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

The enclosed comments are submitted on behalf of Exxon Mobil Corporation ("ExxonMobil" or the "Company") with respect to the referenced new proposed rule 13q-1 (the "Proposed Rule") and related release (the "Proposing Release") approved by the U.S. Securities and Exchange Commission (the "Commission") on December 11, 2015. ExxonMobil is the largest non-government-owned oil and gas company in the world and has been deeply involved in issues surrounding Dodd-Frank Section 1504 and its implementing rule since the adoption of that statute in 2010.

Given the extensive comment record already established by ExxonMobil, as well as the American Petroleum Institute ("API") and other industry participants, this letter will be limited to key issues we believe are essential to making the Proposed Rule effective for its intended purpose. In the Commission's own words, that purpose is "to empower citizens of… resource producing countries to hold their governments accountable for the wealth generated by those resources,"[1] a goal ExxonMobil has long supported.

## Background

ExxonMobil has been directly and constructively engaged in transparency advocacy and initiatives since the Company helped form and launch the Extractive Industries Transparency Initiative (EITI) at a Lancaster House Conference in London in 2003. At that conference, twelve EITI Principles were announced, and these remain the foundational principles for the initiative, which is growing rapidly and is now being implemented in 49 countries. Section 1504(2)(E) of the Dodd Frank Wall Street Reform and Consumer Protection Act states:

[1] Proposing Release p. 7

> To the extent practicable, the [SEC rule]… shall support the commitment of the Federal Government to international transparency promotion efforts relating to the commercial development of oil, natural gas, or minerals.

For the SEC to comply with this mandate, we believe it is essential for the Commission to adopt a rule that is consistent with the EITI Principles and that can help the cause of transparency succeed on a global scale.[2]

All twelve EITI principles are attached to this letter as Appendix A, but we highlight the following key principles as being especially relevant to proposed Rule 13q-1:

4. We recognise that a public understanding of government revenues and expenditures over time could help public debate and inform choice of appropriate and realistic options for sustainable development.
5. We underline the importance of transparency by governments and companies in the extractive industries and the need to enhance public financial management and accountability.
6. We recognise that achievement of greater transparency must be set in the context of respect for contracts and laws.
8. We believe in the principle and practice of accountability by government to all citizens for the stewardship of revenue streams and public expenditure.
9. We believe that a broadly consistent and workable approach to the disclosure of payments and revenues is required, which is simple to undertake and to use.
10. We believe that payments' disclosure in a given country should involve all extractive industry companies operating in that country.

The EITI requires all extractive companies in participating countries to report their government payments. Payments are to be publicly disclosed on a project basis consistent with SEC and/or EU rule.

The Proposing Release and certain commenters argue that the EU standards for project-level reporting have already become a global norm and that it is, in effect, too late for the SEC to take a different course. **This is not the case.**

First, reporting under the EU transparency and accounting directives has not yet begun. As far as we are aware, many if not most member states with significant oil and gas developments are still finalizing their implementing legislation. Even where initial legislation is complete, the first reports have not yet been published.

Second, EU directives contemplate that the reporting approach initially taken will be reviewed after the first filing years to determine whether the rules are effective for their intended purpose; how the rules are affecting reporting issuers; and to compare the EU approach to other

[2] As detailed in this letter, we believe the API model represents a far better approach for this purpose than the Proposed Rule or similar rules recently put in place in the EU, Canada, and elsewhere.

transparency reporting regimes that may have been developed. Specifically, the EU accounting directive states:

> The Commission shall review and report on the implementation and effectiveness of this Chapter [relating to transparency reporting], in particular as regards the scope of, and compliance with, the reporting obligations and the modalities of the reporting on a project basis.
>
> The review shall take account of international developments, in particular with regard to enhancing transparency of payments to governments, assess the impacts of other international regimes and consider the effects on competitiveness and security of energy supply. It shall be completed by 21 July 2018.
>
> The report shall be submitted to the European Parliament … together with a legislative proposal, if appropriate.[3]

Finally, as noted above, EITI contemplates that member country reporting could be accomplished consistent with either the EU rule or the final SEC rule, even if the SEC rule takes a somewhat different (and in our view, far more effective) approach to defining specific disclosure requirements.

