January 10, 2011

SEC Proposes Rules Requiring Disclosure of Payments by Resource Extraction Issuers

In December, the SEC published proposed rules that would implement a provision of the Dodd-Frank Wall Street Reform and Consumer Protection Act (the "Dodd-Frank Act")[1] requiring resource extraction issuers to include in their annual reports disclosure with respect to payments made by the issuer, a subsidiary or other entity controlled by the issuer, to a non-U.S. government or the U.S. federal government for the purpose of the commercial development of oil, natural gas or minerals.

Covered Issuers

Scope. The proposed disclosure rules apply to all U.S. and non-U.S. 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, irrespective of the size or extent of the business operations of the issuers and irrespective or whether or not such issuers are controlled or owned by governments. Issuers must also disclose payments made by a subsidiary or an entity under the control of the issuer. Under the proposed rules, whether an issuer has "control" (which is defined consistently with the definition of "control" under the Securities Exchange Act of 1934, as amended (the "Exchange Act")), should be based on a consideration of all relevant facts and circumstances. At a minimum, an issuer will be deemed to control any entity for which the issuer must provide consolidated financial information in the financial statements included in its reports under the Exchange Act.

Commercial development of oil, natural gas or minerals. The proposed rules define commercial development of oil, natural gas or minerals to include the exploration, extraction, processing, export and other significant actions relating to oil, natural gas or minerals or the acquisition of a license for any of the above activities. The SEC has indicated that the proposed rules are meant to cover only activities that are directly related to the commercial development of oil, natural gas or minerals and are not meant to capture ancillary or preparatory activities such as the manufacture of a product used in the commercial development of these resources, or transportation activities related to these resources. The SEC has indicated that issuers involved in the removal of impurities from natural gas after it is extracted but before it is transported would be included in the definition of commercial development for purposes of the new disclosure requirements because such removal is a necessary part of natural gas processing prior to transportation.

[1] The proposed rules were published in an SEC release, Disclosure of Payments by Resource Extraction Issuers, pursuant to Section 1504 of the Dodd-Frank Act, which added Section 13(q) to the Securities Exchange Act of 1934, as amended.

Covered Payments

Payments. The proposed additional disclosure rules apply to the following payments by issuers engaged in commercial development of oil, natural gas or minerals:

- Payments made for the purpose of furthering the commercial development of oil, natural gas or minerals;
- Payments that are not *de minimus* (the SEC is not currently proposing to specify a standard for what would constitute a *de minimus* payment, believing the phrase to be sufficiently clear); and
- Payments such as taxes, royalties, fees, license fees, production entitlements, bonuses, and other material benefits determined by the SEC to constitute a portion of "the commonly recognized revenue stream for the commercial development of oil, natural gas or minerals," including the following benefit streams:
    - Production entitlements;
    - Taxes on corporate profits, corporate income and production (but excluding value-added taxes, personal income taxes or sales taxes);
    - Royalties;
    - Bonuses paid for grants of extraction rights, achievement of production or other targets and discovery of additional mineral reserves or deposits; and
    - License fees, rental fees, entry fees and other consideration provided for licenses and concessions.

No exception for legally or contractually prohibited disclosure. Unlike the SEC's disclosure rules concerning oil and gas reserves that were adopted in 2008, the proposed additional disclosure rules do not provide an exception to the disclosure requirements in situations where the host country or confidentiality clauses in contracts to which the issuer is a party prohibit such disclosure.

Definition of Foreign Government and Federal Government

The proposed disclosure rules contain an expansive definition of "foreign government," including a foreign national government, subnational government (state, province, county, district municipality or other level of subnational government), department, agency or instrumentality of a foreign government or a company owned by a foreign government.

Disclosure Requirements

Annual reports. Issuers subject to the proposed disclosure rules will be required to provide payment disclosure annually in their annual reports on Form 10-K, Form 20-F or Form 40-F, as applicable, with respect to payments during the fiscal year covered by the report. In each annual report issuers will be required to include a brief statement and cross-reference under a separate heading "Payments Made By Resource Extraction Issuers" directing investors to detailed information regarding payments to foreign governments that is to be included in exhibits to the annual reports.

Format of exhibits. The proposed disclosure rules require issuers to present the payment information in two separate exhibits to their annual reports. One exhibit will be required to be provided in HTML or ASCII format in order to enable investors to read the disclosure without additional computer programs or software. A second exhibit will be required to provide electronically tagged payment information in XBRL format.

Content of disclosure. Under the proposed disclosure rules, an issuer would be required to submit electronically-tagged payment information for any payments a foreign government or the U.S. Federal Government indicating:

- The total amount of payments, organized by category;
- The currency in which payments were made;
- The financial period in which payments were made;
- The business segment of the issuer that made the payments;
- The government that received the payments, including the country in which the government is located; and
- The project to which the payments relate.

The issuer will also be required to provide the type and total amount of payments for each project and to each government in XBRL format, including an electronic tag identifying the currency in which the payments were made.

Furnished not filed. Under the proposed disclosure rules, the disclosure with respect to these payments would be "furnished" rather than "filed" with the SEC. As such, the disclosure would not be subject to liability under Section 18 of the Exchange Act (liability for material misstatements or omissions in documents filed with the SEC) unless the issuer explicitly provides that the disclosure is filed under the Exchange Act and will not be deemed to be incorporated by reference into any other documents (such as short-form prospectuses) filed with the SEC unless the issuer explicitly provides otherwise.

Timing

The proposed rules would require issuers to provide their first disclosure after the first full fiscal year following the SEC's issuance of the final rules. The Dodd-Frank Act requires the SEC to adopt final rules by April 15, 2011, and as such, issuers will likely be required to include disclosure of payments in their annual reports for the fiscal year ending on or after April 15, 2012.

In the proposing release, the SEC lists a number of specific questions regarding the proposed rules as to which it is seeking comment. Comments on the proposed rules are due January 31, 2011.

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This memorandum is not intended to provide legal advice, and no legal or business decision should be based on its content. Questions concerning issues addressed in this memorandum should be directed to:

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