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United States Senate

COMMITTEE ON
HOMELAND SECURITY AND GOVERNMENTAL AFFAIRS
WASHINGTON, DC 20510–6250

February 1, 2011

VIA EMAIL (rule-comments@sec.gov)

Ms. Elizabeth M. Murphy
Secretary
Securities and Exchange Commission
100 F Street, NE
Washington, DC 20549

RE: Disclosure of Payments by Resource Extraction Issuers; File No. S7-42-10

Dear Ms. Murphy,

The purpose of this letter is to express support for, and suggest enhancements to, the proposed rule of the Security and Exchange Commission (SEC) implementing Section 1504 of the Dodd-Frank Wall Street Reform and Consumer Protection Act (Dodd-Frank Act) requiring the disclosure of payments to governments by resource extraction issuers. This rule, like the statute it implements, will bring needed transparency to payments made to the United States and foreign governments by the extraction industries.

Background. The oil, natural gas, and mining industries make critical contributions to global economic stability and prosperity. Too often, these industries operate in countries with autocratic, corrupt, or unstable governments. It is critical for investors to understand the extent of a company's exposure when operating in countries where the company may be subject to expropriation, political or social turmoil, pressure from corrupt officials, or reputational risks. Increased transparency with respect to the payments made by such companies to government officials, by country and by project, will provide critical financial information, deepen investor understanding, promote competition, and encourage better analysis of country-specific, regional, and sector-wide activities. Greater transparency will also help empower citizens to hold their governments accountable for effective management of oil, gas, and mineral resources and revenues. Implementation of Section 1504 will also complement other disclosure efforts already in place, such as the Extractive Industries Transparency Initiative (EITI).

Subcommittee Investigations. The United States has long supported the development of strong international standards to promote fair resource extraction and safeguard the global financial system from corruption, money laundering, and other misconduct. The U.S. Senate Permanent Subcommittee on Investigations, which I chair, has contributed to that effort by conducting investigations exposing how corrupt officials, money launderers, and others have utilized U.S. professionals and financial institutions to conceal, transfer, and spend suspect

funds.[1] The Subcommittee's investigations have provided detailed case histories and concrete evidence of the need for transparency in financial transactions to stop abuses that are fueling crime and undermining the rule of law.

Too often oil, natural gas, and mineral reserves have exposed countries to corruption, infighting, and instability. Countries with rich resources have too often been victimized by government officials who divert funds from public coffers in order to line their own pockets, contributing to poverty, unrest, and conflict.

In 2004, the Subcommittee held a hearing and released a report examining bank accounts opened at Riggs Bank in Washington, D.C., by the government and senior officials of Equatorial Guinea (E.G.), one of the largest oil producers in Africa, and a country known for corruption. During the course of its investigation, the Subcommittee uncovered a number of large payments, some as large as $250,000, that were made to the bank accounts of E.G. officials or their relatives by U.S. oil companies doing business in Equatorial Guinea. The oil companies made these payments for a variety of reasons, including to purchase land, lease office space, or hire security guards. In one instance, a U.S. oil company made office leasing payments totaling $450,000 over 4 years to a 14 year-old relative of the E.G. president. In another instance, an oil company was required to hire security guards from a company owned by a relative of the President. Some oil production contracts required contributions to a college scholarship fund, which the Subcommittee later found was used to benefit the children of wealthy and powerful E.G. officials. The Subcommittee also found that some oil companies entered into business ventures with E.G. companies owned in whole or in part by E.G. officials, including the President of the country. All of these payments were made in exchange for an oil company's being allowed to do business in the country, and none would have been made public had it not been for the Subcommittee's investigation.

