

## securities lawflash

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## SEC Adopts Payment Disclosure Rules for Resource Extraction Issuers

*Most public issuers engaged in the commercial development of oil, natural gas, or minerals must disclose certain payments made to U.S. federal and foreign governments and should implement systems to track these payments.*

On August 22, the Securities and Exchange Commission (SEC) adopted final rules (the final rules) requiring all companies that must file annual reports with the SEC and are engaged in the commercial development of oil, natural gas, or minerals to disclose certain payments made to the U.S. government or foreign governments (and related entities) for the purpose of commercial development of oil, natural gas, or minerals.<sup>1</sup> In 2010, Congress passed Section 1504 of the Dodd-Frank Wall Street Reform and Consumer Protection Act, which amended the Securities Exchange Act of 1934, as amended (the Exchange Act), by adding Section 13(q). The final rules implement Section 13(q) and add Rule 13q-1 to the Exchange Act, requiring companies to file a new Form SD. Companies must provide the new disclosure on Form SD within 150 days after the end of the company's fiscal year for fiscal years ending after September 30, 2013. The adopting release indicates that the estimated total initial cost of compliance for all companies is approximately \$1 billion, and the ongoing cost of compliance is between \$200 million and \$400 million.

The final rules and the adopting release leave a number of unanswered questions. In informal discussions, the SEC staff has provided unofficial guidance and has indicated that it anticipates providing formal guidance regarding the rules in the future. All unofficial guidance provided by the SEC staff is described below as such and does not necessarily represent the views of the SEC.

### Applicability of Final Rules

The final rules require a company to disclose payments made to the U.S. federal government and foreign governments (and related entities) if the company

- is engaged in the commercial development of oil, natural gas, or minerals; and
- is required to file an annual report with the SEC.

"Oil" and "natural gas" include crude oil, condensate, natural gas liquids, and methane. Neither the final rules nor the adopting release specifically define "minerals," but the SEC staff unofficially indicated that the word "minerals" is to be given its common definition. For example, the SEC staff unofficially stated that coal, copper, gold, iron, lead, limestone, salt, and silver are minerals covered by the final rules.

### Resource Extraction Issuers

All companies that meet the above definition are considered "Resource Extraction Issuers." The final rules do not provide exemptions from the definition of "Resource Extraction Issuer" and include foreign private issuers not exempt from Exchange Act registration pursuant to Exchange Act Rule 12g3-2(b), government-owned entities, and smaller reporting companies. Resource Extraction Issuers are required to file this additional disclosure

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<sup>1</sup> Disclosure of Payments by Resource Extraction Issuers, Release No. 34-67717 (Aug. 22, 2012), available at <http://www.sec.gov/rules/final/2012/34-67717.pdf>.

regardless of the size of the company or the extent of business operations constituting the commercial development of oil, natural gas, or minerals.

The final rules do not permit Resource Extraction Issuers to satisfy the disclosure requirements adopted under Section 13(q) by providing disclosures required under other extractive transparency reporting requirements, such as home-country laws, listing rules, or an Extractive Industries Transparency Initiative (EITI) program. The final rules also do not provide exemptions for situations in which a foreign law may prohibit the required disclosure, instances when a company has confidentiality provisions in an existing or future contract, or for commercially sensitive information.

## Payments by Subsidiaries or Companies Controlled by Issuers

Companies are also required to disclose payments made by a subsidiary or another entity controlled by the issuer, including where the subsidiary or entity is consolidated in the Resource Extraction Issuer's financial statements included in its Exchange Act reports as well as payments by other entities it controls, as determined in accordance with Exchange Act Rule 12b-2. A Resource Extraction Issuer may also be required to provide disclosure for entities in which it provides proportionately consolidated information. A Resource Extraction Issuer will be required to determine whether it has control of an entity for purposes of the final rules based on a consideration of all relevant facts and circumstances.

## Commercial Development

The "commercial development" of oil, natural gas, or minerals includes activities of exploration, extraction (including production of oil and gas), processing (including field processing activities and crushing and processing of raw ore prior to the refining or smelting phase), and export from the host country, or the acquisition of a license for any such activity. Commercial development captures both upstream and downstream activities, but it is limited to those activities that are directly related to the commercial development of oil, natural gas, or minerals. Commercial development does not include those activities that are ancillary or preparatory to such commercial development. For example, it does not include the marketing of oil, natural gas, or minerals; the manufacture of products used in the commercial development of oil, natural gas, or minerals (e.g., drill bits or machinery); or the transportation of oil, natural gas, or minerals (unless those activities are directly related to export).

## Disclosure Required of Resource Extraction Issuers

### Payments

A Resource Extraction Issuer is required to disclose certain payments made to the following entities:

- Foreign governments (including foreign subnational governments, such as the government of a state, province, county, district, municipality, or territory)
- Companies that are majority-owned by a foreign government
- U.S. federal government (but **not** subnational or state governments of the United States)

For a "payment" to be subject to the final rules, it must be made to further the commercial development of oil, natural gas, or minerals and must not be *de minimis* (as further explained below). Additionally, it must fall within the following types of payments:

- Taxes (including taxes levied on corporate profits, corporate income, and production, but excluding consumption taxes, such as value-added, personal income, or sales tax)
- Royalties
- Fees (including license, rental, entry, and concession fees)
- Production entitlements
- Bonuses (including signature, discovery, and production bonuses)
- Dividends (excluding dividends paid to a government as an ordinary shareholder)

- Infrastructure improvements (such as building a road or railway, but excluding social or community payments, including payments to build a hospital or school)

Disclosure is required of each payment listed above that is “not *de minimis*,” which the SEC has defined as any payment (whether a single payment or a series of related payments) that equals or exceeds \$100,000 during the most recent fiscal year.

