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Ms. Elizabeth M. Murphy
Secretary, U.S. Securities and Exchange Commission
100 F Street, NE
Washington, D.C. 20549

Subject: Section 1504 of Dodd Frank, *Disclosure of Payments by Resource Extraction Issuers*,
Release No. 34-63549, File Number S7-42-10

Dear Secretary Murphy:

The American Petroleum Institute (“API”) appreciates the opportunity to provide further comments regarding the Commission’s pending rulemaking to implement Section 1504 of the Dodd-Frank Wall Street Reform and Consumer Protection Act.¹ We write to urge the Commission to re-propose the rule. This recommendation is supported by the following three points. First, the Commission has a statutory duty to consider the effects of this rule on efficiency, competition, and capital formation, as recently highlighted in *American Equity Investment Life Insurance Co. v. SEC*, 613 F.3d 166 (D.C. Cir. 2010), and *Business Roundtable v. SEC*, 647 F.3d 1144 (D.C. Cir. 2011). Second, API and other commenters have presented evidence of significant economic and competitive harms that will be imposed by the rule as proposed, along with reasonable, lawful alternatives that enable the Commission to minimize those harms. Third, the economic analysis accompanying the proposed rule is legally deficient.² In the re-proposed rule and in the final rule, the Commission should exercise its definitional authority and, if necessary, its general exemptive authority to limit the potential negative impacts of the rule on efficiency, competition, and capital formation.

¹ This letter supplements API’s previous comment letters submitted October 12, 2010, December 9, 2010, January 28, 2011, and August 11, 2011.

² The Department of Labor recently decided to re-propose a rule regarding the definition of a “fiduciary” under ERISA, in substantial part because it recognized the inadequacy of the economic analysis in the proposed rule. News Release, *US Labor Department’s EBSA to Re-propose Rule on Definition of a Fiduciary* (Sept. 19, 2011), available at <http://www.dol.gov/ebsa/newsroom/2011/11-1382-NAT.html>. The Department is not subject to the heightened requirements to consider economic effects that the Commission is.

I. The Commission Must Consider the Rule’s Total Effect on Efficiency, Competition, and Capital Formation.

Whenever it proposes a new rule, the Commission must consider the rule’s effects on efficiency, competition, and capital formation. As an agency charged with protecting investors, maintaining efficient markets, and facilitating capital formation, it is paramount that the Commission minimize its rules’ costs, even absent a statutory command that it do so. The Commission acknowledges this duty in the proposing release. *See* Proposing Release at 78.

The Commission is required to consider the effects on efficiency, competition, and capital formation as a matter of law. The Commission issued the rule pursuant to several provisions that require it to address economic effects. For example, Section 23(a)(2) of the Exchange Act provides that the Commission “shall consider among other matters the impact any such rule or regulation would have on competition,” and bars the Commission from adopting any rule that “would impose a burden on competition not necessary or appropriate in furtherance of the purposes of [the Exchange Act].” Exchange Act § 23(a)(2). Similarly, Section 3(f) of the Exchange Act provides that when the Commission is engaged in a rulemaking and “is required to consider . . . whether an action is necessary or appropriate in the public interest,” then “the Commission shall also consider, in addition to the protection of investors, whether the action will promote efficiency, competition, and capital formation.” Exchange Act § 3(f). The Commission is promulgating the rule pursuant to Section 23(a)(2) as well as various provisions that require it to consider the public interest, *see* Proposing Release at 85, and which thus require in turn that it consider the effects on efficiency, competition, and capital formation.

The statutory command to consider effects on efficiency, competition, and capital formation applies to the rule in its entirety, not just to those aspects of the rule that are within the Commission’s discretion. None of the relevant statutory provisions—including Section 23(a)(2), Section 3(f), and Section 1504—limits the application of the efficiency, competition, and capital formation analysis to discretionary rules adopted by the Commission. There is no indication whatsoever that Congress intended to exempt a rulemaking under Section 1504 from the requirements of Sections 23(a)(2) and 3(f). One commenter, EarthRights International (“ERI”), has suggested that the Court of Appeals’s decisions in *Business Roundtable* and *American Equity* are inapplicable here because those cases involved rules that were discretionary, that is, that were not required to be adopted. *See* ERI Comment Letter, at 3-4 & n.5 (Sept. 20, 2011). But the courts have never read such a limitation into the statute. On the contrary, in *American Equity* the court made clear that the requirement to consider efficiency, competition, and capital formation is an independent requirement that exists alongside whatever other statutory authority and obligations the Commission may have. In that case the Commission was not absolved of considering efficiency, competition, and capital formation because the products at issue were properly regarded as securities as a matter of law. 613 F.3d at 177-78. The court’s reasoning applies equally here; the Commission must assess the economic effects of the entire rule. The Commission’s duty is to “apprise itself—and hence the public and the Congress—of the economic consequences of a proposed regulation.” *Chamber of Commerce v. SEC*, 412 F.3d 133, 144 (D.C. Cir. 2005) (*Chamber I*). That public and congressional interest is no less when the regulation is statutorily



required. Congress's interest should be even greater when the costs being imposed are due to its own action.

