JONES DAY

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SEC FINALIZES RULES REGARDING DISCLOSURE OF PAYMENTS BY RESOURCE EXTRACTION ISSUERS

On August 22, 2012, the SEC adopted final rules ("Final Rules") to implement the resource extraction issuer disclosure requirements of the Securities Exchange Act of 1934 (the "Exchange Act"), which were added by the Dodd-Frank Wall Street Reform and Consumer Protection Act. These rules will require public companies engaged in the commercial development of oil, natural gas, or minerals to disclose, in the XBRL interactive data standard, payments to the U.S. federal government and foreign governments. We previously reported on the Commission's proposed rules in a February 2011 *Commentary* (http://www.jonesday.com/proposed_rule/), and, for the most part, the Final Rules are consistent with the proposed rules.

WHAT COMPANIES ARE SUBJECT TO THE REPORTING REQUIREMENTS?

The Final Rules apply to "resource extraction issuers," which are all U.S. companies and foreign companies that are engaged in the commercial development of oil, natural gas, or minerals and that are required to file annual reports with the SEC on Form 10-K, Form 20-F, or Form 40-F. The reporting requirements apply regardless of the size of the company or the extent to which the business operations of the company comprise the commercial development of oil, natural gas, or minerals.

The "commercial development[1] of oil, natural gas, or minerals" includes exploration, extraction,[2] processing,[3] and export activities, or the acquisition of a license for these activities.

To be subject to the Final Rules, a company must make a payment to the U.S. federal government or any foreign government (including foreign subnational government units such as a state, province, county, district, municipality, or territory under a foreign national government), as described below. The Final Rules define "payment" to mean a payment (in cash and/or in-kind) that is made to further the

commercial development of oil, natural gas, or minerals that is "not de minimis." In a change from the proposals, the Final Rules define "not de minimis" to mean any payment, whether a single payment or a series of related payments, that equals or exceeds $100,000 during a company's most recent fiscal year. Resource extraction issuers are required to report certain payments to the U.S. federal government and foreign governments (including foreign subnational government units) for the purpose of furthering commercial development of oil, natural gas, and minerals. Payments to U.S. state or local governments are not required to be reported. Payments to companies that are majority-owned by a foreign government are considered to be payments to the foreign government. The SEC noted these disclosure requirements were to increase the transparency of payments made by resource extraction issuers and thereby empower citizens of resource-rich countries to hold their governments accountable for the wealth generated by those resources.

The Final Rules do not include an exemption for certain categories of issuers or for resource extraction issuers subject to similar reporting requirements under home country laws, listing rules, or an Extractive Industries Transparency Initiative program. More importantly, the Final Rules also do not provide an exemption for situations in which applicable law may prohibit the required disclosure, for example, where an issuer is subject to a foreign law prohibition on disclosure or a confidentiality provision in a contract, or for commercially sensitive information.

WHAT INFORMATION IS REQUIRED TO BE REPORTED?

In addition to payments by the issuer, payments by any subsidiary of the issuer or any subsidiary of said company would also be required to be reported.[4] Among the types of payments, including payments in-kind, required to be reported are:

- Taxes, including corporate income, profit, or production taxes, but not value-added taxes or sales taxes;
- Royalties;
- Fees, including license fees, rental fees, entry fees, and concession fees;
- Production entitlements; and
- Bonuses.

In another change from the proposal, the SEC determined to add the following types of payments:

- Dividends, other than those paid pro rata on the same terms as to other shareholders; and
- Payments for infrastructure improvements such as roads (but not social or community payments to build hospitals or schools).

HOW ARE THE PAYMENTS TO BE REPORTED?

