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PROPOSED RULE: DISCLOSURE OF PAYMENTS BY RESOURCE EXTRACTION ISSUERS

Issuers engaged in the commercial development of oil, gas, or minerals will soon have to comply with additional disclosure requirements regarding payments made to non-U.S. governments and to the U.S. government. These requirements were imposed by the Dodd-Frank Wall Street Reform and Consumer Protection Act, the sweeping financial reform enacted by Congress in July 2010.

Specifically, Dodd-Frank directs the Securities and Exchange Commission (the "SEC") to issue rules requiring "each resource extraction issuer to include in an annual report … information relating to any payment made by the resource extraction issuer, a subsidiary of the resource extraction issuer, or an entity under the control of the resource extraction issuer to a foreign government or the Federal Government for the purpose of the commercial development of oil, natural gas, or minerals, including (i) the type and total amount of such payments made for each project of the resource extraction issuer relating to the commercial development of oil, natural gas, or minerals; and (ii) the type and total amount of such payments made to each government."[1]

In order to comply with the requirements of Dodd-Frank, the SEC issued a proposed rule on December 15, 2010.[2] The SEC is accepting comments on the proposed rule though March 2, 2011, and will issue a final rule no later than April 15, 2011.

WHICH ISSUERS ARE SUBJECT TO THE NEW RULE?

The disclosure requirements will apply to any company that is a "resource extraction issuer." A "resource extraction issuer" is an "issuer that

1 Dodd-Frank Wall Street Reform and Consumer Protection Act, Pub. L. No. 111-203 § 1504, 124 Stat. 1375, 2220–21 (2010).

2 Disclosure of Payments by Resource Extraction Issuers, 75 Fed. Reg. 80978 (proposed Dec. 15, 2010).

(i) is required to file an annual report with the SEC; and (ii) engages in the commercial development of oil, natural gas, or minerals." The proposed rule does not make any exception for smaller issuers or issuers that may be engaged in the commercial development of oil, natural gas, or minerals only to a limited extent. The proposed rule also does not make any exception for foreign private issuers, issuers that are owned or controlled by governments, wholly owned subsidiaries, or asset-backed issuers.

The proposed rule defines "commercial development of oil, natural gas, or minerals," to include "exploration, extraction, processing, export, and other significant actions relating to oil, natural gas, or minerals, or the acquisition of a license for any such activity." The SEC states that this definition is not intended to include activities that are "ancillary or preparatory" (such as the manufacture of a product to be used in the commercial development of oil, natural gas, or minerals) or transportation (except for export).

WHAT CONSTITUTES A "PAYMENT"?

The proposed rule defines "payment" as an amount paid that:

- is made to further the commercial development of oil, natural gas, or minerals;
- is not de minimis; and
- includes taxes (including taxes on corporate income and production, but not value-added tax or sales tax), royalties, fees (including license fees), production entitlements, and bonuses.

Congress gave the SEC the authority to include in the definition of "payment" any "other material benefits, that the SEC … determines are part of the commonly recognized revenue stream for the commercial development of oil, natural gas, or minerals." The SEC, however, opted not to specify in the proposed rule any "other material benefits" in addition to those listed in the statute. The SEC states that "other material benefits" would probably not include payments for infrastructure improvements but could include contributions to a host country's hospitals or schools.

The proposed rule also does not provide a definition for "not de minimis." The SEC's stated view is that the term is "sufficiently clear that further explication is unnecessary," although it invites comments, asking whether the final rules should include a standard, and, if so, whether the standard should be based on a "relative measure," such as a percentage of expenses or revenues, or an absolute dollar amount, such as $1,000 or $10,000,000.

Additionally, payments must be reported for each "project," but the term "project" is not defined. The SEC has opted not to define this term "to allow flexibility in applying the term to different business contexts."

WHICH PAYMENTS MUST BE DISCLOSED?

As noted above, resource extraction issuers must disclose payments made by the issuer, a subsidiary, or an entity "under the control of" the issuer to a "foreign government or the Federal Government for the purpose of the commercial development of oil, natural gas, or minerals."

Under the proposed rule, an issuer must report payments made by subsidiaries and controlled entities, even if these are not consolidated subsidiaries. According to the SEC, "control" means the ability to "direct or cause the direction of the management and policies" of an entity "whether through ownership of voting shares, by contract, or otherwise."

The proposed rule, following the language of the statute, defines "foreign government" as a "foreign government, a department, agency, or instrumentality of a foreign government, or a company owned by a foreign government." The definition in the proposed rule also specifically includes "subnational" governments, such as state or local governments. The proposed rule also includes a clarification that a company "owned by a foreign government" is majority-owned by a foreign government.

HOW IS DISCLOSURE MADE?

Dodd-Frank states that these disclosures must be made "in an annual report." The SEC has proposed that the disclosure be contained in an exhibit to Form 10-K (or 20-F or 40-F for foreign issuers). The SEC has also proposed to treat this exhibit as being "furnished" rather than "filed" and therefore not subject to liability under Section 18 of the Securities and Exchange Act of 1934, as amended (which imposes liability for false or misleading statements in "filed" documents).

Under the proposed rule, the disclosure must include:

- the type and total amount of payments for each project and for each government;
- the total amounts of the payments, by category;
- the currency used;
- the financial period in which the payment was made; and
- the business segment that made the payment.

WHAT ACTION SHOULD ISSUERS TAKE?

Each issuer should determine if it will be considered a resource extraction issuer subject to this new rule. Issuers subject to the rule should prepare for the enactment of the final rule on April 15. Issuers should consider the aspects of the proposed rule discussed above and carefully review the final rule to evaluate the impact of any changes that the SEC has made based on comments to the proposed rule.

Issuers should note that under Dodd-Frank, the final rules relating to this disclosure will take effect on the date on which the resource extraction issuer is required to submit an annual report relating to the issuer's fiscal year that ends not earlier than one year after the date on which the SEC issues the final rules. Because final rules are required to be issued by the SEC by April 15, 2011, the statute appears to require that annual reports for fiscal years ending on or after April 15, 2012, would need to comply with the final rule. This means that companies will need to have the proper recordkeeping processes in place prior to the commencement of the fiscal year for which the disclosure will be required. Issuers should also prepare to address any problems that this new rule may cause in light of existing contractual confidentiality obligations, as well as any potential issues the disclosures could cause under the laws of any foreign countries.

LAWYER CONTACTS

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