SEC Extends Comment Period on Proposed Resource Extraction Issuer Rules to March 2011

February 8, 2011

The U.S. Securities and Exchange Commission (SEC) has recently extended the deadline for comments regarding Section 1504 of the Dodd-Frank Wall Street Reform and Consumer Protection Act until March 2, 2011. Under Section 1504, resource extraction issuers must disclose certain payments made for projects relating to the commercial development of oil, natural gas or minerals, including payments to various governments in connection with such projects. Any energy or mining company interested in participating in the final rule-making process regarding Section 1504 should submit their comments to the SEC by the March 2 deadline.

On January 28, 2011, the U.S. Securities and Exchange Commission (SEC) extended the deadline for comments regarding Section 1504 of the Dodd-Frank Wall Street Reform and Consumer Protection Act. Under Section 1504 resource extraction issuers must disclose certain payments made for projects relating to the commercial development of oil, natural gas or minerals, including payments to various governments in connection with such projects. The proposed rules, if adopted, will provide additional guidance to issuers concerning their new disclosure obligations. The SEC has extended the deadline for comments to March 2, 2011.

Section 1504 added Section 13(q) to the Securities Exchange Act of 1934, which provides for a host of new disclosure requirements concerning the type and total amount of payments made for energy and mining related projects and payments to the U.S. and foreign governments. (See Dodd-Frank Act Imposes New Disclosure Requirements on Energy and Mining Companies for a detailed summary of the new disclosure requirements imposed by Section 1504.)

Under the proposed rules, any issuer that engages in an activity directly related to the commercial development of oil, natural gas or minerals and is required to file an annual report with the SEC would be required to provide these new required disclosures. Direct activities would include exploration, extraction, processing, export and other significant actions like procuring a license for any of the above activities. Section 13(q) would apply to domestic and foreign issuers, regardless of their size or whether or not they are owned or controlled by governments. Disclosure would also be mandated for subsidiaries and other entities under the issuer's control, including foreign subsidiaries whose financial information is consolidated with the U.S. parent company for SEC reporting purposes. Manufacturers of a product used in the commercial development of oil, natural gas or minerals (*e.g.*, drill bit manufacturer) and companies

generally involved in transportation activities would be exempted from these disclosure requirements. Under the proposed rules, however, issuers who are engaged in the removal of impurities (such as sulfur, carbon dioxide and water) from natural gas after extraction but prior to its transport through a pipeline, would be subject to Section 13(q) requirements, as such transportation activities are generally considered to be a necessary part of the processing of natural gas.

Under the proposed rules, disclosures would be required to be furnished, not filed, with the annual report either on a Form 10-K, 20-F or 40-F, and posted on a company's website. By furnishing (rather than filing) this information, extraction issuers will not be subject to additional liability under Section 18 of the Exchange Act; however, failure to comply with the proposed rules once finalized can still subject an issuer to liability under Sections 13(a) and 15(d) of the Exchange Act.

Disclosures would be under a separate heading in the annual report entitled "Payments Made By Resource Extraction Issuers" that references two exhibits containing the mandated payment information for the fiscal year covered by the applicable annual report. Under the proposed rules, the first exhibit would be in HTML or ASCII format and the second exhibit in XBRL format with electronic tags that identify the following information:

- Total amount of payments, by category (*e.g.*, payments must be organized by project, not aggregated on a countrywide basis)
- Currency used to make the payments
- Financial period in which the payments were made (*e.g.*, for the fiscal year covered by the applicable annual report)
- Business segment of the resource extraction issuer that made the payments
- The government that received the payments and the country in which the government is located
- Project of the resource extraction issuer to which the payments relate

Under the proposed rules, payments required to be disclosed include those that are made to further the commercial development of oil, natural gas or minerals that are not de minimus (a term not defined by the proposed rules). Such payments can be in cash or in kind and include taxes, royalties, fees (including licensing fees), production entitlements, bonuses and other material benefits (another undefined term) that the SEC, consistent with the Extractive Industries Transparency Initiative (EITI) guidelines, determines are a part of the commonly recognized revenue stream for the commercial development of oil, natural gas or minerals. Certain payments would need not be disclosed, including: dividends paid to the host government as shareholders of the national state-owned company, payments made for infrastructure

improvements and certain taxes (*e.g.*, value-added taxes, personal income taxes and sales taxes). Payments to a foreign government, a department, agency or instrumentality of a foreign government, or a company owned by a foreign government, including sub-national governmental entities, would be disclosed under Section 13(q).

While the proposed rules do not define what constitutes "other material benefits" that must be disclosed, the proposed rules state that, depending on the circumstances, social or community payments (*e.g.*, payments to improve a host country's schools, hospitals, universities or other community activities, or other payments like environmental and remediation liabilities or penalties for violations of law or regulation, personnel training programs, local content, technology transfer and local supply requirements), which are not expressly included within the definition of "payment," may nevertheless be subject to disclosure under Section 13(q).

While the proposed rules provide helpful guidance for what resource extraction issuers' future compliance obligations might be, there are still some unanswered questions. For example, the proposed rules do not define key terms like "de minimus" or "project," so it is unclear whether non-de minimus payments should be based on the size of the issuer and the nature and size of the project, or whether payments should be measured as a percentage of expenses incurred per project, or as a percentage of the total expenses for the reporting year. Likewise, whether "project" will be defined to mean a field, mining property, refinery, or other processing plant or pipeline or other mode of transport is also unclear. Some issuers may want to aggregate payments by country rather than by project, as EITI requires, to avoid added compliance costs. Finally, the proposed rules are silent on what issuers should do when the hosting country has a law that prohibits the resource extraction issuer from disclosing the type of information required by Section 13(q). Under the proposed rules, the issuer would be forced to select between avoiding or abandoning projects in that country and maintaining its registration under the Exchange Act. The SEC is currently seeking comments on these topics, among others.

The SEC has also proposed rules for implementing Section 1502 of the Dodd-Frank Act, which pertains to the disclosure of "conflict minerals" originating from the Democratic Republic of the Congo and adjoining countries. (See SEC Proposes "Conflict Minerals" Disclosure Rules to Implement Dodd-Frank Provisions for more details on Section 1502 proposed rules.)

To the extent that an issuer wants to participate in the rule-making process for either Section 1502 or Section 1504, it should submit comments to the SEC by March 2, 2011. Final rule-making is to be completed by April 15, 2011, and these new disclosure requirements will become effective as of annual reports due on April 15, 2012.

While the impact of the new disclosure rules is unknown at present, energy and mining companies are encouraged to begin their preparations now to comply with them. See McDermott's 2011 Dodd-Frank Compliance Checklist for Resource Extractors and "Conflict Mineral" Manufacturers for more information on what resource extraction issuers can do to prepare for the compliance changes required by Dodd-Frank.