Resource extraction issuers will provide the required payment disclosure in an annual disclosure report on a new Form SD that will be due not later than 150 days after the end of the issuer's most recent fiscal year. This is a change from the Commission's proposals, which would have included the disclosures in the issuer's annual report filed with the SEC. For calendar-year companies, the first Form SD will be due by May 30, 2014 and will reflect payments from October 1, 2013 through December 31, 2013. The body of the Form SD will include a brief statement directing users to the detailed payment information provided in an exhibit to the form. The required exhibit must provide the information using the XBRL interactive data standard that issuers use for their financial statements in their other SEC filings. The payment information must include electronic tags that identify:

- The total amounts of the payments, by category;
- The currency used to make the payments;
- The financial period in which the payments were made;
- The 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; and
- The project of the resource extraction issuer to which the payments relate.

Where a payment is made in-kind, issuers may report such payments at cost or, if cost is not determinable, fair market value, and provide a brief description of how the monetary value was calculated.

In addition, the issuer must provide the type and total amount of payments made for each project and the type and total amount of payments made to each government. Although the payment information generally is required to be reported by project, for taxes that are levied at the entity level, the issuer may report that payment at the entity level.

In an about-face from the Commission's proposals, the Final Rules dictate that the information required under the Final Rules will be deemed to be "filed" instead of "furnished" and therefore will be subject to potential Exchange Act Section 18 liability. This is on top of the addition, in the Final Rules, of an anti-evasion rule that prohibits issuers from trying to avoid disclosures regarding activities and payments that, in substance if not in form, are subject to the Final Rules. Both of these changes are noteworthy in light of the SEC's admission that the legislation and the Final Rules are intended to provide "social benefits" as opposed to investor protection benefits that are typically the goals of SEC rules. Information filed pursuant to the Final Rules, however, will not be deemed to be incorporated by reference into any filing under the Securities Act of 1933 or the Exchange Act, unless the issuer specifically incorporates it by reference into a filing.

CONCLUSION

Affected issuers must comply with the Final Rules beginning with fiscal years ending after September 30, 2013. For the first report filed for a fiscal year ending after September 30, 2013, an issuer subject to the Final Rules may provide a partial year report if the issuer's fiscal year began before September 30, 2013. Accordingly, an issuer who files an annual report with the SEC should (i) determine if any aspect of its business would qualify such issuer as a "resource extraction issuer" under the Final Rules and (ii) determine if any payment or series of related payments in excess of $100,000 were made to the U.S. federal government and/or foreign governments during the period covered by the report. An issuer covered by the Final Rules should then begin to implement internal reporting procedures that will allow for accurate and timely disclosure pursuant to the Final Rules as early as late 2013. An issuer should also consider the impact of the disclosure required by the Final Rules on its business, such as whether disclosure will result in the breach of any confidentiality obligations under outstanding contracts or foreign laws.

LAWYER CONTACTS

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ENDNOTES

1 "Commercial development" is not intended to capture activities that are ancillary or preparatory to such commercial development, such as the manufacturing of a product ultimately used to further the commercial development of oil, natural gas, or minerals, or transportation or marketing activities. The export of oil, natural gas, or minerals across international borders, however, is covered by the Final Rules. As a result, issuers that are not traditionally viewed as being engaged in "resource extraction," such as a company transporting oil, natural gas, or minerals from the United States to Canada, could be subject to the requirements of the Final Rules.

2 "Extraction" includes the production of oil and natural gas, as well as the extraction of minerals, but it does not include the manufacturing of equipment used in the extraction process.

3 "Processing" includes the processing of gas to extract liquid hydrocarbons, the removal of impurities from natural gas after extraction and prior to its transport through the pipeline, and the upgrading of bitumen and heavy oil. In adopting the Final Rules, the SEC made clear that refining and smelting are not considered "processing."

4 Such entities would include a subsidiary or entity that is consolidated in the resource extraction issuer's financial statements included in its Exchange Act reports, as well as other entities the issuer controls as determined in accordance with Exchange Act Rule 12b-2. Because resource extraction issuers often engage in commercial development of oil, natural gas, or minerals through joint ventures, an issuer must determine, based on a consideration of all relevant facts and circumstances, whether it possesses, directly or indirectly, the power to direct or cause the direction of the management and policies of the venture.