In short, it is not too late for the SEC to adopt an approach to transparency reporting along the lines outlined in this letter which would, as we explain in more detail below, be superior both from the standpoint of accomplishing the fundamental government accountability objective of resource transparency while also significantly mitigating the potential for such disclosure to harm reporting companies and their shareholders. If the SEC were to take the approach we describe, we believe it would readily become clear as reports begin to be filed around the world that the SEC approach is superior and would create substantial momentum for the EU and other jurisdictions to modify their approaches to follow the SEC's leadership.

With this background in mind, we highlight below key changes we believe must be made to the Proposed Rule in order to create a workable and effective transparency reporting system.

**<u>Definition of "Project"</u>**

We are disappointed the Proposed Rule takes the same path as the current EU and Canadian rules by essentially defining "project" based on individual contracts. We believe this definition carries maximum potential for competitive harm to companies by allowing competitors – including in particular national oil companies ("NOCs") that control the majority of the world's hydrocarbon resources and in many cases will not be subject to such disclosures under SEC, EU or other rules – to obtain access to a company's highly sensitive and proprietary commercial information. At the same time, we do not believe such a contract-based approach will provide an easily usable tool for

[3] Article 48 – Review, EU Accounting Directive 2013/34/EU, as amended by Article 1(6) of Directive 2014/95/EU

host country citizens to assess and analyze the proceeds their governments receive from resource extraction. We continue to believe the proposed API definition of “project” based on identifying, with standardized XBRL tags, the type of resource being produced; the nature of the production activity; and the sub-national political jurisdiction in which the resource is being produced – combined with the identification of specific payees at all levels of government -- represents a far superior approach.

*Commercial harm to companies*

The contract-based definition of “project” incorporated in the Proposed Rule is worse from the standpoint of potential competitive harm to companies than the lack of a project definition in the original rule which was vacated by the United States District Court in the District of Columbia in *API vs. SEC*. To give a few examples of the potential for competitive harm from a highly-granular, contract-based definition:

- Granular, contract-based company disclosure may allow competitors to identify new areas of potential resource development a company has identified, and to determine the value the company places on such resources, through analysis of exploration bonus payments and terms of early development contracts. For a large company like ExxonMobil, the identification and delineation of prospective new resources reflects the investment of hundreds of millions of dollars in proprietary technology as well as the work of hundreds of highly trained and experienced engineers and scientists. If a competitor is able to use ExxonMobil’s payment disclosures to capture the benefit of the work done by ExxonMobil to identify and evaluate new resource prospects, ExxonMobil and its shareholders will effectively be giving away our proprietary technology and expertise to competitors for free. Such information will also allow competitors to better structure their bids for additional opportunities in the areas ExxonMobil has identified, resulting in higher costs for our shareholders or potential loss of attractive opportunities altogether.

- Even in more established and developed areas, granular contract-based disclosure may allow competitors to reverse-engineer proprietary commercial information regarding the Company’s developments. This is especially the case since payment disclosures will be made on an annual basis, allowing competitors to analyze changes in particular types of payments from year to year. For example, to the extent royalty payments can be linked to a particular field, changes in payments year over year may allow competitors to analyze the decline rates experienced by the Company in a field as well as the relative success of proprietary Company technologies deployed to offset natural decline. Analysis of changes in payments may also allow competitors to determine the commercial and fiscal terms of agreements which often provide for changes in production sharing or payment calculations over the life of a development as particular operational or other milestones are met.

- Finally, we note the potential for commercial harm from granular contract-based disclosure goes well beyond the potential to identify proprietary terms of individual contracts or developments. By analyzing multiple such contracts over time, competitors – most of

> whom maintain business intelligence groups dedicated to better understand the strategic goals and approaches of competing companies - may gradually be able to construct a deep overall understanding of a company's strategic approach to bidding and contracting, including even a company's rate of return criteria. Needless to say, such an understanding would be extremely valuable to the competitor and harmful to the subject company and its shareholders.

Granular, contract-based disclosure under the Proposed Rule would, we believe, also spawn a cottage industry for consultants and contractors to analyze the proprietary information that, as shown in the examples above, will become exposed, and to develop a deep understanding of a company's competitive strategy which will then be used to advise host governments and others in contract negotiations – a service for which there will be no corollary to assist private companies negotiating with host governments and many NOCs. The result will be to weaken the negotiating position of private companies. Private companies will be forced to accept less attractive contract terms or to miss out on profitable opportunities altogether, directly harming the interests of the investors whom the SEC was created to protect.

