

August 24, 2012

SEC Adopts Rules Under Dodd-Frank Requiring Disclosure of Payments Made to Governments by Resource Extraction Issuers

On August 22, 2012, the SEC adopted rules to implement Section 1504 of the Dodd-Frank Wall Street Reform and Consumer Protection Act. The rules require “resource extraction issuers” to disclose details of payments made by the issuer, or 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. Such details include the total amount of any such payments; the government that received the payments; and the project to which the payments relate.

A number of items included in the adopting release are notable:

- The required disclosures will be filed annually with the SEC on a new form (Form SD), as opposed to being included as part of an issuer’s annual report, as was proposed.
- The Form SD will be required to be filed no later than 150 days after the end of the issuer’s most recent completed fiscal year.
- Issuers will be required to comply with the new rules for fiscal years ending after September 30, 2013 and will, in almost all cases, only be required to disclose payments made after September 30, 2013.
- Only payments (whether a single payment or a series of related payments) of \$100,000 or more must be disclosed.
- The required disclosures will be filed with the SEC, not furnished to the SEC as was previously proposed, and therefore will be subject to liability under Section 18 of the Securities Exchange Act of 1934, as amended (the “Exchange Act”).
- The SEC declined to adopt any exceptions for smaller issuers or issuers that engage in a *de minimis* amount of resource extraction activity.
- The SEC declined to adopt an exception to the rules’ disclosure requirements where such disclosure is prohibited by contract or applicable foreign law.

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- The rules do not require resource extraction payment disclosures to be audited or provided on an accrual basis.

Summary of the Adopted Rules

Covered Issuers

Scope. As adopted, the rules apply to all U.S. and non-U.S. companies that are required to file annual reports with the SEC under the Exchange Act and are engaged in the commercial development of oil, natural gas or minerals, irrespective of the size or extent of the business operations of the issuers and irrespective of 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 rules, whether an issuer has “control” should be based on a consideration of all relevant facts and circumstances (the definition of “control” being consistent with the Exchange Act’s definition of such term). At a minimum, an issuer will be deemed to control any entity that it is required to consolidate in the financial statements included in its Exchange Act reports. The adopting release also notes that an issuer may, depending on whether control is present, be required to provide disclosure for entities in respect of which it provides proportionately consolidated financial information.

Commercial development of oil, natural gas or minerals. The rules define commercial development of oil, natural gas or minerals to include the exploration, extraction, processing and export of oil, natural gas or minerals or the acquisition of a license for any such activities. The SEC has indicated that the 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 states, by way of example, that manufacturing drill bits or other machinery used for extraction of oil would not fall within the definition of commercial development.

In the adopting release, the SEC also provides guidance that “processing” includes field processing activities, such as the processing of gas to extract liquid hydrocarbons, the removal of impurities from natural gas after extraction and prior to transport, the upgrading of bitumen and heavy oil, and the crushing and processing of raw ore prior to smelting. The SEC clarified that “processing” does not include refining or smelting. With respect to the meaning of “export,” the SEC is of the view that such term includes the export of oil, natural gas, or minerals from the host country and, therefore, that the rules do not require a resource extraction issuer to disclose payments made for transporting oil, natural gas, or minerals for a purpose other than export.

The rules also include an anti-evasion provision which requires disclosure with respect to an activity or payment that, although not in the form of or characterized as one of the categories of payment or activity specified, is part of a plan or scheme to evade the disclosure requirements of the rules. Under the provision, a resource extraction issuer could not avoid disclosure, for example, by re-characterizing an activity that would otherwise be covered by the rules as transportation.

Covered Payments

Payments. The disclosure required by the rules must be supplied in respect of “payments,” as defined under the rules. “Payment” means an amount paid that:

- is made to further the commercial development of oil, natural gas or minerals;
- is not *de minimus* (meaning any payment, whether a single payment or a series of related payments, that equals or exceeds \$100,000 during the most recent fiscal year); and
- includes taxes, royalties, fees (including license fees), production entitlements, bonuses, dividends and payments for infrastructure improvements.

