure of commercially sensitive information, see *infra* at 16-20.

[36] *See, e.g.*, 80 Fed. Reg. at 80,062, 80,075, 80,080. Another critical difference is that, unlike the proposed rule, EITI applies only in countries that voluntarily adopt it. *See* EITI Standard at 11, *available at* https://eiti.org/files/English_EITI_STANDARD.pdf. There are currently 31 countries that comply with EITI, and an additional 18, including the United States, that are in the process of implementing EITI. *EITI*

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proposed rule, which applies only to companies who must file annual reports with the Commission, EITI applies to all companies who operate in a country, including state-owned companies.[37] That difference is important because many of the largest oil companies in the world are state-owned—for example, Gazprom, the National Iranian Oil Company, and the China National Petroleum Company.[38] Thus, under EITI all companies operate on a level playing field. In contrast, under the Commission's proposed rule, American issuers are at a significant disadvantage because competitors in countries that do not participate in EITI are not subject to any requirement that they reveal commercially sensitive information.

Second, compelled public disclosure is harmful because it may endanger the safety of an issuer's employees. If an issuer is forced to disclose publicly its payments to a government (including specific and granular information about the precise geographic location of its operations), insurgents or terrorist groups can use that information to learn where the government is most vulnerable, and then target the issuer's facilities and personnel.[39] And this is no idle concern—terrorism, including the risk of kidnapping and ransom, is a constant threat in many of the countries in which API's members operate.[40] Indeed, energy companies have already experienced several incidents where facilities have been sabotaged, operations disrupted, and employees endangered by groups who oppose a host government or seek to seize oil facilities in order to collect the associated revenues. Additionally, issuers' employees in countries that prohibit disclosure of payment information could find themselves subject to criminal prosecution for facilitating the release of such information.

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Countries, EITI.org, https://eiti.org/countries. Many countries do not participate, however, including China, Russia, Qatar, and Saudi Arabia. *Id.*

37 EITI Standard at 21, 28, *available at* https://eiti.org/files/English_EITI_STANDARD.pdf.

38 *See* Attachment B to API's Oct. 12, 2010 letter. State-owned oil companies compete for oil projects around the world, not just in their home nations. *See* Attachment C to API's Oct. 12, 2010 letter; *see also* Wan Xu, *Sinochem, Cnooc Bid for State in Brazil Oil Field*, Wall Street Journal, May 12, 2010, *available at* http://www.wsj.com/articles/SB10001424052748703339304575240353207819696.

39 As explained below, the risk of terrorist attacks may also incentivize foreign governments to avoid doing business with companies that are subject to the proposed rule. *See infra* at 18.

40 *See, e.g.*, Heba Saleh & Anjli Raval, *Libya Appeals for Help in Resisting ISIS Attack on Oil Facilities*, Financial Times, Jan. 5, 2016, *available at* http://www.ft.com/intl/cms/s/0/7ec1b170-b3cb-11e5-b147-e5e5bba42e51.html#axzz3wf0xEWi4; Associated Press, *Shell: Militants Attack Nigerian Flow Station, Kill Guard*, Daily Herald, Oct. 11, 2015, *available at* http://www.dailyherald.com/article/20151011/business/310119905/.

Nor are these harms mitigated by rules in the European Union ("EU") and Canada that require public disclosure.[41] Forty-six of the top 100 oil and gas companies are listed only in the United States. Many of these companies have no reportable operations at all in Europe or Canada, or conduct only limited operations in those jurisdictions through subsidiaries. Thus, the proposed rule would subject many issuers to compelled public disclosure for the first time. And many competing companies—including unlisted companies and some state-owned oil companies—will remain free from mandatory-disclosure requirements. The proposed rule will give those companies a competitive advantage over American issuers. Moreover, insofar as new disclosure rules in the EU and Canada may limit the harm imposed by the proposed rule, those rules also reduce any benefits that might arise from compelled public disclosure. That is so because if an issuer discloses the same information twice, the public gains no new information from the second disclosure. Thus, for the purpose of determining the competitive harm imposed by the proposed rule, the rules in the EU and Canada are beside the point—the only relevant companies are those that are not already required to disclose payment information publicly.

E. Requiring Companies To Make Public Disclosures Violates The First Amendment.

Rules in the EU and Canada also need not contend with the First Amendment's limits on compelled speech, which protects "both the right to speak freely and the right to refrain from speaking at all."[42] Here, the proposed rule compels issuers to engage in speech about controversial matters of public policy—how much money governments are receiving for oil, gas, and mineral extraction—so that issuers' speech can be used by groups to lobby the U.S. and foreign governments about how much money they receive and how that money is allocated, and to influence the activities of companies engaged in resource extraction in those jurisdictions. Because Section 13(q) implicates companies' First Amendment rights, the doctrine of constitutional avoidance requires that the Commission construe the statute to avoid violating those rights.

There can be no dispute that this speech is being compelled to further political debate about the activities of governments and resource-extraction companies. Information about government revenues and spending has been at the heart of political speech for time

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[41] *See* 80 Fed. Reg. at 80,080 n.247.

[42] *See Wooley v. Maynard*, 430 U.S. 705, 714-15 (1977) (invalidating requirement that noncommercial automobiles bear license tags with the state motto, "Live Free or Die"); *see also W. Va. State Bd. of Education v. Barnette*, 319 U.S. 624 (1943) (striking down state school requirement that all children must salute the American flag).

immemorial. Oil companies' relationships and activities in foreign countries are also often a topic of political debate and controversy. Indeed, the subject matter of the speech compelled by the Commission's proposed rule is precisely the kind used by various constituencies to lobby foreign governments and conduct "corporate campaigns" directed at API's members.

Indeed, the economic relationships that oil and gas companies have with foreign governments are the subject of frequent, including allegations—however baseless—that the revenues foreign governments receive from oil and gas companies render the companies complicit in alleged human rights abuses and other government misconduct.[43] Some of the leading proponents of these charges are also among the "non-governmental organizations" participating most actively in this rulemaking.[44] These and other rulemaking participants also oppose exploration and development by oil and gas companies because of perceived environmental risks, and occasionally take extreme (and even illegal) actions to impede exploration and development.[45] It must be expected that these groups will use the company-specific information obtained through the proposal's public-disclosure requirements to further embroil those companies in disputes regarding the activities of foreign governments, the environment, and other controversial matters.[46]

Because the proposed rule compels non-commercial speech for political purposes, it must be narrowly tailored to promote a compelling governmental interest.[47] The proposed rule simply cannot survive that standard. It does not serve a compelling interest and, even if it did, is not narrowly tailored to serve that interest. Specifically, the government's "simple interest in providing [individuals] with additional relevant information" is "plainly

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[43] For example, in 2010 EarthRights International published a report that accused resource-extraction companies of being complicit in human rights abuses by the government of Burma. *See* Time.com, July 6, 2010, *available at* http://content.time.com/time/world/article/0,8599,2001962,00.html. Similarly, in 2009 Amnesty International published a report alleging that oil companies were responsible for poverty and human rights abuses in Nigeria. Amnesty International, *Nigeria: Petroleum, Pollution and Poverty in the Niger Delta* (2009), *available at* http://www.amnesty.de/files/Amnesty_Bericht_Niger_Delta_09.pdf.

[44] *E.g.*, Letter from EarthRights International (Jan. 26, 2011); Letter from EarthRights International (February 3, 2012).

[45] *See, e.g.*, Maya Rhodan, *Oil Ship Leaves Portland After Police Force Greenpeace Protesters Off Bridge*, Time.com, July 30, 2015, *available at* http://time.com/3979698/oil-ship-leaves-portland-after-police-force-greenpeace-protestors-off-bridge/.

[46] *See* Letter from Greenpeace (March 8, 2012) (arguing that payment disclosures would help interest groups "oversee and mitigate the social and environmental impacts of extractive industries").

[47] *See Wooley*, 430 U.S. at 714-16; *see also United States v. Playboy Ent. Grp., Inc.*, 529 U.S. 803, 813 (2000).

insufficient to support the constitutionality of its disclosure requirement."[48] Although "transparency" is a laudable goal, the government's purported interest in providing the public with information to hold their governments accountable for revenues generated from natural resources is insufficient to justify an intrusion on companies' First Amendment rights. The Commission's current proposal would result in compelled speech that is less informative and more misleading than a public compilation of the payments made to foreign governments, as proposed under API's proposed "compilation" approach. By requiring disaggregated, contract-level, public disclosures, the Commission will make it more difficult for parties seeking information about how much money governments are ultimately receiving to obtain that information. The resulting lack of clarity could mislead the public about government revenues. A public compilation that aggregates the total amount of money paid to governments for oil, gas, and minerals is more informative and less intrusive on companies' First Amendment rights than disaggregated, contract-level, and company-specific disclosures. Certainly, the Commission cannot have a compelling interest in providing information that is relatively uninformative and misleading.

In addition, the proposed rule is not narrowly tailored because the Commission can implement several alternatives that are less intrusive and still promote transparency. As explained above, the Commission can make available to the public a compilation of the information provided to it by issuers, while allowing issuers to file their payment information confidentially with the Commission. Because this alternative would achieve Section 13(q)'s proffered purpose by providing the public with information about the payments their governments receive from resource-extraction issuers without compelling companies to speak on controversial matters, the First Amendment requires that the Commission adopt this less intrusive option instead of requiring issuers to disclose their payments publicly in the first instance.[49]

The proposed rule would also fail intermediate First Amendment scrutiny. Even assuming that increasing transparency and fighting foreign corruption are important government interests, the proposed rule cannot be said to substantially advance those interests because the Commission has no evidence to suggest that the compelled disclosures will actually lessen corruption. In fact, the Commission concedes that it cannot quantify the benefits of the proposed rule and that those benefits are indeterminate. Under the First Amendment, "the government cannot rest on 'speculation or conjecture.'"[50] Rather the

[48] *See McIntyre v. Ohio Elections Comm'n*, 514 U.S. 334, 348 (1995).

[49] *See Playboy*, 529 U.S. at 813.

[50] *Nat'l Ass'n of Manufacturers v. SEC*, 800 F.3d 518, 526 (D.C. Cir. 2015) (quoting *Edenfield v. Fane*, 507 U.S. 761, 770 (1993)).

Commission has the burden of demonstrating that the proposed rule would "in fact alleviate" the harms it recites "to a material degree."[51] The Commission cannot do so here and the proposed rule therefore violates even the less stringent standard of intermediate scrutiny.

The D.C. Circuit's recent opinion in *National Association of Manufacturers v. SEC* is instructive. There, the court held that the SEC's conflict minerals disclosure rule, which was implemented pursuant to Section 1502 of the Dodd-Frank Act, violated the First Amendment because the SEC had failed to offer any evidence to substantiate the rule's effectiveness in achieving its stated purpose of "ameliorating the humanitarian crisis in the [Democratic Republic of Congo]."[52] In light of the rule's costs (estimated to be $3 billion to $4 billion initially and $207 million to $609 million annually thereafter), the court opined that the rule might actually *undermine* the government's stated purpose because companies might decide to boycott altogether mineral suppliers having connections with Africa. Moreover, if "[t]he idea [was] . . . that the forced disclosure regime [would] decrease the revenue of armed groups in the DRC and their loss of revenue [would] end or at least diminish the humanitarian crisis," then that rationale failed because "it [was] entirely unproven and rest[ed] on pure speculation."[53] Accordingly, the rule could not pass constitutional muster. The same can be said about the Commission's proposed extractive industries rule. There is simply no evidence to substantiate the proposed rule's effectiveness in reducing corruption in resource-rich countries, and absent that evidence, the rule's current incarnation cannot survive First Amendment scrutiny.

As noted above, the Commission's implementation of Section 13(q) must be guided by the doctrine of constitutional avoidance, which precludes an agency from applying a statute in a manner that raises serious constitutional concerns if "there is another interpretation, not raising these serious constitutional concerns, that may fairly be ascribed to" the statute.[54] Because Section 13(q) can be construed to avoid constitutional problems—namely, permitting confidential disclosures by companies, followed by a public compilation of that information by the Commission—the Commission should adopt that construction in

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[51] *Edenfield*, 507 U.S. at 771; *see, e.g.*, *Ibanez v. Fla. Dep't of Bus. & Prof. Reg.*, 512 U.S. 136, 146 (1994); *Turner Broad. Sys., Inc. v. FCC*, 512 U.S. 622, 664 (1994) (plurality opinion); *Pearson v. Shalala*, 164 F.3d 650, 659 (D.C. Cir. 1999); *Action for Children's Television v. FCC*, 58 F.3d 654, 665 (D.C. Cir. 1995) (en banc).

[52] *Nat'l Ass'n of Manufacturers*, 800 F.3d at 524 (citation and alteration omitted).