Such harm will be especially acute since the SEC rule will not create a level playing field, but as previously noted will exclude many NOCs who either are not SEC reporting companies or are readily able to structure their operations through non-reporting entities. These NOC's already own the majority of the world's hydrocarbon resource endowment. In effect, the Proposed Rule will result in SEC registrants being forced to put their proprietary commercial information in the public domain while NOCs continue to keep such information confidential.

The Commission should be intimately familiar with the potential for commercial harm to companies and shareholders that can result from disclosure of contract terms. The Commission has long experience successfully administering provisions for the protection of contracts and other information submitted to the Commission from public disclosure under the Freedom of Information Act including under exemption 4 covering trade secrets or commercial or financial information that is confidential or privileged.[4]

*Aggregation under Proposed Rule*

The Proposing Release suggests on p. 67 that the potential for companies to aggregate the reporting of individual contracts that are "geographically and operationally" integrated – similar to provisions contained in the EU rule – may partially alleviate the potential for disclosure of proprietary commercial information. **We respectfully disagree**.

First, the aggregation provided under the Proposed Rule is based solely on the particular structure of a company's operations in an area, not on the potential commercial sensitivity of the information that might be disclosed. Thus, any commercial protection provided by such aggregation is an unintended consequence and essentially random. In fact, aggregation under the

[4] See https://www.sec.gov/foia/conftreat.htm; SEC Rule 83

Proposed Rule would likely have the perverse effect of protecting contract information that is least likely to be highly sensitive while exposing contract information that is most likely to result in competitive harm. To illustrate, consider two different hypothetical operations:

- Operation A represents multiple contracts that are geographically and operationally integrated, such as multiple wells tied to a central production platform and/or feeding into a single gathering system and processing plant. With such facilities in place, Operation A is likely to represent a mature, well-known and well-developed production area in which other companies participate. This is the type of operation that would appear subject to aggregation under the Proposed Rule but also represents the type of operation in which contract terms are likely to be standardized or otherwise generally known by multiple participants and where disclosure is less likely to result in significant commercial harm.

- Operation B represents an exploration or initial development contract in a highly prospective new area identified by a company's proprietary technology and research that may not have been identified as such by competitors. Granular contract information regarding Operation B likely represents the company's most highly sensitive proprietary commercial information, yet is least likely to be subject to aggregation under the Proposed Rule since a new area is less likely to involve multiple geographically and operationally integrated contracts.

In fact we note with concern that, in numerous sections of the Proposing Release, the Commission appears to view the ability to determine specific terms of resource contracts as an **objective** the Proposed Rule should promote, rather than a significant potential harm to investors the Proposed Rule must mitigate. See, for example, footnotes 84-95 of the Proposing Release and accompanying text, indicating, among other things, that granular contract disclosure is necessary to compare contract terms among different companies; to determine whether companies are in fact properly calculating payment amounts under individual contracts; and, to determine whether contract terms are "fair" and appropriate.

Nothing in Dodd-Frank Section 1504 suggests the purpose of the rule is to interfere with contract negotiations between companies and host governments or to create an industry of self-appointed "auditors" to insert themselves into contract negotiations, to determine the fairness of contract terms or to assess compliance of payments with contract terms.

Commercial business contracts are negotiated between the parties, and it is for the parties to determine – by agreeing or not agreeing to a particular contract – whether each party finds the terms acceptable. It is also for the parties to the contract to determine whether contract terms are being adhered to and, if not, to pursue appropriate recourse. Section 1504 is not intended to alter these basic principles.

We understand some non-governmental organizations hold as an ultimate policy objective the concept of so-called "contract transparency" or "open contracting," under which oil and gas contracts would be negotiated in a kind of public-utility framework whereby groups other than the parties themselves would have seats at the table and pass judgment on contract terms. Needless to say, such third party intervention in commercial business negotiations would make it more difficult to achieve equitable agreements that appropriately balance risk vs. reward and to maintain those agreements going forward, resulting in serious harm to investors in oil and gas companies.

The purpose of Section 1504 is to enable citizens to hold governments more accountable for the revenues they receive.[5] For this purpose – as the court found in *API vs. SEC* – it is not even necessary for individual company payment information to be made public. Rather, all that is needed is a clear picture of total revenues received by host governments from resource extraction.