In 2010, the Subcommittee held a hearing and issued a report examining the use of U.S. lawyers, bankers, real estate agents, and others by senior officials from Angola, Equatorial Guinea, Gabon, and Nigeria, all oil producing countries. The investigation found that oil wealth once again appeared to be subject to misuse by top government officials, their relatives, or associates who transferred millions of dollars in suspect funds through U.S. financial accounts to benefit them. In one instance, the daughter of the President of Gabon deposited $1 million in cash brought into the United States by her father for the purchase of real estate. In another instance, the Vice President of Nigeria transferred over $40 million of funds associated with a Nigerian oil logistics company into U.S. bank accounts. These types of transactions provide concrete evidence of the need for greater financial transparency in the extractive industries, to protect companies from extortion, curb corruption, and enable investors to judge the security and value of their investments.

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[1] See, e.g., U.S. Senate Permanent Subcommittee on Investigations, "Keeping Foreign Corruption out of the United States," S.Hrg. 111-540 (Feb. 4, 2010); "Money Laundering and Foreign Corruption: Enforcement and Effectiveness of the Patriot Act," S.Hrg. 108-633 (July 15, 2004); "Role of U.S. Correspondent Banking in International Money Laundering," S.Hrg. 107-84 (March 1, 2 and 6, 2001); and "Private Banking and Money Laundering: A Case Study of Opportunities and Vulnerabilities," S.Hrg. 106-428 (Nov. 9 and 10, 1999).

Section 1504. One of the purposes of the Dodd-Frank Act is to "promote the financial stability of the United States by improving accountability and transparency in the financial system." Section 1504 directs the SEC to issue rules requiring all resource extraction issuers to provide an annual report disclosing payments made to the U.S. or a foreign government related to the commercial development of oil, natural gas, or minerals. It requires those reports to be made available online to the public. Section 1504 also requires the SEC to issue rules that "[t]o the extent practicable … support the commitment of the Federal Government to international transparency promotion efforts relating to the commercial development of oil, natural gas, or minerals."

Prior to enactment of the Dodd-Frank Act, the EITI created a voluntary international standard to promote transparency in the extractive sector. A number of countries and companies made public commitments to the EITI which, after years of effort, has begun to break down the culture of secrecy that now surrounds most oil, natural gas, and mining payments. Its goal of increased transparency has also been endorsed by the G20, International Monetary Fund, World Bank, regional development banks, and other international organizations. Despite this progress, the EITI has had only limited success in actually increasing disclosure by any extractive company or government entity. Section 1504 represents the first set of mandatory disclosure obligations with the potential for making a fundamental change in how oil, natural gas, and mining payments to governments are reported to the public. It is opposed by some companies and foreign officials determined to weaken or undermine the law. I urge the Commission to implement the law as it is written and intended, to create a new mandatory disclosure standard bringing increased transparency in the commercial development of oil, natural gas, and minerals.

The proposed rule identifies a number of issues for comment. This letter addresses seven.

Furnished vs. Filed Information. One of the most important issues to ensure the effectiveness of the proposed rule is implementation of the law's requirement that extractive industry issuers "include in an annual report" the required information related to certain payments. The rule proposes requiring issuers to "furnish" that report, rather than "file" it with the Commission. This wording is critical, because furnished reports do not have to meet the same high standards as filed reports, and their disclosure obligations can be enforced only by the SEC rather than by a private right of action. Investors who purchase or sell a security based upon a statement produced under Section 1504 and then find the statement to be "false or misleading with respect to a material fact," should have the right to sue. Without that right, given the SEC's budget constraints, recalcitrant issuers could ignore Section 1504's disclosure obligations, and investors and the public would have little or no recourse to ensure compliance with the law. Congress intended for Section 1504 to have a significant impact in line with the United States' commitment to international transparency in the commercial development of oil, natural gas, and mining resources. To achieve that objective, Section 1504 reports need to be filed rather than furnished to the SEC.

