Publish What You Pay
United States

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Jana Morgan, Director
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March 8, 2016

By E-Mail:
Chair Mary Jo White
Commissioner Michael Piwowar
Commissioner Kara Stein

Re: Disclosure of Payments by Resource Extraction Issuers, File No. S7-25-15, Release No. 34-76620

Dear Chair White and Commissioners:

We appreciate the opportunity to submit this comment to the Commission as part of its rulemaking to implement Section 1504 of the Dodd-Frank Wall Street Reform and Consumer Protection Act (hereafter referred to as Section 1504). We believe that a robust rule to implement Section 1504 that requires fully public, company-specific, project-level reporting with no exemptions is in the best interests of governments, shareholders, and citizens in resource-rich countries.

Evidence supports this. Research shows that resource revenue transparency can significantly boost economic growth, which can lead to increased Foreign Direct Investment into resource-rich countries and increased per capita incomes for their citizens.[1] Separate research that specifically analyzes the impact of Section 1504 on firms and their shareholders finds that they may benefit from lower cost of capital.[2]

We note that one commenter has suggested to the Commission that a body of literature exists that purportedly demonstrates that the level of transparency proposed in the Commission's proposed rule would have "evident private costs" for issuers. As evidence, the commenter points to a working paper (Healy and Serafeim 2015). Based on an event analysis of Section 1504 between 2010 and 2013 using a small sample of firms, the paper concludes that the stock market reacted negatively to Section 1504.

[1] See Caitlin Corrigan submission to the SEC, February 16, 2016. https://www.sec.gov/comments/s7-25-15/s72515-28.pdf
[2] See Anthony Cannizzaro and Robert Weiner submission to the SEC, February 11, 2016. https://www.sec.gov/comments/s7-25-15/s72515-22.pdf

However, a more recent study reaches the opposite conclusion using a more robust event analysis that focuses on four key developments in Section 1504 between 2012 and 2015, including the Commission's proposed rule release on December 11, 2015.[3] That study concludes that the stock market reacted favorably to events in which Section 1504 moved closer to implementation, and reacted unfavorably to events that threatened its implementation (e.g. the legal challenge to the Commission's August 2012 rule). Pointing to a large body of scholarly literature that finds that investors view increased information disclosures positively, the study's authors conclude that "investors believed the value of their stock was higher under project-level disclosure."[4]

Closer analysis of the Healy and Serafeim paper reveal several methodological shortcomings that potentially undermine its conclusions regarding the market's reaction to Section 1504. I have attached as an Appendix an updated version of comments sent by a coalition member to the paper's authors in August 2015 noting those methodological issues.

Thank you for this opportunity to comment, and we would welcome any questions you may have regarding this submission.

Sincerely,

Jana S. Morgan

Jana Morgan,
Director, Publish What You Pay

CC:
Mr. Brent J. Fields, Secretary of the Commission, Office of the Secretary
Ms. Elizabeth Murphy, Associate Director, Division of Corporation Finance
Ms. Tamara Brightwell, Senior Special Counsel to the Director, Division of Corporation Finance
Mr. Barry Summer, Associate Director, Division of Corporation Finance
Mr. Elliot Staffin, Special Counsel, Division of Corporation Finance
Mr. Vladimir Ivanov, Financial Economist, Division of Corporation Finance

[3] Ibid.
[4] Ibid, p. 4.

Methodological Challenges of "Voluntary, Self-Regulatory and Mandatory Disclosure of Oil and Gas Company Payments to Foreign Governments"[5]

Comments submitted to the paper's authors on August 27, 2015[6]

We read this paper with great interest, not least of all because of our own interest in the topic. But we came away disappointed and even a bit frustrated by the analysis, which in our view suffers from a number of fairly significant methodological shortcomings and other errors.

In its treatment of several major events used in the analysis, the paper fails to sufficiently isolate the hypothesized causal variable – i.e. mandatory payment disclosure – to be able to draw definitive conclusions about its impact on the dependent variable – i.e. the change in oil and gas company stock prices. For three significant events heavily relied upon in the analysis, the paper treats a very large and complex piece of legislation, the Dodd-Frank Wall Street Reform and Consumer Protection Act (hereafter "the Dodd-Frank Act"), as a proxy for the hypothesized causal variable.[7] In so doing, it fails to convincingly demonstrate that it was, in fact, the hypothesized causal variable, and not some other factor(s), that account(s) for the reported findings.