In any event, Section 1504 gives the Commission ample discretion in fashioning an extraction issuers payment rule, and the Commission must consider the economic effects of its action as it exercises that discretion. Those effects are best understood in the context of the costs imposed by the rule as a whole.

Finally, the costs imposed by the rule as a whole will inform the Commission's consideration of whether and how to exercise its definitional and exemptive authority to avoid a severe adverse economic effect. This is discussed in Section IV below.

II. The Proposed Rule Would Have Significant Adverse Effects on Efficiency, Competition, and Capital Formation.

Numerous commenters—including API—have illustrated the severe economic impact of the rule, especially on American resource extraction companies operating abroad. For example, as API has explained, the proposed detailed disclosures will place American companies at a significant competitive disadvantage to foreign companies not covered by the proposed rule (in particular, foreign, state-owned oil companies). API Comment Letter, at 2-3 (Jan. 28, 2011). Those foreign companies could use the detailed disclosures required by the proposed rule to piggyback on the exploration of American companies or to negotiate more favorable terms from host governments, among other potential competitive harms. *Id.*; see also API Comment Letter, at 5 & Attachments B-D (Oct. 12, 2010) (noting that many of the top worldwide oil and gas companies would not be covered by the rule, including Gazprom, the China National Petroleum Company, and the National Iranian Oil Company). These competitive effects, along with the many others raised in the comments, must be quantified and addressed before the Commission finalizes the rule.

In light of these concerns, commenters have proposed numerous ways in which the Commission may satisfy the requirements of Section 1504 while avoiding undue economic costs. See, e.g., API Comment Letter, at 3-4 (Jan. 28, 2011). Specifically, the Commission should revise the rule to require only the reporting of aggregate payment information by country, rather than on a company-specific basis. See *id.*; see also *id.* at 38-39. Additionally, the Commission should define "project" to mean activities in a particular geologic basin or province, and should include only those projects that reasonable investors would consider "material." See *id.* at 17-19. The Commission should also craft the rule so that it does not require issuers to make disclosures that would violate the law of a foreign government. See *id.* at 24-30; see also *infra* Part IV.

III. The Discussion of Efficiency, Competition, and Capital Formation in the Proposing Release Is Deficient, and Requires That the Rule Be Re-Proposed.

The two-page discussion of the effects on efficiency, competition, and capital formation in the proposing release contains *no* analysis by the Commission and would not survive judicial review, particularly in the wake of the *Business Roundtable* decision.

The Commission has a statutory obligation “to *determine as best it can* the economic implications of the rule it has proposed.” *Chamber I*, 412 F.3d at 143 (emphasis added). That obligation is not excused when the Commission cannot quantify regulatory costs with precision; rather, the Commission must at least endeavor to estimate the range of regulatory costs. *Id.* That is, it must “estimate and quantify the costs it expect[s] companies to incur,” or otherwise explain why such quantification is impossible. *Business Roundtable*, 647 F.3d at 1150. The Commission may not “duck[] serious evaluation of th[ose] costs.” *Id.* at 1152.

Our review of prior Commission rulemakings indicates that the cursory treatment of economic costs in the proposed rule is briefer and less substantive than the analyses in the proposed rules in at least three instances where the final rule was invalidated by the courts for insufficient economic analysis. For example, the Commission’s analysis is more superficial than the analysis in the proposing release in *Business Roundtable*, where—when the rule was finalized—the Commission was held to have “failed adequately to quantify the certain costs or to explain why those costs could not be quantified; neglected to support its predictive judgments; . . . and failed to respond to substantial problems raised by commenters.” 647 F.3d at 1148-49. Here, the Commission has provided *no* analysis. It merely noted two potential competitive harms identified by commenters, without ascertaining whether those harms would materialize or how significant their consequences would be. *See* Proposing Release at 79.