This point cannot be over-emphasized: Section 1504 is a *revenue* transparency statute, not a *contract* transparency statute. The SEC rule implementing the statute must – like the API model – be tailored to achieve the specific statutory objective of revenue transparency, and must not – like the Proposed Rule – become a vehicle for enacting a wish-list of activist policy goals reaching far beyond the Commission's statutory mandate.

*Limited usefulness to host country citizens*

In addition to the serious potential for competitive harm companies could suffer from contract-based disclosures, we believe a contract-based definition of project will make it difficult or impossible for citizens of resource-producing countries to assess and analyze the payments their governments receive. Put bluntly, we do not believe the Proposed Rule will be effective for the intended purpose of Section 1504.

Notwithstanding references in the Proposed Rule to XBRL tagging and the flexibility of the EDGAR system, contract-based disclosure will create inherent barriers to ready use of the reported data for three key reasons:

- Different issuers structure their contracts in different ways, so that there may be only partial overlap between the activities covered by one company's contract vs. activities covered by another company's contract in the same area.
- Different issuers will aggregate geographically and operationally integrated contracts in different ways, based on the structure of their own particular operations and their own interpretations of the rule.
- There are no standardized naming conventions by which different companies designate their contracts. Hence, there is no ready system to match contracts reported by different companies even if they relate to the same underlying operations.[6]

[5] 156 Cong. Rec. S3816 (May 17, 2010) (Statement of Senator Lugar) ("The essential issue at stake is a citizen's right to hold its government to account."); 156 Cong. Rec. S5872 (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.").

[6] We note at least one NGO commenter has recognized the need for a standardized definition of project. The solution proposed by that commenter, however - to develop a standardized database of projects using a complex naming

As a result, compiling and analyzing contract-based information relating to the same area will require extensive research and analysis of thousands of different and inconsistent data points reported by hundreds of different issuers – a task we believe will be laborious and difficult at best and impossible at worst (especially for citizens of relatively poor countries who may not possess extensive resources for such a task).

We also believe the different approaches likely to be taken by different companies in categorizing, reporting, and aggregating contracts under the Proposed Rule will likely result in extensive ongoing “second-guessing” litigation, especially under the U.S. legal system in which the private right of action available with respect to securities law disclosures together with the availability of class actions and large damage awards create a far more litigious disclosure environment than in the EU or Canada.

*Proposed API definition of “project” provides greater protection for companies and more useful data for host country citizens*

As explained in detail in prior API[7] and other comment letters, including demonstrations made to the Commission and its staff and a demonstration model available on API’s website,[8] we strongly believe the proposed API definition of “project” – based on the type of resource being produced, the nature of the production activity, and the (first level of) subnational political jurisdiction (state, province, etc.) in which the activity is located – is significantly more effective both for minimizing the potential for competitive harm to companies and shareholders and for providing information in the most useful form for compilation and analysis by citizens of resource producing countries.

First, by focusing on *payments received by governments* rather than *payments made by individual companies,* the API proposal reflects the intended purpose of Section 1504 to assist *government* accountability. As explained in more detail in prior API comment letters[9], and as acknowledged in the Proposing Release by repeated references to “users” of the reported data, 1504 disclosure is not intended for the benefit of investors but to enable citizens of resource producing countries to better hold their governments accountable for the expenditure of revenues the governments receive from

convention - is naively aspirational. Under the convention proposed by that commenter, a project in Gabon, for example, might have the project tag “ga//oba-x7ip1q”. Such a convention would be decidedly less intuitive and informative for users than API’s approach of, for example, “Nigeria/Delta State/Onshore/Oil.” Not only would a standardized database of project names be outdated almost immediately after it is published, but the grouping of operations making up such a database would have to be agreed by all stakeholders – necessitating a difficult and effectively never-ending negotiation.