The mandatory disclosure provision in the Dodd-Frank Act ("Dodd-Frank 1504") was but one of a large number of issues addressed in the legislation around which the analysis centers. The marathon 20 hour House-Senate conference committee hearing on June 24-25, 2010 (defined as "Event 1" in the paper) addressed a wide range of issues, and the final law passed on July 21, 2010 contained more than 2,300 pages and 398 regulations.[8]

By treating key legislative moments involving a complex piece of legislation as a proxy for the hypothesized causal variable, the analysis fails to consider the possibility that other issues contained in the legislation – or exogenous events – may have caused, or at least influenced, the stock price changes cited in the paper. Several such possibilities are outlined below.

1. Investors in oil and gas companies covered by the Dodd-Frank Act may very well have been reacting to other perceived risks in the legislation and not to the mandatory payment disclosure provision. A number of other provisions included in the Dodd-Frank Act were of potential interest to oil and gas investors, including:

[5] Paul Healy and George Serafeim, 2015, "Voluntary, Self-Regulatory and Mandatory Disclosure of Oil and Gas Company Payments to Foreign Governments," Working Paper. http://papers.ssrn.com/sol3/papers.cfm?abstract_id=1961404

[6] These comments have been edited for length and updated slightly to reflect changes made by the authors since the original comments were sent. As noted in this submission, a number of methodological concerns remain in the paper.

[7] This is the case for the first 3 events outlined in the paper pertaining to the Dodd-Frank Act. While the EU Accounting and Transparency Directives are not the primary focus of the paper, several of the indicators used in the analysis are based on legislative actions involving the Directives. As such, the methodological shortcomings outlined here also apply to the paper's treatment of the Directives given that they too, like the Dodd-Frank Act, touch on a wide-range of issues that investors in oil and gas companies may have deemed relevant.

[8] The Wall Street Journal, July 20, 2014, "Four Years of Dodd-Frank Damage," http://www.wsj.com/articles/peter-wallison-four-years-of-dodd-frank-damage-1405893333

a. The regulation of derivatives – one of the center pieces of the Dodd-Frank Act – was billed as a way to "stop Wall Street traders from artificially driving up prices of heating oil, gasoline, diesel fuel and other commodities through unchecked speculation."[9] Since oil and gas companies profit when oil, gasoline and diesel fuel prices increase, investors may have perceived the clampdown on derivatives as having a negative impact on future company earnings and stock price.

b. The Dodd-Frank Act contained a provision expanding whistleblower protection, which investors may have viewed negatively given its potential to expose companies to increased reputational and regulatory risk.[10]

c. Led by the US Chamber of Commerce, a number of companies active in the oil, gas and mining sector – including ExxonMobil, Freeport McMoRan, and Tesoro Corporation – were actively opposed to a CEO pay rule included in the Dodd-Frank Act that requires companies to release key executive compensation information.[11]

d. Provision 1502 of the Dodd-Frank Act was vehemently opposed by the US Chamber of Commerce and the mining industry, which feared that the reporting requirements would be overly burdensome.[12] This provision could have influenced the perceived risk of the Dodd-Frank Act to investors in BHP Billiton, a global mining and petroleum company included in the paper's sample. Dodd-Frank 1502 experienced a legislative and rulemaking timeline analogous to Dodd-Frank 1504, having been voted on in the same House-Senate conference committee on June 24-25, passed into law on July 21, and implemented by an SEC final rule issued on August 22, 2012.[13]

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[9] Vermont Business Magazine, May 27, 2010, "Leahy named conferee on Wall Street reform bill," http://www.vermontbiz.com/news/may/leahy-named-conferee-wall-street-reform-bill

[10] The National Law Review, September 14, 2014, "Dodd-Frank Whistleblower Litigation Heating Up," http://www.natlawreview.com/article/dodd-frank-whistleblower-litigation-heating