[53] *Id.*

[54] *See Edward J. DeBartolo Corp. v. Fla. Gulf Coast Building & Construction Trades Council*, 485 U.S. 568, 576-77 (1988).

implementing the statute.[55] API discusses this alternative, its consistency with the statutory language, and its efficacy in achieving the Commission's proffered objectives, in greater detail below.[56]

III. The Commission's Definition Of Project Is Not Statutorily Required, Imposes Significant Competitive Harms On Issuers, And Does Not Advance Section 13(q)'s Transparency Objectives. [*Responding to Questions 24, 25, 26, 27, 28, 42, 46, 62, 63, 78*]

The Commission's proposed requirement that companies disclose payments at the contract-level is unmoored from the statute and imposes tremendous competitive harms on issuers without any significant transparency benefit. Indeed, to the extent the Commission has attempted to ascribe any benefits to contract-level disclosure, those benefits are vague, conclusory, and—by the Commission's own admission—unquantifiable.[57] In short, the proposed rule imposes a severe anticompetitive burden on issuers despite the Commission's inability to identify any concrete reason for doing so.[58] The proposed rule is therefore inconsistent with the Commission's statutory obligations to ensure that "any burden on competition . . . is necessary or appropriate," to protect investors, and promote competition, efficiency, and capital formation,[59] as well as Section 13(q)'s mandate that the Commission make payment information publicly available only "[t]o the extent practicable."[60]

A. Section 13(q) Does Not Require A Contract-Level Definition Of Project.

The harm that results from compelled public disclosure is exacerbated by the Commission's decision to define "project" at an unnecessarily granular level. Section 13(q) requires issuers to disclose "the project of the resource extraction issuer to which the payments relate."[61] Importantly, Congress defined several terms in Section 13(q) but left "project" undefined, confirming Congress's intent that the Commission adopt a definition that promotes transparency, while also ensuring that any burden on competition is necessary

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55 80 Fed. Reg. at 80,080; *API v. SEC*, 953 F. Supp. 2d at 16.

56 *See infra* 31-35.

57 80 Fed. Reg. at 80,089.

58 *But see Pub. Citizen*, 374 F.3d at 1218.

59 *See* Exchange Act §§ 3(f), 23(a)(2), 15 U.S.C. §§ 78c(f), 78w(a)(2).

60 15 U.S.C. § 78m(q)(3)(A).

61 *Id.* § 78m(q)(2)(D)(ii)(VI).

and appropriate and minimizing the harm to issuers, their shareholders, and capital markets.[62] In light of that calculation, the Commission should adopt a definition that allows payments to be aggregated at a reasonable level that is not unduly burdensome to resource-extraction issuers.

Instead, the proposed rule defines a resource-extraction "project" as "operational activities that are governed by a single contract, license, lease, concession, or similar legal agreement, which form the basis for payment liabilities with a government."[63] In addition, the proposed rule requires issuers to identify the "specific, subnational, geographic location" of each project.[64] Thus, under the new rule issuers must publicly disclose highly sensitive information about their operations—namely, contract-specific details about an issuer's payments to a government, including municipal and local governmental entities. That requirement imposes a severe burden on issuers, contrary to the Commission's responsibility to minimize costs.

This definition is not necessary to achieve Section 13(q)'s purpose. The Commission contends that a contract-specific definition of "project" serves the statute's purpose because of a faulty assumption—that more granular disclosure fulfills Congress's intent.[65] But nothing in Section 13(q) suggests that Congress wanted highly granular disclosure. Instead, Congress mandated only that companies provide information about "the type and total amount of such payments made for each project" and "the type and total amount of such payments made to each government."[66] Congress referred to "each project" and "each government" because it wanted companies to provide information about the resource at issue, the payments made for those resources, and the region in which that resource is located. By mandating project-level information, Congress ensured that the Commission would be able to tie payments to specific resources when aggregating them for its public compilation. Congress did not mandate that the Commission collect information about each "contract," and it certainly did not mandate that the Commission make that information publicly available. Because Section 13(q) plainly permits a less granular "project" definition, and because there are significant burdens associated with contract-level disclosure, the Commission has a duty under the Exchange Act to adopt a less burdensome definition, particularly where, as here, the Commission is requiring companies to disclose

[62] *See* Exchange Act §§ 3(f), 23(a)(2), 15 U.S.C. §§ 78c(f), 78w(a)(2).

[63] 80 Fed. Reg. at 80,110.

[64] *Id*. at 80,111.

[65] *See* 80 Fed. Reg. at 80,076.

[66] 15 U.S.C. § 78m(q)(2)(A)(i) & (ii).

project-level information directly to the public, while refusing to comply with its obligation to produce a publicly available compilation of project and payment information.

B. The Proposed Definition Of "Project" Imposes Competitive Burdens On Issuers Because It Forces Them To Reveal Commercially Sensitive Information.

The definition of "project" in the proposed rule puts issuers at a critical disadvantage with respect to competitors that are not subject to the rule or similar requirements—for example, many state-owned oil companies—because it forces issuers to reveal commercially sensitive information to the public.[67] As explained above, that is a critical difference between the proposed rule and the disclosures required under EITI, which applies to all companies equally in the countries that choose to adopt it.[68] Revealing contract-level information is competitively harmful for three reasons.[69]

First, other resource-extraction companies can use contract-specific disclosures to harm the disclosing issuer. For example, if a competitor knows what an oil company paid for drilling rights under a specific contract, the competitor can learn the value the issuer places on a particular asset—*e.g.*, a block of acreage in territory that the government has recently made available for development. Competing oil companies often have very different views of a region's development potential because of differences in technology, scientific expertise, or experience. Thus, an issuer's valuation of new territory is a closely guarded secret, lest competitors piggyback on the issuers' hard-earned knowledge. To illustrate the point, consider the following hypotheticals:

[67] As explained below, the competitive harm imposed by the proposed rule may actually reduce transparency overall by incentivizing foreign issuers to delist and reducing the market share of SEC filers. *See infra* at 28.

[68] *See supra* at 8-9. Although EITI requires project-level reporting, it appears to give member countries and companies flexibility to agree to a higher level of disaggregation. *See* EITI Standard at 31, *available at* https://eiti.org/files/English_EITI_STANDARD.pdf ("The multi-stakeholder group is required to agree [to] the level of disaggregation for the publication of data. It is required that EITI data is presented by individual company. . . . Reporting at [a] project level is required, provided that it is *consistent with* the United States Securities and Exchange Commission rules and the forthcoming European Union requirements.") (emphasis added). Moreover, because EITI is voluntary for the host country, no nation would be compelled to adopt a granular definition of project.

[69] As shown above, the competitive harm results not just from the Commission's definition of "project," but also from the Commission's unnecessary and unconstitutional decision to require issuers to disclose payment information publicly.

AmeriCo, an SEC filer that uses new seismic-imaging technology, discovers that a new prospect, New Oil Field, has greater potential profitability than others in the industry assume. AmeriCo offers the host government a higher upfront bonus payment than other companies, to ensure that it will acquire the development rights to several blocks of land in and around New Oil Field. If AmeriCo is forced to disclose the amount of its upfront payment for that specific contract, competitors learn valuable information. From the size of the payment they can infer that New Oil Field has more oil, or is otherwise more commercially viable, than they previously believed. Later, when the host government makes more blocks of land available in and around New Oil Field, the competitors will increase their bids because of the information they discovered from AmeriCo's public disclosures, which will drive up AmeriCo's costs and make it more difficult for AmeriCo to win the rights to the new territory.

To further illustrate the point, imagine a situation in which AmeriCo knows about new, high-potential exploratory territory that other companies are entirely unaware of. AmeriCo might use agents in the host country to purchase property confidentially, before other companies learn of the territory's value. Those purchases might require the company to make payments to local governments, however, and if AmeriCo must disclose those payments, its identity will be revealed, and competitors will learn of its interest in the new opportunity. The competitors may then seek to purchase the remaining land. That drives up AmeriCo's costs and frustrates its objectives.

In addition, even if every company knows about the underlying resources and their value, granular, contract-level information about what an issuer is willing to pay to develop those resources is still sensitive, because companies compete for the same contracts. For example, if a competitor learns that an issuer paid $50 million for a contract to develop a particular block of land, the competitor can infer that the issuer will bid roughly the same amount for a similar contract, and use that information to its advantage the next time the two companies compete for the same territory. Likewise, detailed information about the structure of an issuer's contracts and the rate of return the issuer is willing to accept over the life of a contract may be inferred from contract-specific payment disclosures. All of this information is valuable to competitors because it will help them compete directly for contracts with host governments and because it will allow them to mimic the issuer's overall strategy. Where the competitors are not SEC filers, this asymmetry of information creates a significant competitive disadvantage for the U.S. issuer.

Second, host governments themselves can use public, contract-specific information about an issuer's payments to other governments to the issuer's disadvantage. For example, if one government knows the size of a bonus an SEC filer paid under an earlier contract in a different country, the government will expect at least the same amount in a new agreement with the filer. Likewise, if a government knows the rate of return an SEC filer was willing to accept on an earlier contract, the government can use that information in its negotiations with the filer to gain more favorable terms, to the filer's detriment and the detriment of its shareholders.

Third, because contract-specific information is also viewed as sensitive by host governments, those governments may be less willing to enter into agreements with issuers that are subject to the proposed rule, and may instead choose to do business with competitors—like state-owned oil companies—that are not obligated to disclose information that the governments would rather keep confidential.[70] Likewise, host governments may choose to remove from existing projects issuers that are subject to the proposed rule, in order to avoid the public disclosure of sensitive information. Imagine, for example, a government that is willing to grant an issuer favorable tax and royalty terms for one project, but does not want to make similar terms available for other projects in later years. If the contract-specific terms are publicly available, other oil companies may demand similar terms, making negotiations more difficult for the government. The government may therefore decide to reach agreement with a competitor that is not subject to the proposed rule's disclosure requirements, so as to keep the contract-specific tax and royalty terms confidential.

Aside from the potential commercial harm, host governments have national-security reasons to keep contract-specific information confidential. For example, contract-specific information about the payments a government receives, identified by a specific geographic location, gives insurgents or terrorists valuable information about where the government is most financially vulnerable. Insurgents can use that information to plan their attacks, putting the host country's economy—not to mention the safety of its citizens and the issuer's employees—at risk.[71] As explained above, this is a very real threat in many of the countries in which API members operate.[72] In addition, detailed information about payments might increase tension between a government and its neighbors. Imagine, for example, Country A, which earns a substantial amount of revenue from an oil field that crosses Country A's border with Country B. If Country B knows the size of the payments Country A receives, identified by a specific geographic location that lies near the border, that knowledge could lead to a dispute about ownership of the oil, or a dispute over the borders themselves.

[70] As discussed below, some governments actually prohibit the disclosures required by the proposed rule, which would impose additional harms on issuers and their investors. *See infra* at 27-28.

[71] The risk to an issuer's employees arises both from the granularity of the required disclosure and the proposed rule's requirement that companies themselves report payments publicly. *See supra* at 9.

[72] *See supra* at 9.

Because of that potential dispute, Country A's government might treat the contract-specific payment information as a state secret, and therefore choose to avoid doing business with companies that are subject to the proposed rule. Nor is this a hypothetical concern—territorial disputes related to oil and natural gas resources are common around the world.[73]

The Commission concedes that its definition of project will require issuers to disclose commercially sensitive information.[74] And the Commission also concedes that competitors and special-interest groups will be able to learn much more than simply the amount of money a government receives from an issuer. For example, in the proposing release, the Commission states that special-interest groups can use disclosures under the proposed rule to learn the details of an issuer's contracts with a host government,[75] and that the disclosures could be used to calculate the "cost curves that determine whether and for how long a project may remain economical."[76] That is precisely the kind of information that companies strive to keep confidential and that will be subject to exploitation by a company's competitors.

Nevertheless, the Commission contends that allowing issuers to aggregate contracts that are "substantially interconnected" will reduce the competitive harm of contract-level disclosure.[77] But that protects the least-sensitive contracts while offering no protection to an issuer's most-sensitive agreements, which are those that are new and therefore unlikely to be "substantially interconnected" with other operations. Consider an oil project in a mature, developed area with multiple wells connected to shared infrastructure. This is the type of situation in which the proposed rule would likely allow an issuer to aggregate multiple contracts into one "project." But contracts for projects like this tend to be old, and the general terms are likely to be known even if technically not public. In contrast, consider a contract related to an exploratory or initial development well in a frontier area. The well may represent a new discovery in an area not previously known to be productive. This is precisely the type of contract that is most commercially sensitive, yet is also the kind that is

[73] *See, e.g.*, William Neuman, *In Guyana, a Land Dispute With Venezuela Escalates Over Oil*, N.Y Times, Nov. 18, 2015, *available at* http://www.nytimes.com/2015/11/19/world/americas/in-guyana-a-land-dispute-with-venezuela-escalates-over-oil.html?_r=0; *Somalia Takes Kenya to ICJ Over Sea Border*, BBC News, July 13, 2015, *available at* http://www.bbc.com/news/world-africa-33505310.

[74] *E.g.*, 80 Fed. Reg. at 80,077.

[75] *Id.* at 80,066-67 & nn.89-90.

[76] *Id.* at 80,090-91. As the Commission correctly notes, this information will be of little use to investors because most issuers are already required to disclose their most significant risks in their annual reports under the Exchange Act. *Id.* at 80,091 & n.350.