The final version of the rules adds an instruction to clarify that “fees” include rental fees, entry fees, and concession fees, and that “bonuses” include signature, discovery and production bonuses. In addition and as proposed, the rules include an instruction to clarify that a resource extraction issuer will be required to disclose payments for taxes levied on corporate profits, corporate income, and production, but will not be required to disclose payments for taxes levied on consumption (e.g., value added taxes, personal income taxes, or sales taxes). Resource extraction issuers must also disclose any payments of the specified types that are made in kind. The rules specify that issuers may report in-kind payments at cost or, if cost is not determinable, fair market value, and should provide a brief description of how the monetary value was calculated.

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 rules do not provide an exception to the disclosure requirements in situations where host country law or confidentiality clauses in contracts to which the issuer is a party prohibit such disclosure.

Definition of Foreign Government and Federal Government

The 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.

The final rules clarify that “Federal Government” means the U.S. Federal government. The rules therefore do not require disclosure of payments made to state or other subnational governments in the United States.

Disclosure Requirements

Annual Filing of Form SD. In a change from the proposing release, the rules as adopted require a resource extraction issuer to provide the required disclosure annually by filing a new

form, Form SD, with the SEC. The report on Form SD will provide the required disclosure with respect to payments made during the last fiscal year. Form SD will require issuers to include a brief statement in the body of the form under an item entitled, "Disclosure of Payments By Resource Extraction Issuers," directing users to detailed payment information provided in an exhibit to the filing. In the proposing release for the rules, the SEC had suggested that the required disclosures be provided annually in issuers' annual reports on Form 10-K, Form 20-F or Form 40-F.

The rules require the presentation of payment information in one exhibit to new Form SD rather than in two exhibits, as was proposed. The required exhibit must provide the information in XBRL. However, the SEC is not requiring, as previously proposed, a separate HTML or ASCII exhibit in addition to the XBRL exhibit. The SEC is developing a new XBRL taxonomy for the payment information, which the SEC expects will be published for comment soon.

Content of disclosure. Under the rules as adopted, an issuer will be required to submit electronically-tagged payment information for any payments to 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.

Consistent with the proposed rules, the final rules leave the term "project" undefined. The rules do, however, permit issuers to disclose payments at the entity level if the payment is made for obligations levied at the entity level rather than the project level. Thus, if an issuer has multiple projects in a host country, and that country's government taxes the issuer on its income in the country as a whole, and not with respect to a particular project or operation within such country, the issuer is permitted to disclose the resulting income tax payments without specifying a particular project associated with the payments.

The final rules permit issuers to choose between providing the required payment disclosure in either U.S. dollars or its reporting currency. In addition, 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, as applicable, in one of three ways: (1) using the exchange rate at the time of the payment; (2) using a weighted average of the exchange rates during the period; or (3) based on the exchange rate as of the issuer's fiscal year end. An issuer must

disclose the method used to calculate the currency conversion. The final rules do not require the resource extraction payment information to be audited or provided on an accrual basis.

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.

Filed not Furnished. The rules as adopted provide that the payment disclosure included as an exhibit to Form SD will be considered “filed” with the SEC. As such, the disclosure will be subject to liability under Section 18 of the Exchange Act (liability for material misstatements or omissions in documents filed with the SEC). This is a significant change from the proposal, which provided that the required disclosures would be “furnished” to the SEC as exhibits to issuers’ annual reports, and therefore not subject to Section 18 liability. However, consistent with the rule proposal, such information will not be deemed to be incorporated by reference into any other documents (such as prospectuses) filed with the SEC unless the issuer explicitly provides otherwise.

Timing

A resource extraction issuer will be required to file its Form SD on EDGAR no later than 150 days after the end of its fiscal year, and will be required to comply with the new rules for fiscal years ending after September 30, 2013. An issuer is permitted to provide a partial year report for the first Form SD filed if the issuer’s fiscal year began before September 30, 2013. Such a partial report will cover the period beginning October 1, 2013 through the end of the issuer’s 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.

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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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