[11] Zach Carter, August 5, 2015, "SEC Finally Approves Rule on CEO Pay," http://www.huffingtonpost.com/entry/sec-ceo-pay-rule_55c2250ae4b0f7f0bebb12e6?kvcommref=mostpopular; Bloomberg News, September 18, 2013, "Divided SEC proposes Menendez-backed rule to say more about CEO pay," http://www.nj.com/business/index.ssf/2013/09/divided_sec_proposes_sen_menen.html; US Chamber of Commerce submission to the SEC, December 2, 2013, https://www.sec.gov/comments/s7-07-13/s70713-567.pdf; US Chamber of Commerce submission to the SEC, May 22, 2014, https://www.sec.gov/comments/s7-07-13/s70713-969.pdf; ExxonMobil submission to the SEC, December 2, 2014, https://www.sec.gov/comments/s7-07-13/s70713-568.pdf; Freeport McMoRan submission to the SEC, December 2, 2014, https://www.sec.gov/comments/s7-07-13/s70713-508.pdf; Tesoro Corporation submission to the SEC, November 21, 2013, https://www.sec.gov/comments/s7-07-13/s70713-442.pdf

[12] The New York Times, March 19, 2012, "Use of 'Conflict Minerals' Gets More Scrutiny From U.S.," http://www.nytimes.com/2012/03/20/business/use-of-conflict-minerals-gets-more-scrutiny.html?_r=2 ; AllGov, January 12, 2011, "Mining Companies Ask for Delay in SEC Conflict Minerals Ruling," http://www.allgov.com/news/us-and-the-world/mining-companies-ask-for-delay-in-sec-conflict-minerals-ruling?news=842041

[13] US Securities and Exchange Commission, last modified May 30, 2013, "Specialized Corporate Disclosure," https://www.sec.gov/spotlight/dodd-frank/speccorpdisclosure.shtml

2. The paper does not adequately address the possibility that the (downward) movement of oil and gas company stock prices in the sample was impacted by any number of exogenous events that occurred during the periods analyzed, including:
    a. The potential influence on the reported findings of a spillover effect of broader (downward) market trends. A rather substantial body of scholarly literature has analyzed the impacts of market psychology and investor emotions on stock prices, particularly during volatile or bullish/bearish markets, and concluded that investors will often "chase" the market.[14] This possibility seems particularly relevant for the time periods comprising Event 1 and Event 2 in the analysis, given that the Dodd-Frank Act as a whole was met with fierce resistance by the business community, an oil spill in the Gulf of Mexico had placed the oil and gas sector under intense public scrutiny, and markets were still reeling from a global economic recession that had left investors skittish.

    b. The paper does not fully address the potential impact of the Gulf of Mexico oil spill in 2010 on the stock prices of oil and gas companies included in the sample. While the authors report that removing BP from the analysis does not materially change the paper's findings, there remains a real possibility that the findings are skewed by the broader impacts the spill had on the oil and gas market. Extensive news coverage of the spill, combined with government regulatory actions (both actual and threatened), may have fueled negative investor perceptions toward against the oil and gas industry that negatively impacted the share prices of individual companies. A quick glance at the historic share prices of both the Dow Jones US Oil & Gas Index and a number of companies included in the paper's sample supports this. Between April 20, 2010, the day of the explosion and fire on the Deepwater Horizon drilling rig, and the market's close on June 22, 2010, the eve of Event 1 in the paper, the Dow Jones US Oil & Gas Index declined 11.4%. By the time its 3-month slide bottomed out on July 2, 2010, the Index had lost 18.7% of its pre-April 20 value. Hess Corporation's share price dropped 16.5% from April 20 to June 22 during a 23.5% downward slide that ended July 1. Royal Dutch Shell's share price shed 12.2% of its value April 20-June 22, before bottoming out 18.4% below its pre-April 20 price on July 1. Chevron's share price dropped 9.8% April 20-June 22 on its way to bottoming out on July 2 at 18% below its pre-April 20 price. ExxonMobil saw its share price drop 10.2% April 20-June 22, 2010, bottoming out on July 2 at 18% below its pre-April 20 price. And so on. **Puzzlingly, the impact of such a momentous negative exogenous event on the broader oil and gas sector (beyond BP) is not seriously considered in the paper** despite the fact that it was happening simultaneously to Event 1, a key moment relied on heavily in the analysis,