[77] *Id.* at 80,075-76, 80,103.

least likely to be substantially interconnected to other contracts and hence receives the least protection under the proposed rule. Thus, although allowing issuers to aggregate substantially interconnected contracts reduces the adverse effects in some circumstances, it does little to mitigate the competitive harm imposed by the Commission's definition of project, or the requirement that projects be identified by their precise geographic location.[78]

The Commission also claims that it will consider granting case-by-case exemptions for issuers who might otherwise be forced to disclose commercially sensitive information.[79] But hypothetical exemptions in the future do nothing to alleviate the burden imposed by the proposed rule as currently written, and the Commission cannot discount those harms on the speculative assumption that case-by-case exemptions will actually be provided.[80] In addition, the Commission contends that the competitive harm resulting from its definition of project is mitigated by similar definitions in the European Union and Canada.[81] But, as shown above, those rules do not apply to issuers who are not listed in the EU or Canada. In addition, to the extent dual-listed issuers may be subject to obligations to disclose contract-level information in the EU and Canada, the existence of those regimes reduces the benefits of a U.S. contract-level definition of project.[82]

C. Contract-Level Disclosure Is Not Necessary To Achieve Section 13(q)'s Purpose.

No corresponding benefit justifies the burdens imposed on issuers by the Commission's contract-level definition of "project." The Commission cites Section 13(q)'s general purpose of increasing accountability for the proposition that contract-level transparency is "potentially beneficial."[83] But the Commission concedes that it has no data to

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[78] If the Commission does adopt a definition of project that requires contract-level disclosure, the Commission should, as proposed, allow issuers to aggregate contracts regardless of whether the contracts' specific terms are substantially similar. *See id.* at 80,076. Contracts that are operationally and geographically connected to each other should not be disaggregated based on the details of the individual contracts.

[79] *Id.* at 80,077 n.216.

[80] The Commission's suggestion that hypothetical, case-by-case exemptions mitigate the burdens imposed by its proposal is discussed in more detail below. *See infra* at 25-28.

[81] 80 Fed. Reg. at 80,077.

[82] *See supra* at 10.

[83] 80 Fed. Reg. at 80,065.

support that assertion.[84] And the Commission never explains in any concrete manner why detailed, contract-level disclosure serves Section 13(q)'s purpose better than an alternative approach, including that proposed by API.[85] Instead, the Commission simply contends that the more granular the disclosure, the more useful the information is to the public.[86] As explained above, nothing in Section 13(q) supports this claim; to the contrary, the statute's text suggests that Congress envisioned disclosure at a higher level of generality than individual contracts, and that Congress wanted the Commission to use its discretion to balance transparency against the Commission's corresponding obligation to minimize the burden on issuers, their shareholders, and capital markets.[87]

Even absent the substantial burden on issuers, contract-specific disclosure actually frustrates Section 13(q)'s transparency objective. Section 13(q)'s purpose is to provide the public with information about the overall revenue that national governments receive from natural resources, so that the public can seek to hold the government accountable for how much it is receiving and how it spends that money. Such information could include the type of resources and the regions of the country from which the government earns the bulk of its revenue. Information at that level of granularity would give the public a general sense of where, and how, their governments earn resource-extraction revenue, without revealing commercially sensitive information or information that could pose a risk to national security or employee safety. In addition, overly granular information could very likely make it *more* difficult for the public to make use of the disclosures. As Chair White has recognized in discussing this very statute, excessive reporting can contradict the goals of a disclosure system, by overloading the public with irrelevant or cumulative information.[88] Here, Section 13(q)'s goal of transparency is best served by a definition of project that aggregates payments to a more-useful—*i.e.*, higher—level of generality, instead of burying the public in an avalanche of data that is irrelevant to the law's avowed purpose.

Nor does a local community need contract-level disclosures to determine that someone is drilling for oil nearby or whether the community is receiving enough money from

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84 *Id.* at 80,090.

85 *See infra* at 31-35.

86 *See* 80 Fed. Reg. at 80,076.

87 *See supra* at 15-16.

88 The Honorable Mary Jo White, *The Importance of Independence*, AA. Sommer, Jr. Corporate Securities and Financial Law Lecture, Fordham Law School, SEC.gov, Oct. 3, 2013, *available at* http://www.sec.gov/News/Speech/Detail/Speech/1370539864016.

its national government.[89] Under API's proposed definition of "project," payments could still be sorted by subnational political jurisdiction, which would tell local communities how much money was generated in their region compared to others.[90] In this context, the community's knowledge that its national government received $5 billion for extraction activities in one province compared to $50 million from activities in another, for example, is more useful than its knowledge of how much the government received for each individual lease. Thus, even under the Commission's overly broad theory of Section 13(q)'s purpose, its definition of project offers no additional benefits.

At times, the Commission also appears to suggest that giving public-interest groups access to the specific terms of an issuer's contracts is a benefit of the proposed rule.[91] But Section 13(q) was enacted to inform the public of the amount of money governments receive for the development of natural resources, not to involve public-interest groups in the negotiation of individual contracts. Moreover, some of the groups the Commission identifies have goals that go far beyond increasing government accountability.[92] Some of the commenters even suggested that they will use contract-specific disclosure to oppose the development of a country's natural resources when, in their view, the costs of development outweigh the benefits to a local community.[93] That is a distortion of Section 13(q)'s purpose, which, according to the Commission, is to improve transparency so that citizens can know how much revenue their governments earn from resource-extraction. Nothing in the statute or the legislative history suggests that Section 13(q) was intended to make it more difficult for issuers to develop natural resources in the first place. To the extent public-interest groups seek to use the proposed rules to involve themselves in the negotiations between issuers and government, that is not a benefit of the proposed rule; rather, it is a problem that will cause competitive harms and harms to shareholders that the Commission is obligated to avoid.[94]

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[89] *But see* 80 Fed. Reg. at 80,066.

[90] For API's alternative approach, which would identify payments by subnational political jurisdiction, see *infra* at 31-35.

[91] *E.g.*, 80 Fed. Reg. at 80,066-67.

[92] *See, e.g.*, *Our Work*, Oxfam International, https://www.oxfam.org/en/explore/issues-we-work-on (describing goals including "[g]ender justice," environmental protection, and "[s]ustainable food"); *Climate Change—a conversation we can't just ignore*, Publish What You Pay, http://www.publishwhatyoupay.org/pwyp-news/climate-change-a-conversation-we-cant-just-ignore/.

[93] *See* 80 Fed. Reg. at 80,067 n.94 ("'Project level payment data is also necessary to enable communities to conduct an informed cost-benefit analysis of the projects in their backyard . . . .'") (quoting Feb. 20, 2015 letter from the National Advocacy Coalition on Extractives).

[94] *Cf. Bus. Roundtable*, 647 F.3d at 1152 (holding that the Commission acted arbitrarily by failing to consider whether "investors with a special interest, such as unions and state and local governments whose interests

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Finally, the Commission makes a passing reference to the anticorruption benefits that purportedly result from the "deterrent effect" of contract-level disclosure.[95] But, as shown above, Section 13(q) is a transparency statute that covers lawful payments to the governments themselves, not unlawful bribes to government officials.[96] And to the extent Section 13(q) helps the public identify the "unlawful misuse of" resource-extraction revenue, the public still needs to know only how much the government received, not how much companies paid for individual contracts.[97] Moreover, the Commission makes almost no attempt to explain why a contract-level definition of project is necessary to achieve the "deterrent effect," as opposed to a broader definition of project, like that proposed by API and set forth below, that would minimize the competitive harm to issuers and their investors.[98]

IV. The Proposed Rule Improperly Omits Exemptions For Countries That Prohibit Disclosure And For Contracts That Prohibit Disclosure Without The Contracting Government's Permission.

As Congress made clear and the district court confirmed, Section 13(q) does not pursue transparency at all costs.[99] Instead, Section 13(q) requires that the Commission use its discretion to pursue transparency, while avoiding excessive burdens on issuers, shareholders, and capital markets. Because issuers have billions of dollars at risk in countries that prohibit the disclosures required by the proposed rule, either by law or by contract, the Commission should exempt payments that issuers make to governments in those countries.

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in jobs may well be greater than their interest in share value, can be expected to pursue self-interested objectives rather than the goal of maximizing shareholder value").

95 80 Fed. Reg. at 80,077.

96 *See supra* at 7-8.

97 *See* 80 Fed. Reg. at 80,077; *supra* at 8.

98 As discussed in more detail below, API proposes defining a "project" based on three criteria: the resource being extracted (*e.g.*, oil vs. natural gas), the type of operation (*e.g.*, offshore vs. onshore), and the subnational political jurisdiction where the extraction takes place (*e.g.*, the state, province, or comparable area). *See infra* at 31-35.

99 *See* Exchange Act §§ 3(f), 13(q), 23(a)(2), 15 U.S.C. §§ 78c(f), 78m(q), 78w(a)(2); *API v. SEC*, 953 F. Supp. 2d at 22.

A. The District Court Invalidated The First Rule Because The Commission Failed To Offer Reasoned Explanation For Its Refusal To Grant An Exemption For Countries That Prohibit Disclosure.

Despite the district court's decision in 2013, the Commission has once again proposed a rule that lacks an exemption for circumstances in which disclosure under Section 13(q) would violate a host country's laws. The district court vacated the Commission's first proposed rule, in part, because the Commission failed to provide any reasoned explanation for its refusal to provide exemptions for companies in countries that prohibit the disclosure of payments to the government, deeming that omission a "serious error that independently invalidate[d] the Rule."[100] As the court recognized, the Commission has the authority to grant an exemption under Section 12(h) of the Exchange Act.[101] Moreover, Section 13(q) "emphasizes practicability."[102] Thus, by flatly refusing to grant an exemption despite billions of dollars in potential costs, the Commission had "abdicated its statutory responsibility to investors" by focusing "on the statute's apparent purpose—a purpose it conceived more broadly than the statutory text[.]"[103] The court therefore held that the Commission's analysis and explanation was arbitrary and capricious and that its "view of the statute's purpose—international transparency at all costs, exemptive authority or not— . . . contradicts what section 13(q) says on the very question."[104] The Commission should heed that admonition, comply with its obligation under Sections 3 and 23 of the Exchange Act to minimize harm to investors, and issue a rule that includes an exemption for countries that prohibit the required disclosures.

An exemption is warranted for the independent reason that statutes should be construed "to avoid unreasonable interference with the sovereign authority of other nations."[105] That principle extends to agencies, like the Commission.[106] Indeed, in Rule 1202 of Regulation S-K the Commission already allows registrants to omit disclosures of proved

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100 *API v. SEC*, 953 F. Supp. 2d at 20.

101 15 U.S.C. § 78*l*(h). The Commission also has the authority to grant an exemption under Section 36(a) of the Act, 15 U.S.C. § 78mm(a).

102 *API v. SEC*, 953 F. Supp. 2d at 23.

103 *Id.*

104 *Id.* at 22.

105 *F. Hoffman-La Roche Ltd. v. Empagran S.A.*, 542 U.S. 155, 164-65 (2004); *see also Murray v. Schooner Charming Betsy*, 6 U.S. (2 Cranch) 64, 118 (1804).

106 Restatement (Third) of Foreign Relations Law § 403 cmt. g (1987).

reserves "if that country's government prohibits such disclosure."[107] The Commission should do the same here.

The Commission contends that granting a blanket exemption would undermine Section 13(q)'s purpose because it might encourage other governments to pass similar prohibitions.[108] As the district court recognized in 2013, the Commission could have "fully address[ed] this concern" by "limit[ing] the exemption to the four countries cited by the commentators or [as] to all countries that prohibited disclosure as of a certain date[.]"[109] And the Commission's "general statement about incentive problems with a broad version of the exemption does not satisfy the requirement of reasoned decisionmaking when, by the Commission's own estimates, billions of dollars are on the line."[110] Moreover, the Commission fails to explain why its preferred alternative—case-by-case exemptions—would not create the very same incentives.

B. The Commission's Failure To Provide Exemptions In The Rule Itself Imposes A Substantial Burden On Issuers.

As noted above, the Commission's failure to grant an exemption imposes an enormous burden on issuers who have billions of dollars in assets in countries in which public disclosure under Section 13(q) would be illegal.[111] Indeed, as the Commission concedes, these issuers may be forced to forego lost revenues from the operation of facilities in jurisdictions that prohibit public disclosure and to relinquish all of their assets in those countries or to sell off those assets at fire-sale prices.[112] Although issuers may be able to seek permission from a host government to disclose payment information on a case-by-case basis, the government would be under no obligation to grant that permission. Issuers' employees could find themselves subject to criminal prosecution for facilitating the release of such information. Moreover, aside from the enormous costs associated with forced violation of a host country's law or contracts, the Commission's failure to grant an exemption imposes

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107 Modernization of Oil and Gas Reporting, 74 Fed. Reg. 2158, 2171 (Jan. 14, 2009).

108 *See* 80 Fed. Reg. at 80,097.

109 *API v. SEC*, 953 F. Supp. 2d at 22-23.

110 *Id.* at 23 (citing *Bus. Roundtable*, 647 F.3d at 1148).

111 As discussed above, some countries have legitimate reasons to prohibit certain disclosures, including national security and the commercial sensitivity of the information. *See supra* at 18-19.

112 80 Fed. Reg. at 80,099-101. As discussed below, the Commission's estimate of potential losses under either scenario is too low; the real numbers would in fact be much higher. *See infra* at 30.

severe competitive harm on U.S. listed companies whose competitors, including many state-owned oil companies, will not be subject to the Commission's rule.[113]

As an initial matter, API can confirm that at least two countries—Qatar and China—continue to prohibit the required disclosures.[114] API members have billions of dollars of assets in both countries and, as described below, the result for those assets would be a total loss if Qatar or China refuses to grant members permission to comply with the proposed rule.[115]

Moreover, in the absence of an exemption, other countries may pass similar laws as a means of expropriating an issuer's assets. This possibility is not a purely hypothetical concern—nationalizations in the oil and natural gas industry are a recurring problem,[116] and Section 13(q) may make it easier for a host government to take over an issuer's assets without paying any penalty.[117] Consider, for example, Country A, whose government wishes to seize AmeriCo's assets, including AmeriCo's rights to drill in Country A's vast oil fields. AmeriCo is an SEC filer, and under the proposed rule must disclose contract-specific payment information about its agreements with Country A. As a pretext for expropriating AmeriCo's assets, Country A enacts a law that bars companies from publicly disclosing details about resource-development agreements. Because the Commission failed to grant an

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113 *See supra* at 8-9 & nn.36-37.