This economic assessment is so deficient that, as a matter of law, the Commission may not finalize the rule without first re-proposing it with a proper economic analysis on which the public may comment. An opportunity for the public to review, comment upon, and inform the analysis underlying an agency’s action is, of course, the essence of notice and comment rulemaking under the Administrative Procedure Act. *See Sprint v. FCC*, 315 F.3d 369, 373 (D.C. Cir. 2003); Exec. Order No. 13,563, *Improving Regulation and Regulatory Review*, 76 Fed. Reg. 3,821-23 (Jan. 18, 2011) (requiring “an opportunity for public comment on all pertinent parts of the rulemaking docket, including relevant scientific and technical findings”). In the wake of the litigation over the Commission’s mutual fund governance rule, annuities regulation, and proxy access rule, a critical part of the Commission’s rulemaking process—and therefore one warranting public scrutiny and input—is the analysis the Commission conducts of the economic consequences of its action.

To date, however, the Commission has given the public no glimpse whatsoever of its assessment of the economic effects of this rule nor, in light of those effects, the regulatory choices the agency believes are appropriate. For the Commission to finalize the rule in these circumstances without re-proposal would be a repeat of the *Chamber II* litigation—although the deficiency here would be even more stark. In that case, the Commission re-adopted a rule without notice and comment after remand from the Court of Appeals; it relied on a handful of materials that had not been exposed to public comment, but—when its action was challenged—argued that those materials did not require comment because they merely confirmed the agency’s initial analysis. The court disagreed, and ultimately vacated the rule. *Chamber of Commerce v. SEC*, 443 F.3d 890, 903-905 (D.C. Cir. 2006).

Here, the Commission has not even provided an initial analysis—it has neither informed the public of any economic materials it is relying on, nor even disclosed its assessment of how the rule will



affect efficiency, competition, and capital formation. We fail to see how finalizing the rule without re-proposing it and providing an economic analysis would satisfy *Chamber II*. See also *Engine Mfrs. Ass'n v. EPA*, 20 F.3d 1177, 1182 (D.C. Cir. 1994) (invalidating rule because materials provided to public were too “opaque” and “[t]here [was] no way to know the agency’s methodology from what little it reveal[ed] in the cost analysis”); *Prometheus Radio Project v. FCC*, 652 F.3d 431, 447-53 (3d Cir. 2011) (vacating FCC rule due to insufficient opportunity to comment on economic materials).

As noted, last fall the Department of Labor announced its intention to re-propose its regulation redefining “fiduciary” because of deficiencies in the economic analysis accompanying the proposed rule. See News Release, *supra* note 2. The deficiencies here are even greater, and the same course is required of the Commission as a matter of law.

IV. The Commission Should Use Its Definitional Authority and Its Exemptive Authority As Necessary To Mitigate Any Significant Adverse Effects of the Rule.

In conjunction with its appraisal of this rule’s effects on efficiency, competition, and capital formation, the Commission should exercise its definitional authority under Section 3(b) and its exemptive authority under Section 36 of the Exchange Act to prevent adverse economic effects. In the re-proposed rule and in the final rule the Commission ultimately issues, the Commission should exercise its definitional and exemptive authority as discussed below to reduce the negative impacts of the rule on efficiency, competition, and capital formation.

Section 3(b) authorizes the Commission to define the terms in the Exchange Act “consistently with the provisions and purposes” of the Act. Exchange Act § 3(b); see *Am. Bankers Ass’n v. SEC*, 804 F.2d 739, 754-55 (D.C. Cir. 1986) (recognizing Commission’s definitional authority under Section 3(b)). The Commission should use that authority (and its rulemaking authority) to define the statutory term “project” to encompass activity within a particular geologic basin or province. See, e.g., API Comment Letter, at 18-22 (Jan. 28, 2011). This furthers the statutory purpose of Section 1504, by ensuring that disclosures are made on a project basis, while also furthering the purposes of the Act as a whole, by avoiding highly specific disclosures that would reveal confidential and proprietary information to the detriment of the very shareholders the Exchange Act is meant to protect. In addition, the Commission should define “project” to exclude activities that are not material to investors, and activities that are prohibited from being disclosed by the laws of the host country. See *id.* at 12-15, 24-25. These definitions would likewise enable the purposes of Section 1504 to be served, while furthering the many “provisions and purposes” of the Act intended to protect investors’ interests.