[7] See in particular *American Petroleum Institute* letter dated November 7, 2013
[8] http://www.api.org/Policy-and-Issues/Policy-Items/1504/API-1504-Model; see also the report filed November 23, 2015 by the American Security Project
[9] *American Petroleum Institute* letter dated April 15, 2014

the production of national resources.[10] In fact the Commission explicitly notes in the Proposing Release that Section 1504 appears "designed primarily to advance U.S. foreign policy objectives."[11]

For this purpose, the use of the sub-national political jurisdiction of production activities as one of the three key parameters of the project definition is perfectly suited to 1504's intended goal of political accountability. By definition, political influence is exerted at a political level. Hence, grouping payments by national and sub-national political jurisdiction directly links the data to the political purposes for which it is intended to be used.[12]

We understand some commenters and the Commission itself appear to believe disclosure under the API project definition would not provide sufficiently granular information for host country citizens. We respectfully disagree. As noted, the API project definition is directly tied to the political levels of government at which 1504 disclosure is intended to make a difference. Moreover, some commenters appear to overlook the fact that project tagging is only one aspect of the multiple data points to be included in 1504 reports. In addition to tagging payments by project, companies would also report each payment outside the U.S. by specific government payee, including national, sub-national, and local and community-level government payees. Thus, the API project definition combined with reporting of payments at all levels of government will enable host country citizens easily to determine the amounts received by their local, state and federal government agencies from resource extraction activities occurring in their state or province. Citizens would know how much money is coming directly from the industry at each level of government and be able to lobby the applicable level of government for greater accountability for the use of such revenues, such as by advocating for changes in revenue sharing or allocations to local needs.

We note also the Commission appears not fully to appreciate the operation of a key aspect of the API project definition. As explained in the original API proposal[13] and subsequent letters and demonstration models, one of the parameters for defining a project under the API approach would be identification of the individual sub-national political jurisdiction in which the activity is located. However, on page 71 of the Proposing Release, the Commission notes that there are "nine separate

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[10] As explained in more detail in the letter cited in footnote 9 above, investors are already provided with more than enough information to assess country risks to which resource extraction issuers may be exposed. If additional disclosure of cash payments to governments were actually found by the Commission to be necessary for investors, then such disclosures (i) should be limited to material information like other investor disclosures; and (ii) should apply to all industries involving government contracts, including high technology, defense, pharmaceuticals, investment banking, and many other industries.

[11] See note 55 to the Proposing Release.

[12] National and sub-national (state/provincial) governments typically have the greatest involvement in receipt of revenues from resource development in countries where mineral rights are not owned by private citizens. Local towns and municipalities generally are not resource owners themselves and their receipts are typically limited to permitting fees which as noted later in this letter would still be subject to specific disclosure under the API proposal. Local governments may also receive social payments that may or may not be covered by the Proposed Rule – see subsequent discussion of that issue in this letter under "Additional Comments".

[13] See note 7 above in this letter

states within the Niger River Delta" and appears to believe resource extraction activities in such states would be reported under the API definition as a single regional project. This is incorrect. To the extent a company conducts extraction operations in all nine states of the Niger River Delta, the API definition would require disclosure of at least nine separate projects – more if the company conducts both oil and gas operations in some of those states.[14]

Finally we note references in the Proposing Release and some comments to an anti-corruption purpose for disclosure under Section 1504. Here again, to the extent transparency disclosure is intended to highlight potential corruption it is with respect to *governments* and the use they make of the revenues they receive, not company payers.[15]

Another key advantage of the API project definition is the *standardized* nature of the data tags for resource type, nature of production, and sub-national political jurisdiction (which can rely on existing ISO codes). This highly standardized method of tagging means any host country citizen with a reasonable working knowledge of spreadsheet software would be able to readily compile and analyze government receipts from resource extraction in the manner most suited to the citizen's specific political interest, including comparing receipts by local, state and national governments to total revenues generated in a given state. Thus under API's approach, host country citizens would be able to maximize use of reported data in the ways they see fit and would not be dependent on third-party contractors or advocacy organizations to attempt to analyze and compile thousands of different and non-comparable contract-level disclosures, which we believe would ultimately prove impracticable under the Proposed Rule in any case.

Moreover, by moving away from a contract-based definition to a project definition based on government political organization, disclosure under the API project definition would substantially mitigate the potential for company competitors and host government consultants to reverse-engineer specific proprietary contract terms and greatly reduce the potential costs of the rule to SEC registrants and their shareholders.