114 *See* Letter from Royal Dutch Shell PLC at Appendix C (May 17, 2011); Letter from Exxon Mobil Corp. at Attachment II (March 15, 2011); *see also In re BDO China Dahua CPA Co., Ltd.*, Initial Decision Release No. 553, at 104-05 (File Nos. 3-14872, 2-15116) (Jan. 22, 2014) (impliedly construing Chinese law to prohibit disclosures of the kind required by the proposed rule).

115 *See infra* at 30.

116 *See* S. Guriev, A. Kolotilin & K. Sonin, *Determinants of Nationalization in the Oil Sector—A Theory and Evidence From Panel Data,* 27 J. L. Econ. & Org. 301, Appendix B (2011) (identifying 98 instances of expropriation of international oil company assets from 1960-2006 alone).

117 *Cf.* Corina Pons & Alexandra Ulmer, *Venezuela Ordered To Pay Exxon $1.6 Billion for Nationalization*, Reuters, Oct. 10, 2014, *available at* http://www.reuters.com/article/us-venezuela-exxon-idUSKCN0HY20720141010. Even in situations where resource-extraction issuers have legal recourse, receiving compensation for expropriated assets is extremely difficult. *See* Emily Witten, *Arbitration of Venezuelan Oil Contracts: A Losing Strategy?*, 4 Tex. J. Oil, Gas, & Energy L. 55 (2008). In Venezuela, for example, ExxonMobil and ConcocoPhillips were forced to abandon multibillion dollar investments when faced with a hostile government. *See* Robert Pirog, The Role of National Oil Companies in the International Oil Market, U.S. Congressional Research Service (2007), *available at* http://fas.org/sgp/crs/misc/RL34137.pdf

exemption in the proposed rule, AmeriCo and its shareholders risk losing of billions of dollars.[118]

In addition to laws that prohibit disclosure, many companies' contracts with host governments contain clauses requiring the government's permission before a company publicly reveals payment information.[119] Although some of these contracts allow an issuer to disclose payment information to comply with securities laws, many contracts do not, particularly older contracts. Thus, in the absence of an exemption the proposed rule would force some issuers to breach their existing contracts. The consequence effectively would be the same as violating the host government's laws—the issuer would be at risk of either losing its assets or negotiating with the government from a substantially weakened position.

The Commission's primary response is that it will consider granting exemptions on a case-by-case basis for issuers who must choose between complying with Section 13(q) or a host country's laws.[120] But the district court already considered and rejected that argument, because "a rule requiring disclosure without providing exemptions immediately affects parties contracting in the shadow of its requirements."[121] The Commission's vague promise that it "will consider" providing exemptive relief "if and when warranted"[122] is of little comfort to an issuer that faces enormous financial losses resulting from investments that the issuer made long before the Commission adopted the proposed rule. Further, the Commission must base its justification of its action on the terms of the rule that it is proposing, not a rule as later amended by a series of possible case-by-case exemptions. The Commission cannot use its assurance to consider an exemption in the future as a basis to ignore the consequences of its failure to grant an exemption now.

Moreover, there would be substantial practical and administrative difficulties associated with obtaining timely exemptive relief under the proposed rule. As proposed, the Commission (rather than its staff) would consider issuers' requests for exemptive relief on a case-by-case basis pursuant to Commission authority under the Exchange Act. Exemptions

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[118] Even if a host country does not take the extreme step of nationalization, it could still use disclosure as a basis for pressuring the issuer's managers and employees, imposing financial fines, or withholding permits or other forms of government approval that the issuer requires.

[119] In Nigeria, for example, one API member has contracts worth billions of dollars containing clauses that prohibit disclosure without the government's permission.

[120] 80 Fed. Reg. at 80,082, 80,097.

[121] *API v. SEC*, 953 F. Supp. 2d at 20 n.7.

[122] 80 Fed. Reg. at 80,082.

would have to be granted by the full Commission. It may simply be impossible for an issuer to apply for exemptive relief, and for the Commission to review that application and grant such relief, before the issuer's reporting obligations become due.

The Commission also notes that issuers can negotiate with host governments for permission to disclose payments.[123] But a host government would be under no obligation to do so because the issuer, not the government, would be the one breaching an existing obligation to comply with the host country's laws. Consequently, issuers need an exemption to protect them in the event a country refuses to grant permission to disclose payment information. Moreover, any negotiation would start from a position of weakness for the issuer, especially if that issuer has already invested billions of dollars in facilities and development rights that it stands to lose if the government does not cooperate. Even if an issuer is able to obtain permission to disclose payments, that permission will likely come with a hefty price tag. And negotiations would offer no opportunity for relief where a host government uses Section 13(q) disclosures as a basis to expropriate an issuer's assets.

Finally, the Commission contends that the new rules in the European Union and Canada, and the continued influence of EITI, will discourage host governments from enforcing laws that prohibit disclosure. But issuers need more certainty than that; they should not have to risk billions of dollars in shareholder assets on the gamble that a host government will turn a blind eye to violations of its laws.

C. The Lack Of An Exemption May Actually Reduce Overall Transparency.

The Commission concedes that foreign issuers may decide to delist from American exchanges as a result of the lack of an exemption for countries that prohibit disclosure without the government's permission.[124] Those issuers may choose to do so both because of the costs imposed by the rule and because of the competitive advantage they would gain over SEC filers. Thus, the net result of the lack of an exemption might actually be less, not more, transparency, for two independent reasons. First, fewer companies would be subject to Section 13(q) in the first place, and hence fewer companies would disclose payments to the Commission. Second, companies that remain subject to Section 13(q) would lose market share, and hence the companies that do disclose their payments to the Commission would have fewer payments to report.

[123] *Id.* at 80,097.

[124] *Id.* at 80,097, 80,099.

V. The Commission's Cost Benefit Analysis Is Deficient.

A. The Commission Concedes That The Proposed Rule's Benefits Are Vague And Indeterminate, While The Costs Are Concrete And Substantial.

The Commission has a statutory obligation to "do what it can to apprise itself—and hence the public and Congress—of the economic consequences of" the proposed rule.[125] Specifically, Section 3(f) of the Exchange Act requires the Commission "to consider or determine whether an action is necessary or appropriate in the public interest," and also to "consider, in addition to the protection of investors, whether the action will promote efficiency, competition, and capital formation."[126] And under Section 23(a)(2) of the Exchange Act, the Commission must consider "the impact any . . . rule or regulation would have on competition" and refrain from "adopt[ing] any . . . rule or regulation which would impose a burden on competition not necessary or appropriate in furtherance of the purposes of" the Exchange Act.[127]

Here, the Commission discusses Section 13(q)'s generalized interests in increasing transparency and government accountability but fails to determine with any specificity how, or if, the proposed rule will actually serve those interests. Instead, the Commission concedes that the benefits of the proposed rule are merely "potential," that they "cannot be readily quantified," and that "[t]he current empirical evidence on the direct causal effect of increased transparency in the resource-extraction sector on societal outcomes is inconclusive[.]"[128]

On the other side of the ledger, the Commission estimates massive, concrete costs to issuers.[129] But instead of attempting to reduce or minimize those costs, the Commission tallies them and then hands companies and their shareholders the bill. That is arbitrary and capricious. Where the Commission concedes that the benefits of an action are imperceptible,

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125 *Chamber of Commerce v. SEC*, 412 F.3d 133, 144 (D.C. Cir. 2005).

126 15 U.S.C. § 78c(f).

127 15 U.S.C. § 78w(a)(2).

128 80 Fed. Reg. at 80,088, 80,089.

129 *Id.* at 80,094 (estimating between $54.96 million and $577.1 million in total initial compliance costs for all issuers assuming no fixed costs, and between $262 million and $726 million assuming fixed costs of $500,000); *id.* at 80,095 (estimating between $105 million and $601 million in ongoing compliance costs assuming $200,000 in fixed costs); *id.* at 80,099-100 (estimating up to $6.7 billion in losses for companies with assets in countries that prohibit disclosure).

and potentially very slight, it has a statutory duty under Sections 3(f) and 23(a)(2) of the Exchange Act to minimize costs and ensure that it imposes only those competitive burdens that are necessary and appropriate.[130] These statutory obligations are especially important where, as here, the statute being implemented requires public disclosure only "[t]o the extent practicable."[131] In finalizing the rule, the Commission must adhere to these principles. That Congress required a rule is no answer—although Congress directed the Commission to adopt a rule, it did not require *this rule*, and it certainly did not intend for Section 13(q) to supersede the Commission's other longstanding obligations under the Exchange Act.

B. The Commission Seriously Underestimates The Costs Associated With The Lack Of An Exemption And Contract-Level Disclosure.

The Commission acknowledges that its refusal to grant an exemption may result in billions of dollars in costs to issuers with assets in countries that prohibit disclosure, but its analysis is deficient in several significant respects and it seriously underestimates the actual costs to issuers operating in those jurisdictions.

Among other things, the Commission quantified assets for only 20 of the 49 issuers that the Commission concluded have assets in countries that prohibit disclosure, and for the assets that the Commission did quantify, it made no attempt to analyze what kinds of assets are at risk. This omission is important, because a large percentage of an issuer's assets in these countries cannot be moved or used for any other purpose or location, even if the host government allows the issuer to keep them (an uncertain prospect for issuers who are forced to breach contracts and violate local law in order to comply with the proposed rule). The Commission's fire-sale analysis is also flawed because it compares immobile assets, like an oil pipeline, to mobile assets, like airplanes and tools. Finally, the analysis compares the sale of fixed assets in a hostile country, where a sale might be impossible, to ordinary distressed sales. In each of these respects, the SEC substantially underestimated the costs associated with its decision to deny an exemption for issuers in countries that prohibit disclosure. The Commission's flaws are discussed in greater detail in the attached report by NERA Economic Consulting. *See* Attachment B at 3-9.

In addition, although the Commission concludes that the proposed rule will impose billions of dollars in costs on resource-extraction issuers, its economic analysis improperly omits any estimate of the costs that will result from forcing issuers to reveal commercially

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130 15 U.S.C. §§ 78c(f), 78w(a)(2).

131 *Id.* § 78m(q)(2)(E), (3)(A); *see also API v. SEC*, 953 F. Supp. 2d at 22 (noting that Section 13(q) "emphasizes practicability" and does not pursue "international transparency at all costs").

sensitive details about their operations.[132] Those costs can be substantial, particularly for issuers who are forced to divulge sensitive information about the value they have attributed to newer projects. *See* Attachment B at 9-11.

VI. Alternatives To The Proposed Rule Achieve Section 13(q)'s Objectives While Substantially Reducing The Rule's Costs.

A. The Commission Should Make Only A Compilation Of Company-Provided Information Publicly Available And Should Adopt API's Proposed Definition of Project. [*Responding to Questions 24, 25, 27, 28, 29, 40, 62, 63, 64, 65, 66, 78*]

As explained above, after issuers file their annual reports the Commission "shall" produce a public compilation.[133] An approach under which issuers filed their reports confidentially and the Commission's compilation served as the means of making information publicly available, coupled with API's less granular definition of "project," would substantially alleviate the burdens imposed by the Commission's proposed rule, while better serving the statute's transparency objectives by making the disclosed information more accessible to and usable by the public.

Under API's proposed approach, issuers would file annual reports confidentially with the Commission. The reports would include electronically tagged data that identifies payments by several categories, including the type of payment (*e.g.*, bonuses vs. taxes), government payee (*e.g.*, including national and subnational governmental entities), and project (*e.g.*, drilling for oil offshore in Alaska vs. extracting natural gas in North Dakota). The Commission would then use each issuer's confidential annual report to produce a compilation that the Commission would make available to the public online.[134]

API would define a "project" based on three criteria: first, the type of resource being extracted (*e.g.*, primarily oil vs. primarily natural gas); second, the type of operation (*e.g.*,

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[132] The Commission notes that revealing sensitive information may have an anticompetitive effect. 80 Fed. Reg. at 80,095-96. And in its estimate of the rule's costs, the Commission recognizes that its definition of "project" will increase issuers' compliance costs. *Id.* at 80,103. But nothing in the economic analysis analyzes the specific economic losses that result from making commercially sensitive information publicly available or attempts to determine the difference between the losses caused by the proposed rule and an alternative approach. *See id.* at 80,087-80,107.

[133] *See supra* at 3-4.

[134] *See* Exchange Act § 13(q), 15 U.S.C. § 78m(q)(3).

offshore vs. onshore drilling); and third, the major subnational political jurisdiction where the extraction takes place (*e.g.*, the province, state, or comparable area). In each issuer's annual, confidential report, the issuer would identify a project by each of the three categories, electronically tagged using the Commission's XBRL interactive data system. Thus, a project to develop offshore oil in Sakhalin Island, Russia, would be identified in the confidential report, and later in the Commission's public compilation, as "Oil/Offshore/Russia/Sakhalin." A project to produce natural gas on land in Aceh, Indonesia would be identified as "Natural Gas/Onshore/Indonesia/Aceh."[135]

This approach is superior to the Commission's proposed approach in numerous respects.

