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Issuers subject to the new rule should expect substantial compliance costs, potential liability under the Exchange Act, U.S. and foreign scrutiny over payments and the likelihood of shareholder activism as a result of the disclosure.

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SEC Adopts Final Rule on Disclosure of Payments by Resource Extraction Issuers

AUGUST 30, 2012

At an open meeting on August 22, 2012, the SEC adopted a final rule on disclosure of payments by resource extraction issuers, implementing Section 13(q) of the Securities Exchange Act of 1934 and Section 1504 of the Dodd-Frank Wall Street Reform and Consumer Protection Act. Resource extraction issuers are those issuers required to file an annual report with the SEC and engaged in the commercial development of oil, natural gas or minerals.

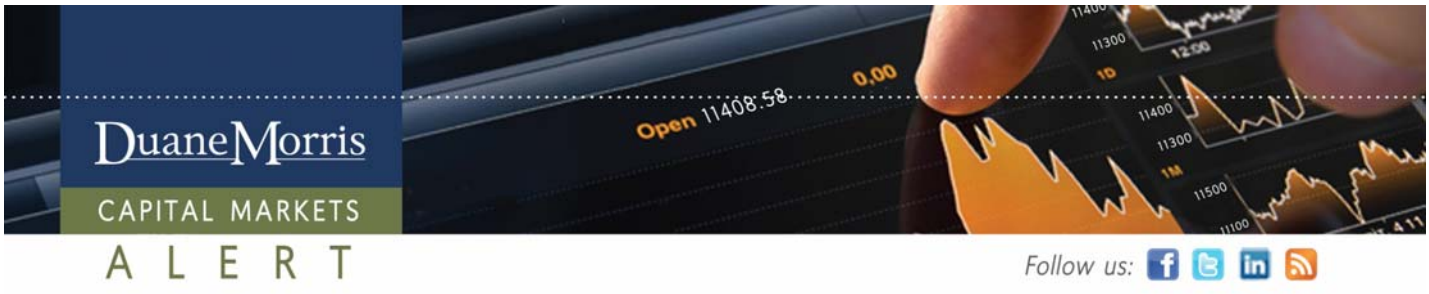
Issuers subject to the new rule should expect substantial compliance costs, potential liability under the Exchange Act, U.S. and foreign scrutiny over payments and the likelihood of shareholder activism as a result of the disclosure.

Section 13(q), new Rule 13q-1 and Form SD require issuers to provide information about payments made to the U.S. federal government or foreign national or subnational governments for the purpose of the commercial development of oil, natural gas or minerals.

The SEC stated that Congress' intent in adopting Section 13(q) was to increase the transparency of these payments, helping empower citizens of resource-rich countries to hold their governments accountable for the wealth created by these resources.

Compliance Dates

Issuers must comply with the new rule for fiscal years ending after September 30, 2013. Issuers with fiscal years that began before September 30, 2013, will file a partial-year report for the period October 1, 2013, through the end of their fiscal year. For fiscal years beginning on or after September 30, 2013, issuers will file a report for their full fiscal year. Reports will be due within 150 days after fiscal-year end.



Potential Liability and Costs

In a change from the proposed rule, the new disclosure on Form SD will be filed with rather than furnished to the SEC. As a result, issuers will be subject to potential liability under Exchange Act Section 18. Section 18(a) provides that a person will be liable for false or misleading statements of a material fact in documents filed under the Exchange Act under certain circumstances, unless the person can establish that he acted in good faith and had no knowledge the statement was false or misleading.

The information in Form SD, however, will not be deemed incorporated by reference into Securities Act or Exchange Act filings, unless the issuer specifically incorporates it by reference, and will not be subject to the Exchange Act CEO and CFO certifications.