Although we do not think it comports with a proper reading of the statute in light of the First Amendment of the U.S. Constitution and the Commission's obligation to create a "compilation," our concerns would be substantially mitigated if the Commission required company-specific public disclosure but adopted API's proposed definition of project.[16] This would also allow disclosure pursuant to the SEC rule to meet EITI requirements for company project-level disclosure.

[14] The confusion on this point may have resulted from the fact that one of the hypothetical project examples included in the API demonstration model represents onshore oil production from the particular Nigerian State named Delta.
[15] Corrupt payments by companies are illegal under the Foreign Corrupt Practices Act, which prohibits SEC registrants from making corrupt payments to foreign government officials and political candidates. See Securities Exchange Act of 1934, Section 30A. Dodd-Frank Section 1504 relates solely to payments to governments themselves, not government officials, thus by definition cannot be intended as an FCPA enforcement mechanism.
[16] There may still be occasional cases where even under the API project definition a company would still need to request confidential treatment of its information, such as where a company's contract represents the only oil and gas activity in a particular state or province.

However, if the Commission retains its current approach of using a contract-based definition, we believe the only way to mitigate the potential for serious commercial harm to companies and shareholders is via aggregation of company information (whereby companies file individual payment information with the Commission and the Commission compiles that information across companies before releasing it to the public) as explained in prior ExxonMobil and API comment letters and endorsed in the *API v. SEC* ruling. Given the expressly political purpose of the disclosure compelled under Section 1504,[17] compilation of company information would also appear to be a reasonable way to meet the strict scrutiny standard applicable under the First Amendment and to achieve the policy objectives of the statute in the most narrowly tailored manner.[18]

*Conclusion*

In short, we are disappointed the Commission has chosen in the Proposed Rule to pursue a contract-based definition of project, apparently disregarding both the court ruling in *API v. SEC* and the many comments, concerns, and good-faith proposals for alternative approaches put forward by industry in our many engagements with the Commissioners and staff over the past two years.

We believe we have well demonstrated that the alternative API definition of project is superior in all respects, and we strongly urge the Commission to reconsider this issue. As explained in the Background section at the beginning of this letter, it is not too late for the Commission to establish a precedent for a superior approach to transparency that we believe will ultimately enhance the accountability of governments and influence the future development of transparency disclosures around the world while also protecting investors – which is the Commission's core mission.

## <u>Conflict of laws</u>

We are modestly pleased that the Proposed Rule makes reference to the potential that disclosure could be held in confidence via an exemption request in cases where the disclosure would cause a company to violate host country law. However, we do not believe the mere possibility of an exemption – which may or may not be granted and even if granted could be revoked or challenged at any time – provides adequate comfort to companies and investors against the potential for being forced to halt operations in a country because of a conflict of laws situation, especially given that any such action by a company would likely represent a breach of the company's contractual obligation to the country and force the company potentially to suffer a total loss of its local operations – operations which could be worth tens of billions of dollars as previously indicated –

[17] See notes 1, 5 and 9-11 and accompanying text above in this letter.
[18] See *NAM vs. SEC*, DC Court of Appeals, August 18, 2015.

with no basis for offsetting compensation.[19] The SEC acknowledges this risk to companies in its discussion of costs of the Proposed Rule in its Proposing Release.

We are also concerned the Commission appears to contemplate that such exemption requests would be considered in a public forum, which could result in disclosure of competitively sensitive information and/or violation of host country law simply by virtue of applying for the exemption. At a minimum, we urge the Commission to take the same approach as in the recently approved CEO pay ratio disclosure rule, in which any claimed exemption based on conflict with local data privacy laws would require issuers to make reasonable efforts to obtain permission for disclosure, file legal opinions supporting any non-disclosure, and be subject to review by the Commission, but would otherwise be self-executing.[20]

**Additional comments**

In addition to the key points noted above, we also provide the following more detailed comments on selected aspects of the Proposed Rule.

*Definition of "control" and proportionate consolidation*

We strongly encourage the SEC to clarify its intent, and revise the rule-making language if appropriate, related to the definition of "control" under Item 2.01(c)(3), specifically as it relates to the language "…or proportionately consolidates an interest in an entity or operation…." While U.S. GAAP accounting principles allow an issuer in the extractive industry to proportionately consolidate its interest in certain entities, such an issuer generally does not control the entire entity. Item 2.01(a) indicates that an issuer must disclose those payments made "…by the resource extraction issuer, or an entity under the control of the resource extraction issuer…"[emphasis added]. The logical interpretation of the rule as written in Item 2.01, which we strongly support, is that an issuer would therefore report 100% of those eligible payments it makes, and 100% of any eligible payments made by a subsidiary it controls. It would NOT report its proportionate share of payments made by any entities it does NOT control.