First, API's project definition and compilation model would ensure that companies are providing the Commission with all of the information required by Section 13(q) in a sortable format, including electronic tags, so that the Commission can compile and aggregate it to provide payment, resource, location, operation, and recipient information in a single location and in a standardized and interactive format that can be easily accessed and manipulated by the public. In contrast, under the proposed rule, the Commission would play no role in making a compilation, leaving members of the public to comb, sort, and aggregate disparate and voluminous contract-level data on EDGAR in order to determine how much their governments are receiving from resource extraction.[136] In this respect, API's proposal is both more faithful to the statute's command that the Commission "shall" make a "compilation" publicly available and better serves Section 13(q)'s purpose of providing information about government revenues to members of the public.[137]

Second, API's standardized approach would allow information compiled from different companies to be easily compared at project and regional levels. In other words, an individual seeking to compare how much the Nigerian government received for onshore oil extraction in the Niger Delta with the amount received by the Russian government for offshore oil extraction in the Sakhalin region would be able to access the Commission's compilation and specify each of those tags to pull up that information. By contrast, an individual using the Commission's more cumbersome, albeit more granular, disclosure

[135] A model of API's proposed interactive disclosure model is available at http://publications.api.org/API1504/. For more information about API's proposed approach, *see* API's Nov. 7, 2013 letter to the Commission, *available at* https://www.sec.gov/comments/df-title-xv/resource-extraction-issuers/resourceextractionissuers-12.pdf.

[136] 80 Fed. Reg. at 80,085.

[137] 15 U.S.C. § 78m(q)(3)(A).

regime would have to access EDGAR, pull up each oil company's contract-level information in the Niger Delta and the Sakhalin regions, separate onshore from offshore activities, distinguish payments based on government payee, and then aggregate the payment information company-by-company and compare the totals.

In addition, the information the Commission proposes to provide to the public is likely to be inherently less useful because various portions of the proposed rule are susceptible to varying interpretations. For example, issuers may construe the Commission's "substantially interconnected" standard differently, and therefore report payments for similar projects at different levels of aggregation.[138] Thus, for similar activities, one company might consider dozens of agreements to be dozens of individual projects; another might consider all of its agreements to be part of one project, making the disclosures fundamentally less useful and less comparable than API's proposed model. Similarly, the proposed rule's ambiguous instructions for reporting a project's geographic location could be interpreted differently by different issuers.[139] As a result of the lack of standardization, a user seeking to generate useful comparisons may be forced to employ a manual process and potentially undertake extensive research. API's approach, in contrast, requires issuers to report geographic locations by one simple, uniform standard—the state, province, or comparable area where the resource-extraction project takes place—thus ensuring ease of comparability and obviating the need for independent research.

Third, API's approach minimizes the burden that Section 13(q) imposes on issuers, because it lessens the disclosure of confidential and commercially sensitive information by allowing issuers to report payments confidentially, and by aggregating payment disclosures to a higher level of granularity. Thus, API's approach reflects Section 13(q)'s requirement that the Commission make information publicly available "[t]o the extent practicable."[140] Meanwhile, the information is still sufficiently localized to inform citizens of the amounts their national and subnational governments are receiving in resource-extraction revenue.

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[138] 80 Fed. Reg. at 80,075.

[139] *See id.* at 80,111 ("The 'geographic location of the project' as used in Item 2.01(a)(10) must be sufficiently detailed to permit a reasonable user of the information to identify the project's specific, subnational, geographic location. In identifying the location, resource extraction issuers may use subnational jurisdiction(s) (*e.g.*, a state, province, county, district, municipality, territory, etc.) and/or a commonly recognized, subnational, geographic or geological description (*e.g.*, oil field, basin, canyon, delta, desert, mountain, etc.). More than one descriptive term may be necessary when there are multiple projects in close proximity to each other or when a project does not reasonably fit within a commonly recognized, subnational geographic location. In considering the appropriate level of detail, resource extraction issuers may need to consider how the relevant contract identifies the location of the project.").

[140] 15 U.S.C. § 78m(q)(3)(A).

A more detailed explanation of the types of information that can be accessed and organized under the API regime illustrates the superior utility and convenience of API's proposed compilation model. In particular, a citizen of Nigeria using API's compilation model would be able to access the Commission's online compilation and immediately obtain and compare payment information based on specified locations (including subnational jurisdictions), operations (including mining, onshore and offshore oil operations, and gas), payees (including the national government, subnational governments, governmental agencies, and state-owned oil companies), and mineral segments (*e.g.*, oil, gas, copper, and coal).[141] By contrast, the Commission is vague about how citizens will create comparisons and compilations using company-specific disclosures on EDGAR, opting instead for conclusory claims that users will be able to "easily … extract, aggregate, and analyze the information in a manner that is most useful to them."[142] It appears, however, that under the Commission's proposal, the same Nigerian citizen would have to access EDGAR, specify certain full-text search terms, analyze the Form SDs containing those search terms to identify relevant contracts and payments within the relevant subnational jurisdiction, and then aggregate company- and contract-level information in order to make meaningful comparisons.

More specifically, a Nigerian citizen looking to determine the amount of money the Nigerian government receives from oil extraction in the Niger Delta would be able, using API's model, to specify search parameters based on the resource, the region, the payments, and the government payee. That citizen would then receive aggregated information and charts detailing all payments in the Niger Delta from the Commission's online compilation. By contrast, it appears that under the Commission's model, the same Nigerian citizen would have to access EDGAR, search for all Form SDs containing "Niger Delta," sort through contract and lease payments to determine which involve oil, and then aggregate that information to determine a total number of oil payments in that province. In these and other respects, API's model is more user-friendly and better informs citizens of the remuneration their governments are receiving for resource-extraction activities.[143]

Indeed, the Commission's reasons for rejecting API's compilation model are meritless. The Commission contends that API's proposed definition of project would

141 *See* API's proposed model at http://publications.api.org/API1504/.

142 80 Fed. Reg. at 80,084; *see also id*. at 80,104.

143 More detailed examples of confidential company submissions and of the compiled reports that could be readily prepared by users under API's proposal are set forth in Attachment A to this letter.

sometimes cover a broad geographic area, and allows issuers to aggregate payments to a higher level of generality.[144] But, as explained above, nothing in Section 13(q) suggests that a project must be identified in granular detail.[145] Moreover, the proposed rule's definition of project will also, at times, cover a broad geographic area, as the Commission recognizes.[146] And unlike the proposed rule's approach, API's definition is clear, uniform, and minimizes the disclosure of commercially sensitive information. The Commission also contends that, under API's approach, data for nine separate states in the Niger River Delta, occupied by 30 million people, would be aggregated into one project. But under API's approach a project would be defined by its major subnational political jurisdiction—*e.g.*, a state—and hence operations in each state would be separate projects. Thus, the Commission simply misunderstands API's proposed approach.

B. The Commission Should Provide An Exemption For Countries That Prohibit Disclosure Via Law Or Contract. [*Responding to Question 45*]

As explained above, API also proposes that the Commission grant a general exemption that excuses issuers from disclosing payment information where the disclosure would violate a host government's laws or existing contracts.[147] An exemption for host country legal prohibitions on disclosure could take three forms. First, the rule could exempt issuers from reporting payments in any country whose laws prohibit the disclosure. This is the approach most consistent with the Commission's obligation to adopt a rule that requires disclosure only "[t]o the extent practicable."[148] Second, the rule could exempt issuers from reporting payments in any country whose laws prohibited the disclosures, so long as those laws existed before the Commission adopted its rule. This would satisfy the Commission's concern about incentivizing countries to pass laws prohibiting disclosure, although we caution that this approach would still leave issuers vulnerable to the risk of a host nation passing an anti-disclosure law and subsequently expropriating the issuers' assets. Third, the rule could exempt issuers from reporting payments in specific countries—for example, China and Qatar—where the risk to issuers is particularly acute. While each of these exemptions would be preferable to the proposed rule's case-by-case exemption, should the Commission continue to deny a blanket exemption for countries that prohibit public disclosure of payment information, the Commission should incorporate language in the final rule indicating that it

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144 80 Fed. Reg. at 80,076.

145 *See supra* at 15-16.

146 80 Fed. Reg. at 80,076.

147 *See supra* at 24-28.

148 Exchange Act § 13(q), 15 U.S.C. § 78m(q)(3)(A).

will consult and coordinate with foreign governments to avoid the imposition of penalties on companies subject to the rule.

C. The Commission Should Adopt Three Other Exemptions To Minimize Undue Burdens On Issuers. [*Responding to Questions 41, 42, 43*]

The Commission should adopt three other exemptions to mitigate some of the other burdens imposed by Section 13(q).[149] First, the Commission should exempt disclosures that would reveal commercially sensitive information. This could be accomplished by allowing issuers to redact payment information temporarily until a later time when the disclosure would be less harmful (*e.g.*, after news of a new discovery is public knowledge). Second, the Commission should exempt disclosures in situations where revealing payment information would breach contractual obligations that existed before Congress passed Section 13(q). Many issuers have older, long-term contracts that forbid disclosure absent the host country's permission, and some of those contracts do not have exceptions for disclosures that are necessary to comply with securities laws. For these contracts, compelled disclosure has much the same effect as it laws that prohibit issuers from reporting payments. A company in breach may be forced to forgo anticipated profits from resource extraction, as well as assets that the company is forced to leave behind or sell at fire sale prices, resulting in massive losses. Finally, the Commission should exempt disclosures that might jeopardize the safety of an issuer's employees (including physical harm or criminal prosecution) or the national security of a host nation. This exemption would prove particularly helpful in countries that have active insurgencies or terrorist activity.

VII. The Commission Should Allow Issuers to "Furnish" Rather Than "File" The Required Disclosures. [*Responding to Question 67*]

The SEC has indicated that Section 13(q)'s purpose is to increase transparency and the accountability of governments for the revenue they receive from their countries' natural resources. As the Commission itself acknowledges, "these objectives and benefits differ from the investor protection benefits that [the Commission's] rules typically strive to achieve[.]"[150] Indeed, disclosure under Section 13(q) will not be material to the vast majority of investors. Thus, the Commission should allow issuers to "furnish," rather than "file," their

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[149] As shown above, the Commission's promise to "consider" case-by-case exemptions in the future is an inadequate substitute, because issuers need the certainty of knowing how the rule will affect them now. *See supra* at 27-28.

[150] 80 Fed Reg. at 80,087.

annual disclosures under Section 13(q). That would reduce costs to issuers and avoid subjecting them to potential liability under Section 18.[151]

The Commission contends that Section 13(q)'s text supports its decision to require issuers to "file" their annual reports because the statute defines a "resource extraction issuer" as "an issuer that is required to file an annual report with the Commission."[152] But that definition simply defines *who* must disclose payment information under Section 13(q)—SEC filers that "engage[] in the commercial development of oil, natural gas, or minerals"—not *how* they must disclose it.[153] The Commission also equivocates as to whether disclosures under Section 13(q) are useful to investors.[154] But resource-extraction issuers are already subject to numerous reporting requirements that provide investors with ample information to make investment decisions. And although the Commission cites a handful of commenters who claimed that the information disclosed under Section 13(q) would be material to them, the fact that a small number of special-interest investors desire access to information is insufficient for the Commission to conclude that the disclosures benefit investors as a group.[155]

VIII. The Commission's Proposed Definition of "Control" Is Preferable To An Alternative Definition Under Rule 12b-2, But Imposes Unreasonable Burdens On Issuers And Undermines Section 13(q)'s Purpose. *[Responding to Question 20]*

For the reasons discussed in API's November 2013 comment letter to the Commission, API generally supports a definition of "control" under generally accepted accounting principles in the United States, or under similar international reporting standards, rather than under SEC Rule 12b-2.[156] Nonetheless, one aspect of the Commission's new proposed definition of "control" would unreasonably burden companies that develop oil and natural gas through joint ventures and undermine Section 13(q)'s purpose of informing citizens of government revenues.

151 *See* 15 U.S.C. § 78r.

152 80 Fed. Reg. at 80,086 (citing 15 U.S.C. § 78m(q)(1)(D)(i)).

153 15 U.S.C. § 78m(q)(1)(D).

154 *See* 80 Fed. Reg. at 80,086.

155 *See Bus. Roundtable*, 647 F.3d at 1152.

156 80 Fed. Reg. at 80,074, 80,110.

Under proposed Item 2.01(c)(3), "control" means "that the resource extraction issuer consolidates the entity *or proportionally consolidates* an interest in an entity or operation."[157] The proposing release elaborates on this phrase's meaning: "The extent to which the controlled entity is consolidated would determine the extent to which payments made by that entity would need to be disclosed. For example, a resource extraction issuer that proportionally consolidates an entity *would have to report that entity's eligible payments on a proportionate basis*, listing the proportionate interest."[158] This would appear to require an issuer who participates in extraction activities as part of a joint venture to report the issuer's proportional share of payments made to a host government by another issuer in the joint venture. API requests that the Commission change the definition of "control" and include sufficient clarifying language in the final rule's adopting release that would require *only the company actually making a payment to the host government* to report that payment (even if a portion of such a payment is on behalf of other companies in the joint venture).