[14] For instance: Avraham Beja and M. Barry Goldman, 1980, "On the Dynamic Behavior of Prices in Disequilibrium", http://www.researchgate.net/profile/Barry_Goldman2/publication/4766991_On_the_Dynamic_Behavior_of_Prices_in_Disequilibrium/links/0046353284d938819f000000.pdf; De Long et al. October 1987, "The Economic Consequences of Noise Traders," http://www.nber.org/papers/w2395.pdf; Andrew Lo, October 2011, "Fear, Greed, and Financial Crises: A Cognitive Neurosciences Perspective," http://alo.mit.edu/wp-content/uploads/2015/06/Fear__Greed__and_Financial_Crises_A_Cognitive_Neurosciences_Perspective.pdf

and demonstratively had a rather significant negative impact on share prices before, during, and after the period ascribed to Event 1.

c. Changes in oil prices can significantly impact oil and gas stock prices, yet the paper does not appear to have considered this potential impact on the reported findings. On June 23, 2010, for instance, the price of Brent crude oil dropped 3.7%. Across the 3-day period used to describe Event 1 in the paper, Brent crude prices slipped 2.4%. The stock prices of several listed companies in the sample seem to closely track the up- and downward movement of oil prices during the months of June and July 2010 (covering CAR2 and CAR3), rising from early- to mid-June, before sliding backwards until early July, before rising again through the final 3 weeks of July. At a minimum, this would suggest the need to take a closer look at the influence that oil price changes had on the sample companies during the events proposed in the paper.

d. The paper does not address the possibility that other types of company-specific exogenous events could be impacting the reported findings. As an illustrative example, take the June 25, 2010 news that ExxonMobil paid $25 billion in shares to acquire the natural gas company XTO, taking on $10 billion in XTO debt in the process. Notably, news stories about the sale reported that ExxonMobil's share price dropped 1.6% on the day (June 25) the sale was announced.[15] No news story that we have found about the sale or the corresponding decline in ExxonMobil's share price makes any mention of the mandatory disclosure provision introduced in the Congressional hearing held the previous day, suggesting that it was not on the radar screen of business journalists that closely follow the industry.

e. The paper states as fact industry claims that Dodd-Frank 1504 runs afoul of host country laws that (allegedly) prohibit disclosure in a small number of countries (i.e. Angola, Cameroon, China and Qatar). Leaving aside questions surrounding the validity of that claim, which was rebutted in various submissions to the SEC and dismissed as lacking evidence by both the EU and the Canadian government, the relevant point in regards to the paper's analysis – given that it assesses investor perceptions/reactions – is that, to our knowledge, affected oil and gas companies didn't begin making that assertion until the SEC's rulemaking in 2011-12, well after the law had been passed in July 2010. As such, it is difficult to imagine that that claim had any bearing on investors' risk perceptions at the time of Congressional debate or law passage in June-July 2010, which form the basis of variables CAR2 and CAR3 in the paper's methodology.

Instead of confronting head-on the issues raised above, the paper dismisses them In a seemingly tautological manner, by suggesting that "the negative correlation between the market-adjusted returns

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[15] The Dallas Morning News, June 25, 2010, "Exxon closes on purchase of natural gas company XTO Energy," http://www.dallasnews.com/business/headlines/20100625-Exxon-closes-on-purchase-of-natural-305.ece

at the announcement/passage of section 1504, and those at the court decision to vacate the new disclosure rules gives us confidence that the effects reflect investor expectations of the impact of the new disclosure rules on the industry."[16]

[16] Paul Healy and George Serafeim, 2015, "Voluntary, Self-Regulatory and Mandatory Disclosure of Oil and Gas Company Payments to Foreign Governments," Working Paper. p. 24, http://papers.ssrn.com/sol3/papers.cfm?abstract_id=1961404