However, Instruction (5) of the Instructions to Item 2.01 states "When a resource extraction issuer proportionately consolidates an entity or operation under U.S. GAAP or IFRS, as applicable, and must disclose payments made by such entity or operation pursuant to this Item, such payments must be disclosed on a proportionate basis and must describe the proportionate interest." Similarly, in Section II.D, the Proposed Rule indicates that an "issuer that proportionately consolidates an entity

[19] Qatari law, for example, has not changed from what is described in ExxonMobil's comment letter dated March 15, 2011 with respect to the original rule proposal, including attached legal opinion from local Qatari counsel. We note the court in *API v. SEC* specifically indicated that a disclosure exemption for Qatar would not do significant harm to the overall objective of global resource transparency.

[20] We continue to hope that conflict of law issues are only a potential concern, and that negotiations with relevant host governments will be successful in resulting in permission for required disclosures. However we believe the chances of obtaining such permission are significantly greater under the disclosure model of project proposed by API since such an approach would also help protect host governments from disclosure of specific commercial information those governments may view as vital state secrets.

would have to report that entity's eligible payments on a proportionate basis, listing the proportionate interest." This language appears inconsistent with Items 2.01(a) and 2.01(c)(3) discussed above. It is also inconsistent with EITI's method of payment reporting. Since its inception, EITI has operated under the premise that the most effective way to track and reconcile payments is for each payer to report 100% of the eligible payments it makes, and the government to report how much it received from each payer. Implementing a model in which each working interest owner in a project reports its share of payments made by an operator or other party would eliminate the ability for any reasonable reconciliation of government receipts to industry payments to occur. Not only is 100% reporting by the operator (or other issuer that makes an eligible payment) a more straightforward model, but it also is significantly less costly and more practicable for issuers.

Requiring issuers to report payments on a proportionate basis will result in issuers including payments that they, in fact, did not make. In a typical joint interest operation, the operator pays 100% of the payment to the government on behalf of all the owners in the operation. Non-operators in a proportionately consolidated joint oil and gas development not only do not themselves make payments directly to governments, they do not routinely have access to the necessary detailed data of eligible payments made by operators that would enable reporting. This data includes, but is not limited to:

- The date an operator makes an eligible payment
- The currency in which the payment was made
- The specific government to whom the payment was made

Providing or obtaining this information would be extremely burdensome for issuers as it could require industry to align on and implement global common billing standards, change billing systems, and establish costly, manual processes to enable reporting. Gaining access to such information could also require companies to re-negotiate existing joint venture or joint operating agreements, with no certainty that the counterparties to such agreements – often NOCs or host governments – would agree to the necessary changes, as well as opening the door for such counterparties to extract additional commercial concessions from companies in return for the necessary amendments thus directly harming company investors.

We also believe listing the proportionate interest will lead to confusing, misleading, and irrelevant results as there will be situations where an issuer will have multiple operations with different ownership interests that will be both operationally and geographically interconnected and therefore will be classified as a single project for 1504 reporting purposes. In addition, these various operations may have different owners each with different ownership interests in each operation, further complicating the reporting. As an example, a company may have 50% interest in one portion of the operation, 25% in another part, and 0% in yet another. Another company may have 75% interest in one portion of the operation, but no other interests. Even if the two companies were to aggregate operations into an identical, reportable "project", a reporting approach based on each reporting their respective proportionate share of eligible payments (and "listing the proportionate interest") would be, at best, confusing to users and very likely misleading.

Moreover, moving to a model in which each non-operator reports its proportionate share will result in the under-reporting of total eligible payments when a non-issuer has a working interest in a property. While the alternative, which limits payment reporting to those issuers that actually make the payment, could also result in under-reporting when a non-issuer is the operator of the project, such cases will be much more obvious since the operator's name and status as an issuer is almost always a matter of public record. We strongly support this alternative approach.