By way of further explanation, companies often engage in joint ventures to develop oil and natural gas resources. One party to the joint venture is typically the "operator"—meaning the company has operational responsibility for the project—while one or more other companies are "non-operators"—meaning the companies have a financial investment in the project but do not take part in the actual operation of the project. The costs of developing the project are typically allocated on the basis of ownership in the joint venture. For example, Company X might be the operator with a 40% financial interest in the project, Company Y might be a non-operator with a 30% financial interest, and Company Z might also be a non-operator with a 30% financial interest. As the operator, Company X would make all payments to the host government for the project. Company X would then subsequently invoice Company Y and Company Z for their shares of the government payment. Neither Company Y nor Z would know the *timing* of such payments, however. In fact, Company X might invoice Company Y and Z for anticipated payments to the host government even *before* Company X makes such a payment (known in the business as a "cash call"). Company Y and Company Z, as non-operators, might not even know the identity of the government or entity receiving payments from Company X, or even the currency of the payment itself.

Operator invoices do not provide this level of granular detail, and joint venture contracts do not require that operators provide payee specific information to non-operators. Some of the operators are not SEC registrants and therefore will not be subject to SEC rules

[157] *Id.* at 80,110 (emphasis added).

[158] *Id.* at 80,074 (emphasis added).

requiring the disclosures. This will lead to incomplete data in the reporting of non-operator amounts by the non-operators who are SEC registrants, as this information will not be available from operators who do not voluntarily choose to provide the information to the non-operators.

The costs and time burdens to reporting companies would be diminished, and Section 13(q)'s purposes would be better served, by requiring only the operator of a joint venture to report the payment the operator made to the host government for the project. (To the extent that Company Y or Company Z make independent payments to the host government, those companies would report those payments.) This approach, in which each company reports only the payments it makes, would lower the costs and administrative burdens on reporting companies because it would not require the various companies in the joint venture to spend time and money to determine when the operator made government payments, in what amounts, and which portions should be allocated to which joint venture member. API's proposed approach would better promote the revenue transparency purposes of Section 13(q) because it would accurately capture payments made to the host governments by the companies making the payments. The simpler and clearer methodology of API's proposed approach would also leave less room for error and interpretive differences among reporting companies than the Commission's proposal of requiring companies to determine and independently report their proportional share of a government payment. This approach also aligns with EITI reports and the EU's reporting regime, in which the entity that actually makes the payment reports its payments.

API acknowledges that our proposed change to the Commission's proposed definition of "control" could result in non-reporting of certain payments. Specifically, if an operator of a joint venture is not subject to the Commission's jurisdiction—because it is a national oil company, privately held company, or for some other reason—the operator would not be required to report its payment to the host government even if minority partners in the joint venture are subject to the rule. This reporting lacuna is not specific to API's proposed change to the definition of control, however. Similar reporting gaps would exist under the Commission's proposed definition of control in different scenarios. For example, under the Commission's proposal, if a company subject to the rule is the operator in a joint venture but the minority joint venture partners are national oil companies, the operator would be required to report only its own proportional share of the payment made to the host government, leaving the shares of the minority joint venture partners unreported. This would also result in an incomplete payment disclosure. For these reasons, the Commission should adopt API's proposed definition of "control."

IX. API Supports The Proposed Rule's Provision For Alternative Reporting. [*Responding to Question 49*]

API supports the Commission's proposal to allow alternative reporting under similar disclosure laws in other nations.[159] This approach may reduce the compliance burden on issuers that are subject to the reporting requirements in the EU or Canada, as well as issuers that report payments under EITI.

X. Conclusion

API appreciates the opportunity to provide comments on the Commission's proposed rule implementing Section 13(q). Should you have any questions about these comments, please contact Peter Tolsdorf at [redacted].

Sincerely,

Stacy Linden
Vice President, General Counsel,
& Corporate Secretary

[159] *Id.* at 80,082-83, 80,110.

ATTACHMENT A

EXHIBIT A - EXAMPLE OF PROPOSED INPUTS

(All data is for illustrative purposes only and is not intended to represent actual payment streams)

COMPANY ABC INPUT (payor name submitted but remains confidential)

How	What	Where															
Project																	
Operation Parameter	Mineral Parameter	Country	State/Province/Region	Entity Paid	Taxes	Royalties	Fees	Licenses	Production Entitlement	In kind Entitlement	In Kind Valuation	Bonuses	Dividends	Infrastructure	Currency	Currency Calculation	Business Segment
Onshore	Oil	Nigeria	Bayelsa	Federal Government of Nigeria	75	100		125	150			20			USD		UPSTREAM
Offshore	Oil	Nigeria	Delta	Nigerian National Petroleum Corporation		200	75								USD		UPSTREAM
Onshore	Gas	Nigeria	Delta	Federal Inland Revenue Service	2										USD		UPSTREAM
Onshore	Gas	Nigeria	Delta	Niger Delta Devlopment Commission			42								USD		UPSTREAM
Onshore	Gas	Nigeria	Delta	Nigeria LNG Limted		250			100			50			USD		UPSTREAM
Onshore	Oil	Nigeria	Delta	Federal Government of Nigeria	300	100	25	70	400	200	QMV	50		10	USD		UPSTREAM
Onshore	Oil	Nigeria	Delta	Nigeria State of Delta			50					10		25	USD		UPSTREAM
Onshore	Oil	Nigeria	Delta	Nigerian National Petroleum Corporation				25				150			USD		UPSTREAM
Offshore	Gas	Nigeria	Rivers	Nigeria LNG Limted	80	100			200	50	QMV				USD		UPSTREAM
Onshore	Gas	Nigeria	Rivers	Nigeria LNG Limted	12	75	25		600				25		USD		UPSTREAM
Onshore	Gas	Nigeria	Rivers	Rivers State Internal Revenue Service	75		15								NGN	W/A	UPSTREAM
Non Associated	Non-Associated	Nigeria		Federal Government of Nigeria	300								200		NGN	W/A	
Onshore	Oil	Nigeria	Delta	Delta State Internal Revenue Service	50										NGN	W/A	UPSTREAM

COMPANY CBA INPUT (payor name submitted but remains confidential)

Project																	
Operation Parameter	Mineral Parameter	Country	State/Province/Region	Entity Paid	Taxes	Royalties	Fees	Licenses	Production Entitlement	In kind Entitlement	In Kind Valuation	Bonuses	Dividends	Infrastructure	Currency	Currency Calculation	Business Segment
Mining	Coal	Nigeria	Delta	Nigerian National Petroleum Corporation				25				150			USD		UPSTREAM
Mining	Copper	Nigeria	Delta	Federal Government of Nigeria	300	100	25	70	400	200	QMV	50		10	USD		UPSTREAM
Mining	Copper	Nigeria	Delta	Nigeria State of Delta			50					10		25	USD		UPSTREAM
Onshore	Gas	Nigeria	Delta	Nigeria LNG Limted		375			100			50			USD		UPSTREAM
Mining	Coal	Nigeria	Delta	Delta State Internal Revenue Service	50										NGN	W/A	UPSTREAM

COMPANY XYZ INPUT (payor name submitted but remains confidential)

Project																	
Operation Parameter	Mineral Parameter	Country	State/Province/Region	Entity Paid	Taxes	Royalties	Fees	Licenses	Production Entitlement	In kind Entitlement	In Kind Valuation	Bonuses	Dividends	Infrastructure	Currency	Currency Calculation	Business Segment
Onshore	Oil	Nigeria	Bayelsa	Federal Government of Nigeria	75	100		125	150			20			USD		UPSTREAM
Offshore	Gas	Nigeria	Delta	Nigeria LNG Limted	3	700	4							10	USD		UPSTREAM
Offshore	Oil	Nigeria	Delta	Nigerian National Petroleum Corporation	75	200	75								USD		UPSTREAM
Onshore	Gas	Nigeria	Delta	Federal Inland Revenue Service	2										USD		UPSTREAM
Onshore	Gas	Nigeria	Delta	Niger Delta Devlopment Commission			42								USD		UPSTREAM
Onshore	Gas	Nigeria	Delta	Nigeria LNG Limted		250			100			50			USD		UPSTREAM
Onshore	Oil	Nigeria	Delta	Federal Government of Nigeria	400	100	25	70	400	200	QMV	50		10	USD		UPSTREAM
Onshore	Oil	Nigeria	Delta	Nigeria State of Delta	5		50					10		25	USD		UPSTREAM
Onshore	Oil	Nigeria	Delta	Nigerian National Petroleum Corporation				25				150			USD		UPSTREAM
Offshore	Gas	Nigeria	Rivers	Federal Inland Revenue Service	2	300									USD		UPSTREAM
Onshore	Gas	Nigeria	Rivers	Nigeria LNG Limted	3	75	25		350				25		USD		UPSTREAM
Onshore	Gas	Nigeria	Rivers	Rivers State Internal Revenue Service	75		15								NGN	W/A	UPSTREAM
Onshore	Oil	Nigeria	Delta	Delta State Internal Revenue Service	50										NGN	W/A	UPSTREAM
Non-Associated	Non-Associated	Nigeria		Federal Government of Nigeria	200								10		NGN	W/A	
				Total	**2134**	**3025**	**543**	**535**	**2950**	**650**	**0**	**820**	**260**	**115**			

QMV = Quarterly Market Value

USD = US Dollar

NGN = Nigerian Naira

W/A = Weighted Average

EXHIBIT B - EXAMPLE COMPILATION REPORT: LOCATION

(All data is for illustrative purposes only and is not intended to represent actual payment streams)

Operation Parameter	Mineral Parameter	Location Parameter		Taxes	Royalties	Fees	Licenses	Production Entitlement	In kind Entitlement	In Kind Valuation	Bonuses	Dividends	Infrastructure
		Country	State/Province/Region										
Mining	Coal	Nigeria	Delta	50	0	0	25	0	0	0	150	0	0
Mining	Copper	Nigeria	Delta	300	100	75	70	400	200	0	60	0	35
Offshore	Gas	Nigeria	Delta	3	700	4							10
Offshore	Oil	Nigeria	Delta	75	400	150	0	0	0	0	0	0	0
Onshore	Gas	Nigeria	Delta	4	875	84	0	300	0	0	150	0	0
Onshore	Oil	Nigeria	Delta	805	200	150	190	800	400	0	420	0	70
			Total	**1237**	**2275**	**463**	**285**	**1500**	**600**	**0**	**780**	**0**	**115**

EXHIBIT C - EXAMPLE COMPILAITON REPORT: OPERATIONS

(All data is for illustrative purposes only and is not intended to represent actual

Operation Parameter	Mineral Parameter	Location Parameter		Taxes	Royalties	Fees	Licenses	Production Entitlement	In kind Entitlement	Bonuses	Dividends	Infrastructure
		Country	State/Province/Region									
Mining		Nigeria		350	100	75	95	400	200	210	0	35
Non-Associated	Non-Associated	Nigeria		500	0	0	0	0	0	0	210	0
Offshore		Nigeria		160	1500	154	0	200	50	0	0	10
Onshore		Nigeria		1124	1425	314	440	2350	400	610	50	70
			Total	**2134**	**3025**	**543**	**535**	**2950**	**650**	**820**	**260**	**115**

EXHIBIT D - EXAMPLE COMPILATION REPORT: PAYEES

(All data is for illustrative purposes only and is not intended to represent actual payment streams)

Operation Parameter	Mineral Parameter	Location Parameter: Country	Location Parameter: State/Province/Region	Entity Paid	Taxes	Royalties	Fees	Licenses	Production Entitlement	In kind Entitlement	Bonuses	Dividends	Infrastructure
Mining	Copper	Nigeria	Delta	Federal Government of Nigeria	300	100	25	70	400	200	50		10
Non-Associated	Non-Associated	Nigeria		Federal Government of Nigeria	500	0	0	0	0	0	0	210	0
Onshore	Oil	Nigeria	Bayelsa	Federal Government of Nigeria	150	200	0	250	300	0	40	0	0
Onshore	Oil	Nigeria	Delta	Federal Government of Nigeria	700	200	50	140	800	400	100	0	20
			Total	**Federal Government of Nigeria**	**1650**	**500**	**75**	**460**	**1500**	**600**	**190**	**210**	**30**
Onshore	Gas	Nigeria	Delta	Federal Inland Revenue Service	4	0	0	0	0	0	0	0	0
Offshore	Gas	Nigeria	Rivers	Federal Inland Revenue Service	2	300							
			Total	**Federal Inland Revenue Service**	**6**	**300**	**0**	**0**	**0**	**0**	**0**	**0**	**0**
Onshore	Gas	Nigeria	Delta	Niger Delta Devlopment Commission			42						
			Total	**Niger Delta Devlopment Commission**	**0**	**0**	**84**	**0**	**0**	**0**	**0**	**0**	**0**
Offshore	Gas	Nigeria	Delta	Nigeria LNG Limted	3	700	4						10
Onshore	Gas	Nigeria	Delta	Nigeria LNG Limted	0	875	0	0	300	0	150	0	0
Offshore	Gas	Nigeria	Rivers	Nigeria LNG Limted	80	100			200	50			
Onshore	Gas	Nigeria	Rivers	Nigeria LNG Limted	15	150	50	0	950	0	0	50	0
			Total	**Nigeria LNG Limted**	**98**	**1825**	**54**	**0**	**1450**	**50**	**150**	**50**	**10**
Mining	Copper	Nigeria	Delta	Nigeria State of Delta			50				10		25
Onshore	Oil	Nigeria	Delta	Nigeria State of Delta	5	0	100	0	0	0	20	0	50
			Total	**Nigeria State of Delta**	**5**	**0**	**150**	**0**	**0**	**0**	**30**	**0**	**75**
Mining	Coal	Nigeria	Delta	Nigerian National Petroleum Corporation				25			150		
Offshore	Oil	Nigeria	Delta	Nigerian National Petroleum Corporation	75	400	150	0	0	0	0	0	0
Onshore	Oil	Nigeria	Delta	Nigerian National Petroleum Corporation	0	0	0	50	0	0	300	0	0
			Total	**Nigerian National Petroleum Corporation**	**75**	**400**	**150**	**75**	**0**	**0**	**450**	**0**	**0**
Onshore	Gas	Nigeria	Rivers	Rivers State Internal Revenue Service	150	0	30	0	0	0	0	0	0
			Total	**Rivers State Internal Revenue Service**	**150**	**0**	**30**	**0**	**0**	**0**	**0**	**0**	**0**
Mining	Coal	Nigeria	Delta	Delta State Internal Revenue Service	50								
Onshore	Oil	Nigeria	Delta	Delta State Internal Revenue Service	100	0	0	0	0	0	0	0	0
			Total	**Delta State Internal Revenue Service**	**150**	**0**	**0**	**0**	**0**	**0**	**0**	**0**	**0**
		Nigeria	**Total**		**2134**	**3025**	**543**	**535**	**2950**	**650**	**820**	**260**	**115**