As stated above, companies should note that corporate-level income taxes paid to the U.S. federal government are also to be disclosed by Resource Extraction Issuers.

Further, the final rules do not provide any exemption for any payments included in the list above made by U.S. companies to the U.S. federal government.

## **Disclosure Relating to the Payments**

The following information regarding the payments must be provided:

- Type and total amount of payments made for each project
- Type and total amount of payments made to each government
- Total amounts of the payments, by category
- Currency used to make the payments
- Financial period in which the payments were made
- 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
- The project of the Resource Extraction Issuer to which the payments relate

Payments must be disclosed in either U.S. dollars or in the company’s reporting currency. An issuer may choose to calculate the currency conversion between the currency in which the payment was made and U.S. dollars or the issuer’s reporting currency in one of three ways: (i) by translating the expenses at the exchange rate existing at the time the payment is made; (ii) by using a weighted average of exchange rates during the reporting period; or (iii) by using the exchange rate at the end of the company’s fiscal year. The payment disclosure does not need to be audited or provided on an accrual basis.

Disclosure regarding the business segment of the Resource Extraction Issuer that made the payments must be consistent with the reportable segments used by the Resource Extraction Issuer for purposes of financial reporting.

Neither the final rules nor the adopting release provide guidance regarding how companies are to attribute the payment of corporate-level federal income taxes in instances where companies do not operate entirely as Resource Extraction Issuers.

## **Payments to Be Disclosed by “Project”**

The final rules and adopting release leave the term “project” undefined, but the SEC provides guidance in the adopting release. The SEC did not include a definition of “project” so as to give Resource Extraction Issuers flexibility in applying the term to different business contexts depending on factors such as the particular industry or size of the company. In the adopting release, the SEC indicated that a contract with a government for the purpose of commercial development of oil, natural gas, or minerals typically defines the relationship. Additionally, payment flows between the issuer and the government generally would provide a basis for determining the payments and required payment disclosure associated with a particular “project.” Further, the SEC indicated that “project” is not to be defined as a reporting unit set forth in the Accounting Standards Code 350-20-20 and that it requires more granular disclosure than country-level reporting. The SEC, however, did indicate that payments can be disclosed at the entity level if the payment is made for obligations levied on the company at the entity level rather than the

project level. The SEC has provided the following example: If an issuer has more than one project in a host country, and that country's government levies corporate income taxes on the issuer with respect to the issuer's income in the country as a whole and not with respect to a particular project or operation within that country, the issuer would be permitted to disclose the resulting income tax payments without specifying a particular project associated with the payments.

## Method for Providing the Required Disclosure

A Resource Extraction Issuer must provide disclosure of applicable payments annually by filing a Form SD on the SEC's Electronic Data Gathering, Analysis, and Retrieval (EDGAR) system. The Form SD will require Resource Extraction Issuers to include a brief statement in the body of the form (in an item titled "Disclosure of Payments by Resource Extraction Issuers") directing users to detailed payment information in an exhibit to the form. The required information must be included in an exhibit to the Form SD and electronically tagged using the eXtensible Business Reporting Language (XBRL) format. Form SD requires a brief statement in Item 2.01 of the form directing users to the detailed payment information provided in the exhibits to the form. The new disclosure is not subject to the officer certifications required by Rules 13a-14 and 15d-14 of the Exchange Act.

## Timing of Disclosure

Resource Extraction Issuers are required to file the Form SD on EDGAR no later than 150 days after the end of its fiscal year 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 issuer's fiscal year began before September 30, 2013 (and the issuer will be required to provide a report for the period beginning October 1, 2013, through the end of its fiscal year). For any fiscal year beginning on or after September 30, 2013, a Resource Extraction Issuer will be required to file a report disclosing payments for the full fiscal year. For example, a Resource Extraction Issuer with a December 31, 2013, fiscal year end will be required to file a report disclosing payments made from October 1, 2013, through December 31, 2013.

## Questions that Remain

Neither the final rules nor the adopting release indicate any of the following:

- What constitutes a "mineral," although unofficial guidance from the SEC has been provided regarding certain additional resources that are considered "minerals" for purposes of the final rules as described above.
- How the final rules will affect royalty trusts and similar entities given their passive involvement in the extraction of oil, natural gas, or minerals.
- How companies should allocate tax payments made to the U.S. federal government by companies whose operations are not entirely in resource extraction.

## Next Steps

A company should determine whether it is a Resource Extraction Issuer by examining its operations. For companies required to file an annual report with the SEC, the test is whether it is engaged in any commercial development of oil, natural gas, or minerals. Companies with questions as to whether their particular operations fit within the definition of the commercial development of oil, natural gas, or minerals should contact their securities legal counsel or speak with the SEC staff for guidance.

In connection with this review, a company should evaluate the business operations of its subsidiaries and other entities included in its consolidated financial statements as well as payments by other entities it controls, as determined in accordance with Exchange Act Rule 12b-2. A company should also be mindful that it may be required to provide disclosure for entities in which it provides proportionately consolidated information and for other entities that it may control, based on a consideration of all relevant facts and circumstances.

Once a company determines it is subject to the final rules, it should implement systems to track any payments made by each reporting segment and related entity by project, if applicable, to the U.S. federal government, to foreign governments, or to companies that are majority-owned by foreign governments. Companies should consult with their internal auditor to determine the best method for tracking this information.

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