

August 31, 2012

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SEC Adopts New Rules Requiring Disclosure of Payments by Resource Extraction Issuers to Governments

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Introduction

On August 22, 2012, the U.S. Securities and Exchange Commission (the “SEC”) adopted new rules relating to disclosure of payments by so-called “resource extraction issuers” (the “Final Rules”)¹ pursuant to Section 1504 of the Dodd-Frank Wall Street Reform and Consumer Protection Act (the “Dodd-Frank Act”).² The Final Rules require resource extraction issuers to include in an annual report information relating to any payment made by the issuer (including by any subsidiary or entity controlled by the issuer) to a foreign government or the U.S. Federal Government for the purpose of commercial development of oil, natural gas or minerals. These Final Rules are intended to (i) promote international transparency and accountability and (ii) prevent bribery and corruption in the resource extraction industry. The Final Rules are expansive in nature and provide no exceptions to the reporting obligations set forth in the Final Rules. As a result, many resource extraction companies that have U.S. public reporting obligations will be affected by the Final Rules.

Companies Affected by the Final Rules

The Final Rules affect all so-called “resource extraction issuers,” which is defined to be companies that are reporting companies, both foreign and domestic, under the Securities Exchange Act of 1934, as amended (the “Exchange Act”), that are engaged in the commercial development of oil, natural gas or minerals (“Resource Extraction Issuers”). The “commercial development of oil, natural gas or minerals” includes the activities of exploration, extraction, processing and export and the acquisition of licenses for any of those activities, but excludes ancillary businesses such as the manufacturing of equipment used in the commercial development of oil, natural gas or minerals.

What Must Be Reported

The Final Rules provide that any “payment” that is “not de minimis” made by a Resource Extraction Issuer to a foreign government or the U.S. Federal Government must be reported. “Payment,” within the meaning of the Final Rules, means any payment made to a foreign government or the U.S. Federal Government that is made to further the commercial development of oil, natural gas or minerals.

Payments include, but are not limited to:

- i. taxes;
- ii. royalties;
- iii. fees (including license fees);

¹ See Exchange Act Release No. 67717 (August 22, 2012), available at <http://www.sec.gov/rules/final/2012/34-67717.pdf>.

² See 15 U.S.C. 78m(q)(2)(A).

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- iv. production entitlements;
- v. bonuses;
- vi. dividends; and
- vii. payments for infrastructure improvements.

The Final Rules define “not de minimis” as any payment (or series of related payments) equal to or exceeding US\$100,000. The aggregate effect of the provisions of the Final Rules described above is that in order to satisfy its obligations under the Exchange Act, a Resource Extraction Issuer must report any payment made to a foreign government or the U.S. Federal Government equal to or exceeding US\$100,000 in any fiscal year.

The term “foreign government” is expansively defined to include a foreign national government as well as a foreign subnational government, such as the government of a state, province, county, district, municipality or territory under a foreign national government. Notably, however, the Final Rules do not require disclosure of payments made to subnational governments in the United States, such as states and municipalities, which should reduce the reporting burden for Resource Extraction Issuers that primarily conduct operations in the United States.

Importantly, the Final Rules do not provide any exceptions from the reporting requirements, even for situations in which foreign law or confidentiality agreements prohibit such disclosure. Additionally, the Final Rules include anti-evasion provisions intended to thwart attempts to re-characterize an activity so that the activity would fall outside the scope of the reporting requirements in the Final Rules.

How the Report Must Be Made

The SEC released additional rules to implement Section 1502 of the Dodd-Frank Act on the same day as the Final Rules. As a part of the Section 1502 rules, the SEC adopted the new reporting form known as Form SD. Rather than requiring Resource Extraction Issuers to file the new disclosures required by the Final Rules in their annual reports under the Exchange Act, the Final Rules instead amend Form SD to require the disclosure on that form no less than 150 days after the end of the Resource Extraction Issuer’s most recent fiscal year. As amended, the Form SD requires a Resource Extraction Issuer to disclose the following with respect to payments made to a foreign government or the U.S. Federal Government:

- i. the total amounts of payments, by category;
- ii. the currency used to make the payments;
- iii. the financial period in which the payments were made;
- iv. the business segment of the Resource Extraction Issuer that made the payments;
- v. the government that received the payments (including the country in which the government is located); and
- vi. the “project” (a term that is undefined in the Final Rules) of the Resource Extraction Issuer to which the payments relate.

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When the Final Rules Take Effect

Under the Final Rules, a Resource Extraction Issuer must comply with the reporting requirements of the Final Rules and Form SD for fiscal years ending after September 30, 2013. For the first report filed for fiscal years ending after September 30, 2013, a Resource Extraction Issuer may provide a partial year report if the Resource Extraction Issuer's fiscal year began before September 30, and such Resource Extraction Issuer must provide a report for the period beginning October 1, 2013 until the end of its fiscal year.

Conclusion

The Final Rules are expansive in nature. Given the design and intent of the Final Rules as articulated by the SEC, the best practice for a Resource Extraction Issuer will likely be to err on the side of disclosure. Resource Extraction Issuers will need to implement new systems and financial reporting procedures, if they have not done so already, to allow them to capture the information necessary to comply with the reporting requirements under the Final Rules. As noted above, the definition of the term "project" intentionally has been left undefined by the Final Rules in order to allow flexibility to a Resource Extraction Issuer as to the manner in which projects are defined in the Form SD disclosure. As a result, it is advisable for each Resource Extraction Issuer to adopt a standard practice for defining what constitutes a "project" for reporting purposes. By adopting such standard practice, Resource Extraction Issuers will be better prepared to answer any questions posed by the SEC related to the definition of a project.

Opinions on the Final Rules are strongly divided. Organizations such as the American Petroleum Institute and other industry bodies lobbied strongly against various provisions of the Final Rules, arguing for less detailed reporting requirements, a higher "de minimis" threshold and the application of various exemptions, such as circumstances in which the disclosure of payments is prohibited by local law. However, the SEC strongly rejected such arguments. At the other end of the spectrum, groups such as Transparency International have already welcomed the Final Rules, which they believe set an international benchmark for transparency and mark an important step in the fight against corruption in extractive industries.

In any case, the Final Rules reflect a global trend towards transparency and accountability in the oil, gas and minerals sectors—the Hong Kong Stock Exchange has already introduced mandatory disclosure rules for companies listed there; the European Union is likely to introduce similar legislation later this year for E.U.-listed companies; and the authorities in Australia and Canada are also considering similar proposals.

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