EXHIBIT E - EXAMPLE COMPILATION REPORT: MINERAL SEGMENTS

(All data is for illustrative purposes only and is not intended to represent actual payment streams)

	Location Parameter							Production	In kind			
Mineral Parameter	Country	State/Province/Region	Entity Paid	Taxes	Royalties	Fees	Licenses	Entitlement	Entitlement	Bonuses	Dividends	Infrastructure
Coal	Nigeria	Delta	Delta State Internal Revenue Service	50								
Coal	Nigeria	Delta	Nigerian National Petroleum Corporation				25			150		
			Total Coal	**50**	**0**	**0**	**25**	**0**	**0**	**150**	**0**	**0**
Copper	Nigeria	Delta	Federal Government of Nigeria	300	100	25	70	400	200	50		10
Copper	Nigeria	Delta	Nigeria State of Delta			50				10		25
			Total Copper	**300**	**100**	**75**	**70**	**400**	**200**	**60**	**0**	**35**
Gas	Nigeria	Rivers	Federal Inland Revenue Service	6	300	0	0	0	0	0	0	0
Gas	Nigeria	Delta	Niger Delta Devlopment Commission	0	0	84	0	0	0	0	0	0
Gas	Nigeria	Rivers	Nigeria LNG Limted	98	1825	54	0	1450	50	150	50	10
Gas	Nigeria	Rivers	Rivers State Internal Revenue Service	150	0	30	0	0	0	0	0	0
			Total Gas	**254**	**2125**	**168**	**0**	**1450**	**50**	**150**	**50**	**10**
Non-Associated	Nigeria		Federal Government of Nigeria	500	0	0	0	0	0	0	210	0
			Total Non-Associated	**500**	**0**	**0**	**0**	**0**	**0**	**0**	**210**	**0**
Oil	Nigeria	Delta	Delta State Internal Revenue Service	100	0	0	0	0	0	0	0	0
Oil	Nigeria	Delta	Federal Government of Nigeria	850	400	50	390	1100	400	140	0	20
Oil	Nigeria	Delta	Nigeria State of Delta	5	0	100	0	0	0	20	0	50
Oil	Nigeria	Delta	Nigerian National Petroleum Corporation	75	400	150	50	0	0	300	0	0
			Total Oil	**1030**	**800**	**300**	**440**	**1100**	**400**	**460**	**0**	**70**
			Total	**2134**	**3025**	**543**	**535**	**2950**	**650**	**820**	**260**	**115**

ATTACHMENT B

NERA
ECONOMIC CONSULTING

Analysis of Rule 13q-1

Prepared for American Petroleum Institute

February 16, 2016

Project Team

Jeff D. Makholm, Ph.D.

Laura T.W. Olive, Ph.D

Stephen Collins

Matthew Cowin

NERA Economic Consulting

11th Floor, 200 Clarendon Street

Boston, Massachusetts 02116

Tel: 1 (617) 927-4500 Fax: 1 (617) 927-4501

www.nera.com

I. Summary

The SEC has observed that Section 13(q) of the Exchange Act seeks to promote transparency by requiring resource extraction issuers to include in their annual reports any payment made to the US or a foreign government for the commercial development of oil, natural gas, or minerals (i.e., extractive industries). By its terms, Section 13(q) requires data on the type and total amount of such payments made for each project related to the commercial development of oil, natural gas, or minerals (SEC Proposed Rule, 80 Fed. Reg. 80,058 (Dec. 23, 2015)). One of the issues the SEC has acknowledged in implementing Section 13(q), however, is that governments in at least four countries—Angola, Cameroon, China and Qatar—have laws that could prohibit the disclosure of such information. Absent an exemption or permission from the host country, neither of which is guaranteed, complying with both 13(q) and local laws could require that US issuers halt their commercial oil, gas and minerals activities in those countries. A second issue concerns the SEC's proposed public disclosure of issuers' contract-level payments: whether such contract-level disclosure hurts competition in the oil, natural gas, and mineral industries.[1] We examine both issues in this report.

As an economic matter for extractive industries, these two issues are closely related as they both involve the value of investments that are long-term, immobile, idiosyncratic to particular developments, and essentially sunk. That is, the nature of such investments drives both the potential stranded value of investment due to disclosure requirements in Angola, Cameroon, China, and Qatar and the loss of value generally if competitive industry "trade secrets" cannot be preserved. Put another way, the nature of investment in extractive industries heightens the importance of both long-term relationships with associated enterprises (e.g., landowners, local transport, supporting industries, etc.) and the ability to capitalize on private information (i.e., trade secrets) that motivates particular extraction projects.

[1] The statute refers to project-level disclosure—the SEC has opted for contract level disclosure. *See* Securities & Exchange Act § 13(q)(2)(A), 15 U.S.C. § 78m(q)(2)(A) (addressing disclosure at the "project" level); 80 Fed. Reg. 80,058, 80,0075 (Dec. 23, 2015) (proposing contract-level disclosure).

Conceding that Rule 13q-1 could force issuers to halt activities or exit from countries such as Angola, Cameroon, China, or Qatar, the SEC estimates the associated cost to issuers of what it labels a "fire sale" of those assets. There are good reasons to be skeptical of that analysis in general—but particularly with respect to the size of the harm to issuers. First, the SEC quantifies the total potential issuer value at risk by looking only at issuer *costs*—a particularly unreliable measure of market value in extractive industries where the yield of particular projects is variable and profitability is tied to the world price of commodities. Particularly in extractive industries, where the value of any project's sunk costs depends on the particular payoff to the resources associated with that project, there is no reliable link between asset costs and market values of in-country projects.

Upon an unreliable foundation for potential harm, the agency has also undervalued the "fire sale" losses to extractive industry issuers. The SEC ignores that extractive industry assets are of classes that are tied to a greater degree to specific locations and related businesses than the industries that the SEC uses as benchmarks for "fire sale" losses. Investments in extractive industries are largely sunk and so dedicated to specific business relationships that they pose great difficulties for their owners if the plans that motivated them are interrupted. The businesses used by the SEC to measure possible losses if Rule 13q-1 interrupts operations simply do not reflect that essential nature of extractive industry operations.

In addition, the SEC's "liquidity index" is US-based. In the petroleum industry in particular, the US market exhibits great competitiveness and industrial/financial liquidity at every link in the productive chain. Such is not the case elsewhere—particularly in Angola, Cameroon, China, and Qatar. A US-based "liquidity index" provides no useful information in such countries.

The contract-level disclosures, which the SEC wishes issuers to provide, amount to the loss of trade secrets. Whether competitiveness is hurt by the disclosure of such trade secrets depends on the nature of investment in an industry. For the extractive industries in general, and oil and gas in particular, investments must be risked, and sunk, well in advance of the production of marketable commodities. Extractive issuers have a legitimate business interest in protecting their trade secrets when their great and long-lasting fixed investments couple with volatile market prices based on intangible market expectations. The SEC's proposed rule ignores that reality.

The SEC's proposed rule shows no appreciation for the harm it poses for extractive issuers—the petroleum industry in particular. The SEC's fire sale analysis simply looks at the wrong type of industries (not including resource extraction) in the wrong place (the United States), and its estimation of the magnitude of the harm is understated and unhelpful.

II. Evaluation and Critique of SEC "Fire Sale" Analysis

The SEC presents an analysis with four components to derive the expected costs of disclosure for issuers with assets in Angola, Cameroon, China, and Qatar.[2] The SEC first estimates the market value for 20 companies' assets in those four countries by assuming that it equals the fraction of book value costs of in-country assets to those issuers' total asset costs. Next, the SEC estimates a range of "fire sale" discounts of 3-69 percent by examining economic studies of four US industries (aircraft, aerospace equipment, houses, and stand-alone private firms). To estimate the "fire sale" discount for resource extraction industries in this range, the SEC calculates a "liquidity index" for various US industries to gauge the ease of asset disposal—concluding that resource extraction is highly illiquid. The SEC tried to gauge such a liquidity index for Angola, Cameroon, China, and Qatar, either directly or through calculating the number of corporate control transactions in each country, but could not draw useful conclusions. As a result, the SEC simply takes the high end of the original range (69 percent) as its conclusion of the "fire sale" discount for extractive industries.

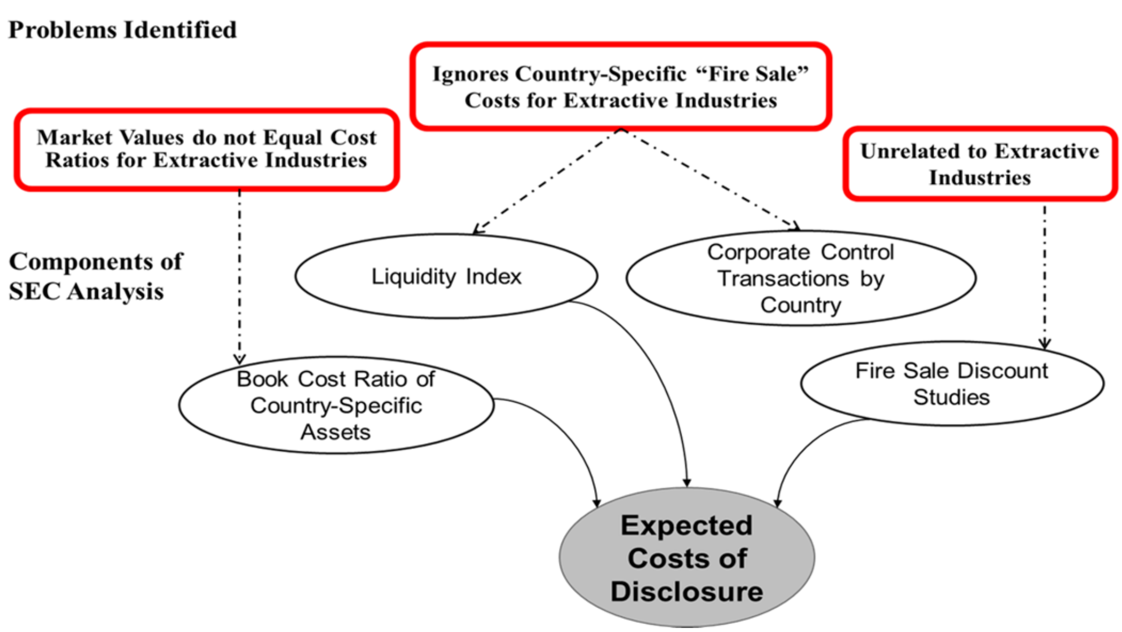
There are three serious problems with the SEC's analysis that show its insensitivity to the costs that contract-level disclosure would pose for issuers in extractive industries. <u>First</u>, book value costs are not reflective of project valuations in extractive industries—where productivity of

[2] SEC Proposed Rule, 80 Fed. Reg. at 80,097-98.

particular projects is variable and related profitability depends not on costs but on the world fuel price. Second, the industries that the SEC uses to gauge the potential for fire sale losses do not exhibit the fundamental characteristics of extractive industries that make sunk-cost investments long in advance of the long-term production profiles expected to make those investments profitable. Third, the SEC's "liquidity index" analysis points to special problems for extractive industries that the agency simply did not answer, choosing instead simply to revert to a "fire sale" estimate for an unreflective industry.

Figure 1 identifies these three problems with the SEC's four-component "fire sale" analysis. The overarching problem with the SEC's analysis is its failure to deal with the characteristics that distinguish the extractive industry from all others—particularly those gauged by the SEC. We conclude that those characteristics reasonably would mean that discounts are considerably greater than those the SEC estimates for its four target industries.

Figure 1: Components of SEC Analysis



a. Booked Asset Costs do not reflect Market Values

The SEC’s analysis uses data on asset costs to estimate exposed value in the four countries mentioned above. While it is true that public data are difficult to obtain on the market value of the projects in these four countries for the companies the SEC examines, asset cost ratios cannot accurately capture the market values of the projects in those countries. Convenience of the SEC’s valuation book value metric does not equate to accuracy. To compute a realistic size of threatened “fire sale” assets in such markets, more reasonable empirical work would have to be done. As the book value of investments is high (in the tens of billions[3]), so, too, the market value for such investments—in the aggregate and over time—is at least that high, as issuers would expect to recoup those costs plus associated investment returns.

b. Failure to Consider Sunk Costs

The SEC’s analysis acknowledges that complying with both local laws and Rule 13q-1 could, as a practical matter, require the exit of US issuers from oil, gas and minerals extractive activities from Angola, Cameroon, China or Qatar. In an attempt to gauge the cost to US issuers of such exits, the SEC has performed its “fire sale” analysis by looking at four diverse industries shown in Figure 2.

