

SEPTEMBER 2012

SEC EXPANDS DISCLOSURE REQUIREMENTS FOR RESOURCE EXTRACTION COMPANIES

On August 22, 2012, the U.S. Securities and Exchange Commission adopted a final rule implementing Section 1504 of the Dodd-Frank Wall Street Reform and Consumer Protection Act. The new rule requires oil, gas, and mineral extraction companies to file an annual report listing all payments (cash or in-kind) in excess of \$100,000 made to any government (U.S. or foreign) or government agent for the purpose of commercial development of oil, natural gas, or minerals. Section 1504 is intended to increase transparency in the target industries and improve government accountability, particularly in oil and mineral-producing countries with long histories of corruption and mismanagement. Compliance with the new rule is expected to impose a significant burden on affected companies.

WHAT BUSINESSES ARE COVERED UNDER SECTION 1504?

Section 1504 applies to all “resource extraction issuers,” which are defined in the rules to include i) any securities issuer, whether foreign or domestic, who ii) is required to file an annual report with the Commission, and iii) engages in the commercial development of oil, natural gas, or minerals.¹ The rules further define “commercial development” to encompass exploration, extraction, processing, and export of oils, natural gas, or minerals, as well as acquiring a license for any of those activities.² The rule is not limited to companies that are solely, or even primarily, engaged in resource production, and this broad definition of resource extraction could pull even seemingly-unrelated companies, such as shipping firms, into its ambit. But the statutory definition does have limits. For example, the rules do not include activities “ancillary or preparatory” to commercial development, such as the manufacture of equipment used in drilling or marketing activities.

WHICH PAYMENTS MUST BE DISCLOSED?

Companies meeting the above definition are required to report on an annual basis all payments (or series of related payments) i) in excess of \$100,000 dollars, ii) made to the U.S. government (or agent thereof) or a foreign government (or agent thereof), iii) for the purpose of commercial development of oil, natural gas, or minerals.³ The rule defines these seemingly straightforward terms broadly. Under the rule, “foreign government” includes any department, agency, or instrumentality of a foreign government, including a

company whose majority owner is a foreign government. This definition also includes principals or agents of sub-national governing bodies such as states, provinces, or counties. Likewise, the term “payment” is interpreted broadly, and includes non-consumption taxes, royalties, fees, production entitlements, bonuses, dividends, and payments for infrastructure improvement. One of the few enumerated exceptions to the disclosure requirements, noted in the comments to the proposed rule, is for “social or community payments” such as construction of schools and hospitals intended to benefit the inhabitants in a resource-extraction area.

The rule also contains an anti-evasion provision, under which the SEC will “look through” the formalities of a transaction and focus on the substantive exchange. For example, an issuer would not be able to avoid disclosure by re-characterizing a licensing payment as a charitable donation to a host government or by having a subsidiary or third-party make a covered payment on its behalf. In essence, the definition of a payment (or payor) under § 1504 is a matter of substance, rather than form.

WHAT ARE THE DISCLOSURE REQUIREMENTS?

Companies covered by § 1504 must submit an annual report on the newly-created SEC Form SD,⁴ setting out detailed information about all payments meeting the above definition. This form must be filed with the SEC no later than 150 days after the close of the issuer’s fiscal year. The required disclosures include:

- type and total amount of payments made in connection with each resource extraction project;
- type and total amount of payments made to each government entity;
- payment totals by category;
- currency used for payment;
- financial period(s) in which payments were made;
- business segment of the issuer making each payment;
- identity of the government and country receiving the payment; and
- identity of the resource extraction project to which each payment relates.

The rule provides no exemption for confidential or commercially-sensitive information related to payments.

WHAT WILL THIS COST?

As mentioned above, the compliance costs associated with the new reporting requirements are expected to be substantial. The SEC Release regarding the adoption of the rule contains a compliance cost estimate predicting an initial compliance cost of \$1 billion and \$200-400 million of ongoing costs, divided among the approximately 1,100 issuers expected to fall under the new rule. The same release includes a statement from ExxonMobil estimating that the company' compliance costs will reach \$50 million, not including any ongoing costs.

WHEN DOES THE NEW REQUIREMENT TAKE EFFECT?

The new obligations under § 1504 will apply to any covered issuer whose fiscal year ends after September 31, 2013.

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