The SEC recognized that the rule will impose significant compliance costs on companies and estimated initial aggregate costs of $1 billion and annual costs thereafter of $200 million to $400 million. The SEC used a combination of the cost analyses provided by commentators and its own analysis and assumptions, with the average first-year cost for large issuers ranging from $90,000 to more than $900,000. These estimates were based on a percentage of assets model and used projections provided by two companies, which had given actual first-year cost estimates of $500,000 and $50 million, respectively. Ongoing costs were estimated to be $350,000. In addition, the SEC recognized the potential for significant losses to issuers that operate in host countries that prohibit them from making Form SD disclosure. Challenges to the rule on the basis of the cost-benefit analysis can be anticipated in light of the large costs and social rather than investor protection benefit of the rule.

Applicability

The final rule applies to all resource extraction issuers, which are now defined as an issuer required to file an annual report with the SEC and engaged in the commercial development of oil, natural gas or minerals. This includes all U.S. and foreign companies, including government-owned companies and smaller reporting companies, regardless of size or the extent of their commercial development business operations. Foreign private issuers that are exempt from Exchange Act registration pursuant to Rule 12g3-2(b) and therefore not required to file annual reports with the SEC are not subject to the rule. There are no exemptions, even where foreign law or confidentiality provisions in contracts may prohibit the disclosure. According to the SEC's final rule release based on comment letters it received, the countries where foreign law may prohibit this disclosure are China, Angola, Cameroon and Qatar.

The disclosure must be provided for payments made during the fiscal year by the issuer, any subsidiary or an entity under the issuer's control. Payments must be disclosed if they are a single payment, or series of related payments, of $100,000 or more. The SEC adopted this absolute standard as its definition of the Dodd-Frank Act term "not *de minimis*," rather than a materiality standard or leaving the term undefined.

The SEC defined "commercial development" to include exploration, extraction, processing and export of oil, natural gas or minerals or the acquisition of a license for such activity. Marketing and transportation are excluded from the definition of commercial development, with no disclosure required for payments to transport oil, natural gas or minerals for a purpose other than export.

In the adopting release, the SEC provided examples of activities covered by the terms "extraction," "processing" and "export":

- extraction includes the production of oil and natural gas as well as the extraction of minerals
- 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 its transport through the pipeline and the upgrading of bitumen and heavy oil
- processing also includes the crushing and processing of raw ore prior to the smelting phase, but does not include refining or smelting and
- export includes the export of oil, natural gas or minerals from the host country, rather than removal of the resource from the place of extraction to the refinery, smelter or first marketable location.

Form SD

The disclosure will be made in an exhibit, in XBRL interactive data format, to the new specialized disclosure report, Form SD, rather than in the issuer's existing Exchange Act annual report. The final rules do not require the payment information to be audited or provided on an accrual basis.

The SEC determined not to define the term "project" in the final rules, although it did provide some guidance. The SEC noted that "project" is a commonly used term whose meaning is generally understood by resource extraction issuers and investors and that issuers routinely enter into contracts with governments for commercial development of oil, natural gas or minerals.

Issuers must disclose:

- type and total amount of payments for each project
- type and total amount of payments made to each government
- total amounts of payments, by category:
    - taxes on corporate profits, corporate income and production
    - royalties
    - fees, including license fees, rental fees and entry fees
    - production entitlements
    - bonuses, including signature, discovery and production bonuses
    - dividends, including those paid in lieu of production entitlements or royalties, but excluding those paid to a government as a shareholder on the same terms as other shareholders and
    - payments for infrastructure improvements

- currency used to make the payments
- financial period in which the payments were made
- business segment of the issuer that made the payments
- government that received the payments
- country in which the government is located and
- project of the issuer to which the payment relates.

There is a catch-all provision requiring disclosure of payments made that do not fall within one of the categories specified but are part of a plan or scheme to evade the disclosure requirements of Section 13(q).

For Further Information

If you would like more information about the topics discussed in this *Alert*, please contact Elizabeth W. Powers, Richard A. Silfen, Laurence S. Lese, any of the members in our Capital Markets Group or the attorney in the firm with whom you are regularly in contact.