In our view the cause of payment transparency will not be advanced by requiring individual working interest owners in a project to each report their proportionate shares of payment made to governments. In fact, it will reduce the straight-forward reading and transparency of issuer's payment reports, will not be aligned with government receipts, will not be aligned with EITI's method of reporting, and will not be aligned with the EU. The simplest approach, and the one that best complies with the language and intent of the legislation, is for the issuer to simply report what they pay. Therefore we urge the SEC to clarify the language in Item 2.01(a) and (c) to indicate that an eligible payment is 100% of a payment made by an issuer or a subsidiary that it controls. Furthermore, we ask the SEC to remove the language related to proportionate consolidation of an interest in an entity in the Instructions to Item 2.01 and in Section II.D.

*Disclosure of payments for infrastructure improvements*

We note the Proposed Rule retains the approach from the original vacated rule of not specifically defining "infrastructure" payments but giving as an example a road or railway built to further the development of oil, natural gas, or minerals. Also like the original rule the Proposed Rule, in a departure from EITI (at least where such expenditures are required by contract), continues to exclude social payments such as for schools or hospitals.

In preparing for disclosure under the original rule prior to the court ruling, we found the determination of infrastructure payments to raise frequent interpretive issues. We also believe social payments, at least when required by contract with the host government, in fact do represent part of the commonly recognized revenue stream of resource development as reflected in EITI reporting.

First, it can be difficult to determine whether construction of a road, for example, represents a public benefit and hence should be considered "infrastructure" in the base case. Presumably, roads built solely within a company complex and not available to the public do not represent a public benefit and hence do not constitute infrastructure (especially if such roads are to be removed after completion of a project and restoration of a development site). However other cases are less clear. For example, a road may be built through uninhabited jungle or desert areas to access a company development, or for maintenance access to a facility. Such a road may technically be available for use by citizens other than company employees, but because the road is located in an uninhabited area such use remains extremely unlikely. We do not believe payments for such "infrastructure" typically represent a public good that should be appropriately included in 1504 reports.

Rather than requiring companies to make case-by-case judgments as to whether or not particular roads or paths truly represent "infrastructure" – and excluding what may well be far more significant expenditures from the perspective of local citizens towards improving local quality of life such as for schools and hospitals – we believe the most efficient approach is to report both infrastructure and other social payments whenever such expenditures are required by contract with the host government. In addition, we believe Form SD [similar to EITI forms] should provide a method for companies voluntarily to report social payments they may make that are not required by contract in order to give citizens a more complete picture of the total local benefits realized from resource development.

**<u>Conclusion</u>**

As detailed above, we believe there is a better path forward for resource transparency that both enhances government accountability and protects the proprietary interests of companies and their shareholders. The SEC is well positioned to lead the world on that better path. We would be pleased to meet with the Commissioners or staff and to provide additional information and answer any questions to help make that better path a reality.

Sincerely,

# Appendix A

# The EITI Principles

The EITI Principles provide the cornerstone of the initiative. They are:

1. We share a belief that the prudent use of natural resource wealth should be an important engine for sustainable economic growth that contributes to sustainable development and poverty reduction, but if not managed properly, can create negative economic and social impacts.
2. We affirm that management of natural resource wealth for the benefit of a country's citizens is in the domain of sovereign governments to be exercised in the interests of their national development.
3. We recognise that the benefits of resource extraction occur as revenue streams over many years and can be highly price dependent.
4. We recognise that a public understanding of government revenues and expenditures over time could help public debate and inform choice of appropriate and realistic options for sustainable development.
5. We underline the importance of transparency by governments and companies in the extractive industries and the need to enhance public financial management and accountability.
6. We recognise that achievement of greater transparency must be set in the context of respect for contracts and laws.
7. We recognise the enhanced environment for domestic and foreign direct investment that financial transparency may bring.
8. We believe in the principle and practice of accountability by government to all citizens for the stewardship of revenue streams and public expenditure.
9. We are committed to encouraging high standards of transparency and accountability in public life, government operations and in business,
10. We believe that a broadly consistent and workable approach to the disclosure of payments and revenues is required, which is simple to undertake and to use.
11. We believe that payments' disclosure in a given country should involve all extractive industry companies operating in that country.
12. In seeking solutions, we believe that all stakeholders have important and relevant contributions to make – including governments and their agencies, extractive industry companies, service companies, multilateral organisations, financial organisations, investors, and non-governmental organisations.