Figure 2: SEC Identified Industries

Commercial Aircraft	Forced Home Sales	Stand-Alone Private Firms	Aerospace Equipment

[3] SEC Proposed Rule, 80 Fed. Reg. at 80,098-99.

The SEC's analysis acknowledges that these industries do not readily compare to resource extraction. For example, the US aircraft market studied in Pulvino (1998) involves the trade of highly mobile capital assets where fire sale discounts arise only when the selling firm is distressed. Forced house sales and sales of stand-alone private firms do not have the relationship-specific features of resource extraction industries (Campbell, et al., 2011; Officer, 2007). The SEC concludes that the aerospace industry is the most comparable to extraction industries and thus that the resulting fire sale discounts are illuminating (Ramey and Shapiro, 2001).

But the "most comparable" of four non-comparable industry groups is unhelpful. The aerospace industry does not display the characteristics inherent in the resource extraction industry that can harm issuers if their projects in these four countries face a fire sale for two reasons. First, extractive industries are dominated by a class of sunk-cost assets that economists label "relationship-specific" or "transaction-specific." Such assets have their full value only in relation to specific transactions and become less valuable if relegated to other uses. If business relationship or contracts are interrupted by a "fire sale" coming on the heels of Rule 13q-1, the market value of such assets is exposed to total loss. The costs of such assets are sunk with nothing to retrieve. Indeed, for practical purposes, the exit of resource extraction activities in these countries, taking place on government-owned land (or even on private land where sub-surface minerals rights are government-owned) could readily prompt opportunistic action to seize or nationalize assets by locally-owned or government-owned enterprises. In such a context, we conclude that the SEC's 69 percent "fire sale" discount is too low.

i. Looking at the Wrong Type of Industries in the Wrong Place

The SEC's economic analysis of proposed Rule 13q-1 fails properly to account for the general immobility and illiquidity of the physical assets used for oil and natural gas development. "Transaction-cost economics" studies how firms organize themselves (e.g., the degree of vertical integration) and how they contract with each other to maintain economic businesses and relationships given such sunk investment costs and uncertainties in markets. From the perspective of "transaction-cost economics" (not a splinter field—it has produced two Nobel Prizes in Economics),[4] it is reasonable to conclude that the SEC's "fire sale" analysis simply looks at the wrong type of industries (not including resource extraction) in the wrong place (the United States).

The problem of sunk investment costs compels investors to forge reliable commercial relationships *before* investing capital in extractive industries (Williamson, 2005; Crocker & Reynolds, 1993). Building first and negotiating later (which a "fire sale" would force) would allow local governments or others to take advantage of the immobility of investors' committed capital to extract concessions, sharply limit expected profitability, or seize assets outright.

Dealing with the sunk costs inherent in extractive industries requires that issuers and local government and business counterparts transact reliably with one another. In any transaction with such sunk investment costs, those investments are vulnerable to opportunistic capture by their counterparties (Williamson, 1996). Such investments pose a cost for which the two remedies are either vertical integration or long-term agreements. Because vertical integration may not be a practical solution available to oil companies in Angola, Cameroon, China, and Qatar, it becomes imperative that they have strong and durable contract terms (Klein, et al., 1978). Interrupting those contracts with a "fire sale" simply hands to counterparties the ability to capture the market opportunities attached to those sunk costs.

The SEC's discussion of the problems facing resource extraction issuers takes none of these particular sunk-cost problems facing extraction industries into account. The SEC draws on businesses that do not have the same difficulty in redeploying assets (either flying them away or shipping them out) as those in extractive industries that cannot be so moved. Further, the SEC does not show an appreciation for the disruptive effect of an extractive industry fire sale on long-

[4] Ronald Coase in 1991 and Oliver Williamson in 2009.

term contracts.[5] Put another way, the SEC does not appear to recognize the unusual transacting disruptions that a rule prompting fire sales would impose on the business of resource extraction.

The proposed rule never mentions "sunk costs" at all.[6] The closest the SEC comes to the concept is its discussion of "specialized equipment" in the aerospace industry.[7] But specialized equipment is not sunk in any way similar to extractive industry investments. It is thus clear enough that the SEC has missed in its analysis the most distinguishing features of extractive industries.

ii. Support Industries for Resource Extraction Issuers

The SEC tries, and fails, to address "fire sale" costs through its analysis of "liquidity."[8] Its "liquidity" analysis is indicative of its inability to appreciate the problem that a "fire sale" would pose for resource extraction industries outside the United States (from which it draws its liquidity analysis). Such "liquidity" for the US petroleum industry in particular is evident in the competitiveness of its related support industries. Using the Department of Labor's Standard Industrial Classification (SIC) codes, the nature of competition in the sectors that supply US oil and gas extraction is evident: SIC 1311 (Crude Petroleum and Natural Gas) contains 146 firms; SIC 1382 (Oil and Gas Field Exploration Services), 16 firms (Ibbotson, 2013). Most of these firms are privately held. For publicly-traded firms, the *Value Line Investment Survey* lists 91 publicly-traded firms in its "Oilfield Services/Equipment Industry" listing—many of which have been in business for decades. These industries have political weight and a unique freedom to operate in the United States. There is a degree of liquidity in this and other industries not in any way reflected by conditions in Angola, Cameroon, China and Qatar.

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[5] The SEC notes: "Affected issuers also could suffer substantial losses if they have to terminate their operations and redeploy or dispose of their assets in the host country under consideration." SEC Proposed Rule, 80 Fed. Reg. at 80,097.

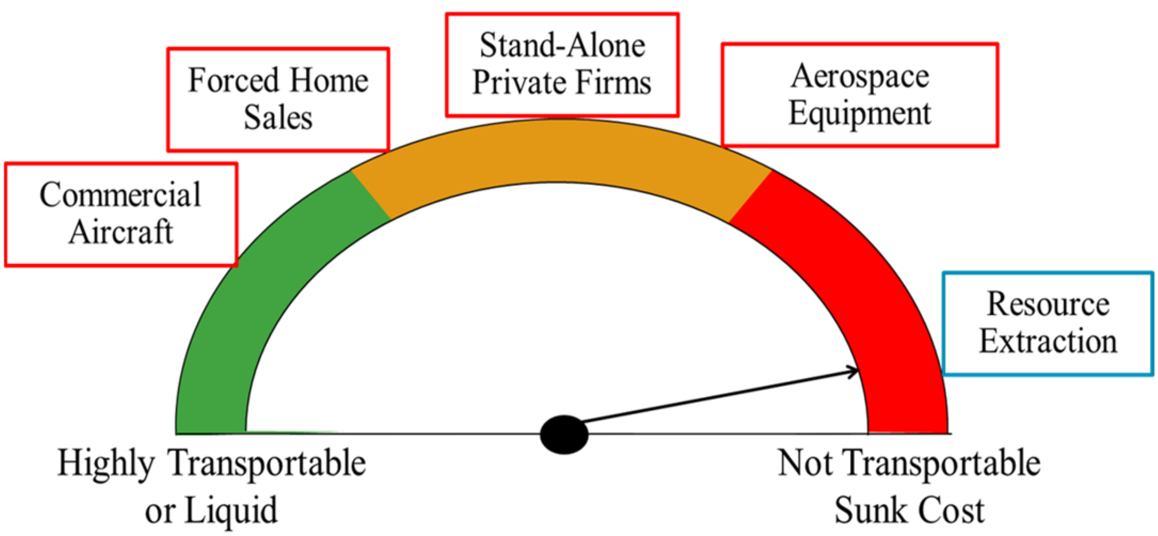
[6] Other than and a couple of brief mentions that losses will be larger if it is difficult to find buyers or alternative uses for extractive industry assets, the SEC analysis does not acknowledge the level of sunk costs associated with resource extraction investments. SEC Proposed Rule, 80 Fed. Reg. at 80,097-98.

[7] SEC Proposed Rule, 80 Fed. Reg. at 80,099.

[8] "We measure the ease with which issuers in a given industry could sell their assets by a liquidity index." SEC Proposed Rule, 80 Fed. Reg. at 80,099.

There is no direct way to account for differences in such related business to the SEC's quantitative fire sale analysis. Rather, it points generally to a lack of appreciation for the extreme difficulties facing extractive industry issuers if they were to face a "fire sale." In addition, any "fire sale" presumes that there would actually *be* a sale. The risk exists that those countries will simply seize an issuer's assets due to violation of local law and breach of contract. Many industry contracts contain provisions prohibiting disclosure without the country's permission that could provide the basis for seizing assets.

Figure 3: Difficulty of Transferring Assets at Market Value



c. Competitive Harm Associated With Disclosures in the Context of Sunk Investment Costs

Beyond simply the SEC's fire sale analysis, it is evident that the agency does not appreciate generally the role of contract-level confidentiality in businesses characterized by the need to plan for the long-term payoff of sunk cost investments. More than for other industries, those with sunk investment costs rely to a greater extent on confidential business relationships and the retention of the intellectual property—the trade secrets—that help to support long-term profitability.

In economic terms, contract-level disclosures amount to the loss of trade secrets. Patents, trademarks and trade secrets are all part of intellectual property—the "ownership of ideas" (Friedman, Landes and Posner, 1991). For the extractive industries, sunk cost investments must be risked well in advance of the production of marketable commodities. Extractive issuers have a legitimate business interest in protecting such trade secrets when their great and long-lasting fixed investments couple with volatile market prices based on intangible market expectations. It has long been held generally, in economics and in practical business, that successful risk-taking and competitive advantage in resource extraction industries rely on competitive and confidential contracting to avoid free-ridership[9] and permit such firms to recover their investments.

Just as with the economic literature dealing with the problems of sunk investment costs, there is a complimentary literature on the value of preserving trade secrets in the presence of such costs. Some of that literature is general and theoretical in nature dealing with trade secrets (Leuz & Wysocki, 2006; Verrecchia, 1990; Wagenhofer, 1990) and free-riders (Darrough and Stoughton, 1990; Leuz and Wysocki, 2006; Verrecchia, 1983). Other literature deals with specific industry problems with disclosure (Aragon, et al, 2012, Betzer and Brinkley, 2015, Clinch and Ferecchia, 1997). Some deal with the petroleum industry specific to the Dodd Frank Act (e.g., Healy and Serafeim (2015)). This literature ranges from abstract to highly specific to individual cases (as in Healy and Serafeim who investigate the private cost to oil and gas companies from increasing government pressure on disclosure, including section 1504 of the Dodd-Frank Act and the Extractive Industries Transparency Initiative (EITI)).

Such literature shows two things. First, trade secrets have value that depends heavily on the nature of the industry in question—more sunk cost and longer-term payoffs mean greater value to preserving intellectual property and trade secrets. It also shows that oil and gas

[9] The "free-rider" problem occurs when those who benefit from resources, goods, or services do not pay for them, which results in an under-provision of those goods or services.

companies value such private information to the extent that they are willing to pursue aggregate-level disclosure (such as through EITI) to deal with public calls for transparency as an alternative to the evident private costs of contract or project level disclosure. The essential problem with the SEC's analysis is that it does not take into account the cause or effect of the harm that Rule 13q-1 poses for extractive issuers. The analysis that it does provide looks at the wrong type of industry in the wrong place.

III. Conclusion

Rule 13q-1 could pose significant private costs for extractive issuers operating in Angola, Cameroon, China and Qatar unless it grants exemptions in those cases. To gauge the magnitude of those costs, the SEC performed an empirical estimate of "fire sale" costs of various industries. The essential fault with the SEC's analysis is that it fails to acknowledge (or make any attempt to capture empirically) the type of costs or contractual relationships that distinguish extractive industries from others, including sunk investment costs and the contract relationships before those investments are made to support the future profitability of those sunk investments. As such, the SEC has understated the cost of imposing Rule 13q-1 without exemptions in those countries, even at the 69 percent discount it estimates. Given the countries involved, the stranded nature of those sunk costs and the ability of local government or related entities to act opportunistically when contracts in such an industry are broken, we conclude that it is more likely that, if extractive issuers are unable to comply both with Rule 13q-1 and local disclosure laws, then extractive issuers would suffer a complete loss of value in Angola, Cameroon, China and Qatar rather than only 69 percent.

From a broader perspective, in its quest for transparency the SEC shows no appreciation for the paramount importance of confidential contracts—or trade secrets—in businesses exemplified by high levels of sunk investment costs. Other such industries use patents and trademarks to defend the intellectual property that makes such investment profitable. Extractive industries use contracts and other private business arrangements—which Rule 13q-1 would cause to be disclosed. The SEC has not addressed the nature and size of such costs by which to balance its desire for transparency.

In this respect, the SEC's analysis does not achieve what it set out to do: to examine the cost of its rule for extractive issuers.

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NERA

ECONOMIC CONSULTING

NERA Economic Consulting
11th Floor, 200 Clarendon Street
Boston, Massachusetts 02116
Tel: 1 (617) 927-4500 Fax: 1 (617) 927-4501
www.nera.com