Project Reporting. The proposed rule notes that the term "project" is not defined in the law and asks if a definition is needed. If Section 1504 is to create a level playing field among U.S. resource extraction issuers and produce meaningful comparable information, this term needs to be defined. Without a definition, issuers are likely to define the term differently,

produce information that is not comparable, and create many questions about the meaning of their disclosures. While the term may have clear application in the case of royalty payments tied to a particular extraction effort, it is not clear how a company should report, for example, expenditures to build a road or hospital near a project, payments to lease office space near a project, payments to hire security guards for a project, hiring a vehicle, ship, or airplane to travel to a project, or capital contributions to create a joint business venture with a government official to distribute fuel from a particular project. In addition, the oil, natural gas, and mining industry may have industry practices that warrant sector-specific rules to identify how particular payments should be treated. Without a definition, these issues will lead to a variety of disclosure practices and produce a patchwork of information that will impede investor and public analysis of company-specific, regional, and sector-wide developments and trends. In addition, without a definition, noncompliant governments may tell companies to provide payments in ways intended to defeat the statute's requirement for project-specific information. These considerations indicate that at least a general definition of "project," with subsequent work to refine the definition, is needed to produce meaningful and comparable disclosures from covered issuers.

Covered Payments. A related issue is the definition of "payment," including payments made for "other material benefits." The Subcommittee's investigations show that foreign governments and their officials have devised a host of creative ways to extract funds from oil, natural gas, and mining companies. It is unclear whether some of these payments will qualify as "part of the commonly recognized revenue stream for the commercial development of oil, natural gas, or minerals," even if they are widespread within a country. The proposed rule would be improved by providing examples of payments that should be reported, including payments made to government agencies, corporations, funds, officials, their relatives, and associates, or to corporations, trusts, or other entities set up to conceal such payments. That list should include payments issuers are required to make for rent, security, food and water, use of roads or airports, the purchase of land, or other material benefits essential to operate in the jurisdiction. The list should also include capital contributions or other funds that companies are required to provide to for joint business ventures with government agencies, corporations, funds, officials, relatives, or associates. The proposed rule must make it clear that covered issuers have to track and report all payments made to the government, a government entity or official, or a government official's relative or associate, in exchange for doing business in the country.

De Minimis Payments. Section 1504 defines payments as "payments made to further the commercial development of oil, natural gas, or minerals" and which "are not de minimis." The proposed rule might benefit from adopting the de minimius reporting thresholds set by the London Stock Exchange's Alternative Investment Market. That organization currently sets a $15,000 minimum threshold for reporting.

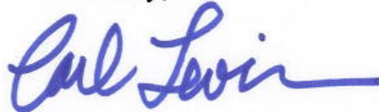
No Disclosure Exceptions. The proposed rule currently does not provide any reporting exceptions, including for companies operating in countries that ban disclosure of information related to their work in the jurisdiction. Exemptions for companies where laws in the host-country prohibit required reporting would contradict the purpose of the legislation and create a clear incentive for those countries, who want to prevent transparency, to pass laws against disclosure. In fact, it is precisely those jurisdictions for which investors and the public need additional transparency. Creating reporting exceptions would also risk creating loopholes that could undermine the rule's creation of a level playing field for all covered issuers.

Smaller Companies. The proposed rule asks if smaller companies should be exempted. They should not. Due to the nature of the extraction business, most U.S. resource extraction issues are large in size, and it is unlikely that many small companies will be covered by this rule. To the extent that they are covered, Section 1504 disclosures will help provide investors with key information to assess the potential risks associated with those smaller companies. Still another issue is that, if smaller companies are exempted, larger companies might attempt to engage in complex corporate maneuvers to create affiliates that quality for the exemption, creating administrative and compliance issues for SEC personnel charged with enforcing the disclosure requirements. Such unproductive activities should be avoided and discouraged.

No Issuer Exemptions. The proposed rule also asks if providing an exemption for certain issuers is consistent with the statute. Creating issuer exemptions that have no statutory foundation would undermine the law and interfere with its objective of creating a level playing field with meaningful disclosures that will enable investors and the public, for the first time, to understand what payments are being made by extractive industries to what governments.

Thank you for this opportunity to comment on the proposed rules.

Sincerely,



Carl Levin
Chairman
Permanent Subcommittee on Investigations