If, however, the Commission were to conclude that it lacks the authority under Section 1504 and general principles of rulemaking and statutory interpretation to craft the rule along the lines identified above, it would then be appropriate for the Commission to invoke its exemptive authority under Section 36 of the Act. Section 36 provides that “the Commission, by rule, regulation, or order, may conditionally or unconditionally exempt any person, security, or transaction, or any class or classes of persons, securities, or transactions, from *any provision or provisions of this title or of any rule or regulation thereunder*, to the extent that such exemption is necessary or appropriate in the public interest, and is consistent with the protection of investors.” Exchange Act § 36 (emphasis added); see

also, e.g., API Comment Letter, at 6-7 (Oct. 12, 2010); Letter from Representatives Bachus and Miller, at 1 (Mar. 4, 2011). Congress added Section 36 to the Exchange Act in 1996, as part of the National Securities Markets Improvement Act. See Pub. L. 104-290, Tit. I, § 105(b), 110 Stat. 3424 (1996) (now codified at 15 U.S.C. § 78mm). In Dodd-Frank, Congress added Section 1504 as an amendment to the Exchange Act; it indisputably is part of the same “title” of the U.S. Code as Section 36. Thus, **Section 36 applies by its terms to Section 1504, and the Commission must give effect to both provisions.** See *King v. St. Vincent’s Hosp.*, 502 U.S. 215, 220 (1991) (observing the “cardinal rule that a statute is to be read as a whole”); *Citizens to Save Spencer Cnty. v. EPA*, 600 F.2d 844, 870-71 (D.C. Cir. 1979) (when construing a statute, “maximum possible effect should be afforded to all statutory provisions”).

Section 36 authorizes the Commission to provide exemptions to any rule or regulation when doing so would serve the public interest. Interpreting two similar grants of exemptive authority in the Exchange Act, the Second Circuit Court of Appeals held that the Commission’s exemptive authority was “unconditional[,]” so long as the Commission finds that the exemption is consistent with the public interest and investor protection. *Schiller v. Tower Semiconductor Ltd.*, 449 F.3d 286, 301 (2d Cir. 2006); see also *id.* at 292 n.5 (noting similarity between Section 36 and exemptive provisions at issue in *Schiller*). Indeed, the court held that the Commission may adopt exemptions even if they lead to a net decrease in investor protection, rejecting the argument of a shareholder who objected that an exemption decreased investor protection. *Id.* “The practical effect of an exemption—which, after all, renders protections that would otherwise be in force inapplicable with respect to a particular class of securities or issuers—is, everything else being equal, a decrease in the net level of investor protection.” *Id.* at 296. “Therefore, the prohibition of any decrease in the level of investor protection would at the very least substantially curtail, if not completely eviscerate, the Commission’s exemptive authority.” *Id.* at 296-97. Recognizing the “congressional intent to grant the Commission flexibility in adopting exemptions,” the court held that “the Commission can promulgate an exemption once it has determined that the exemption serves the public interest while at the same time leaving in place adequate investor protections.” *Id.* at 297.

Here, the Commission has recognized the possible need to “adopt certain exceptions or accommodations.” Proposing Release at 79. Commenters have proposed several viable definitions and exceptions that would serve the public interest while maintaining an adequate level of investor protection. See, e.g., API Comment Letter, at 6-7 (Oct. 12, 2010); API Comment Letter, at 4, 26-27 (Jan. 28, 2011); Exxon Comment Letter, at 7 (Jan. 31, 2011); Letter from Representatives Bachus and Miller, at 1 (Mar. 4, 2011). These terms would greatly reduce the adverse effects of the rule on efficiency, competition, and capital formation—and on the American economy generally. For example, and as discussed above, the rule should be written to avoid a requirement that companies disclose information that would violate the law of a foreign government. “Project” should be defined as activities in a particular geologic basin or province, and should exclude activities that reasonable investors would not consider “material.” Similarly, disclosures that threaten the commercial sensitivity or security of resource extraction projects should not be required.

The Commission’s adoption of those provisions would be supported by the plain terms of Section 1504, by basic considerations of statutory interpretation and regulatory discretion, and by the Commission’s definitional authority. To the extent, however, that the Commission concludes that



additional authority is needed, the Section 36 exemptive provisions supply it. Indeed, it is the very purpose of Section 36 to enable the Commission to use its expertise, insight, and discretion to address specific difficulties not provided for by Congress.

* * *

API appreciates the opportunity to submit these comments, and welcomes the opportunity to meet with any of the Commissioners or their staff to discuss these issues or any other issues of interest to the Commissioners. Please direct inquiries to Peter Tolsdorf, Counsel, API, at (202) 682-8074, or tolsdorf@api.org.

Sincerely,

A handwritten signature in black ink that reads "Harry Ng". The signature is fluid and cursive, with a long horizontal line extending to the right from the end of the name.

Harry Ng

Vice President, General Counsel and Corporate
Secretary, American Petroleum Institute

Cc:

The Hon. Mary L. Schapiro, Chairman
The Hon. Elisse B. Walter, Commissioner
The Hon. Luis A. Aguilar, Commissioner
The Hon. Troy A. Paredes, Commissioner
The Hon. Daniel M. Gallagher, Commissioner

Mr. Mark Cahn, General Counsel
Ms. Meredith Cross, Director, Division of Corporation Finance