

Heads Up

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One of the primary objectives of Section 1504 is to improve transparency by holding governments of resource-rich countries accountable to their citizens for wealth that is created by using a country's natural resources.

Show Us the Money!

SEC Issues Final Rule Requiring Resource Extraction Issuers to Disclose Certain Payments

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Introduction

On August 22, 2012, the SEC narrowly approved (by a 2–1 vote) a [final rule](#)¹ implementing Section 1504 of the Dodd-Frank Wall Street Reform and Consumer Protection Act (the “Dodd-Frank Act”), which adds Section 13(q) to the Securities Exchange Act of 1934 (the “Exchange Act”).² One of the primary objectives of Section 1504 is to improve transparency by holding governments of resource-rich countries accountable to their citizens for wealth that is created by using a country's natural resources. Under the final rule, resource extraction issuers, subsidiaries of resource extraction issuers, and entities under the control of resource extraction issuers are required to disclose certain information about payments made to the U.S. federal government or foreign governments “for the purpose of commercial development of oil, natural gas, or minerals.” Among other things, the final rule:

- Defines the term “resource extraction issuer.”
- Specifies which governments are within its scope.
- Discusses the activities that constitute commercial development (of oil, natural gas, or minerals).
- Indicates the payments that an entity must disclose.

Definition of Resource Extraction Issuers

The final rule defines resource extraction issuers (or “extractive issuers”) as issuers that are (1) required to file an annual report with the SEC and (2) engaged in commercial resource extraction of oil, natural gas, and minerals. Domestic issuers (including smaller reporting companies), foreign issuers, their subsidiaries, and other entities controlled by such extractive issuers are subject to the final rule's disclosure requirements. The final rule notes that the terms “control” and “subsidiary” are defined in Rule 12b-2 of the Exchange Act.³

¹ SEC Final Rule Release No. 34-67717, *Disclosure of Payments by Resource Extraction Issuers*.

² Although the SEC originally issued its proposed rule on Section 1504 in December 2010 and had expected to finalize it in April 2011, it delayed issuance of the final rule to consider feedback received in over 150 comment letters on the proposal and to further evaluate the rule's implementation costs.

³ Footnote 315 of the final rule states that Exchange Act Rule 12b-2 and Regulation S-X, Rule 1-02, “Definitions of Terms Used in Regulation S-X,” define “control” as “the possession, direct or indirect, of the power to direct or cause the direction of the management and policies of a person, whether through the ownership of voting shares, by contract, or otherwise.” In addition, a “subsidiary” of a specified person is defined as “an affiliate controlled by such person directly, or indirectly through one or more intermediaries.”

There are no exemptions from the final rule's disclosure requirements for (1) certain categories of issuers; (2) "resource extraction issuers subject to similar reporting requirements under home country laws, listing rules, or an [Extractive Industries Transparency Initiative (EITI)] program"; (3) "situations in which foreign law may prohibit [such] disclosure"; or (4) instances in which existing or future contracts may include "commercially sensitive information."

Editor's Note: The SEC ultimately concluded that Section 1504's transparency objectives would be best met if all extractive issuers are subject to the final rule's requirements. Because there are no exemptions for situations in which foreign law might be violated, extractive issuers should exercise care and consult with their legal counsel when meeting the final rule's disclosure requirements may be in conflict with a foreign law's prohibition of such disclosures.

Governments Within Scope of Final Rule

The final rule requires extractive issuers to disclose certain payments made to the federal government but excludes from its scope payments made to state and local governments. Certain payments made to foreign national or subnational governments must also be disclosed.

Definition of Commercial Development

Under the final rule, the "commercial development of oil, natural gas, or minerals" includes (1) "exploration, extraction, processing, and export, or [2] the acquisition of license [to perform] such activity." The final rule refers to such activities as "covered activities" and notes that commercial development excludes activities that are not directly related or "ancillary or preparatory to commercial development" as well as the transportation or marketing of covered activities.

Definition of Payment

The final rule defines payments as paid amounts that:

- Advance the commercial development of oil, natural gas, and minerals in a specific region.
- Equal or exceed \$100,000 individually and in the aggregate (i.e., are not de minimis).
- Include items such as taxes, royalties, fees, production entitlements, bonuses, dividends, and infrastructure improvements. The final rule notes that such payments are consistent with those detailed in the EITI⁴ and other statutory requirements.

Disclosure Requirements

The final rule requires resource extraction issuers to disclose:

- The total amount of payments made, by category, for each project and to each government.
- The currency in which payments were made.
- When the payments were made (i.e., the corresponding financial period).
- The business segment of the resource extraction issuer that made the payments.
- The country (government) that received the payments.
- The project(s) for which payments were made.

⁴ The final rule states that "[t]he EITI is a voluntary coalition of oil, natural gas, and mining companies, foreign governments, investor groups, and other international organizations dedicated to fostering and improving transparency and accountability in countries rich in oil, natural gas, and minerals through the publication and verification of company payments and government revenues from oil, natural gas, and mining."

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A controversial aspect of the final rule is the requirement to disclose payment information on a by-project basis. Some commenters on the original proposal were concerned that the term “project” was not defined. They argued that without such a definition, overly disaggregated disclosures would result.

Despite these concerns, the term remained undefined in the final rule because (1) it is not defined elsewhere in SEC rules or regulations, in Section 1504, or by the EITI, and (2) extractive issuers will have more flexibility to determine the appropriate use of the term. In addition, the final rule notes the SEC’s belief that the term “project” is “a commonly used term whose meaning is generally understood by resource extraction issuers and investors.” In considering feedback on whether to define “project,” the SEC rejected constituents’ proposals that the disclosure requirements should be based on “material projects” or that projects should be akin to reporting units.

Editor’s Note: The SEC reiterated its belief that the legislative intent of Section 1504 was for entities’ disclosures to be granular rather than aggregated (i.e., on a project basis rather than at the country level). However, the final rule clarifies that not all costs need to be allocated to projects. For example, the final rule permits extractive issuers to disclose certain payments at the entity level (such as income taxes levied at the corporate level) “if the payment is made for obligations levied on the issuer at the entity level rather than the project level.”

Under the final rule, extractive issuers are required to annually file (rather than furnish) the required disclosures as exhibits to a newly created form, Form SD.

Filing Requirements and Transition

The final rule’s filing requirements differ from those in the proposed rule. Under the proposed rule, extractive issuers would have been required to include, in the body of the annual report (e.g., Form 10-K, 20-F, or 40-F), a brief statement directing investors to attached exhibits containing the required disclosures. However, under the final rule, extractive issuers are required to annually file (rather than furnish) the required disclosures as exhibits to a newly created form, Form SD. Such exhibits must also be electronically tagged in the XBRL interactive data format. Extractive issuers are required to file Form SD with the SEC no later than 150 days after their fiscal year-end and to comply with the final rule’s disclosure provisions for fiscal years ending after September 30, 2013. For its first report, an extractive issuer whose fiscal year began before September 30, 2013, will only need to disclose payments made after September 30, 2013, to the end of the issuer’s fiscal year.

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