
SEC Proposes Disclosure Rules for Resource Extraction Issuers Under Dodd-Frank Act

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The SEC has proposed a new disclosure rule for certain government payments made by “resource extraction issuers.” The proposed rule closely tracks the statutory text of Section 1504 of the Dodd-Frank Wall Street Reform and Consumer Protection Act. Comments may be submitted on the proposed rule until January 31, 2011.

On December 15, 2010, the U.S. Securities and Exchange Commission (SEC) proposed a rule to implement Section 1504 of the Dodd-Frank Wall Street Reform and Consumer Protection Act, which requires disclosure of certain government payments made by “resource extraction issuers.” In its proposing release, the SEC has requested public comments on the rule. Companies in the affected industries may wish to consider submitting comments on the proposed rule and would be well advised to begin planning related financial reporting disclosure controls.

Which companies are affected?

The proposed rule applies to any reporting company that is a “resource extraction issuer,” defined as an issuer that is required to file an annual report with the SEC and that engages in the “commercial development of oil, natural gas or minerals.” There is no exemption for foreign private issuers or smaller reporting companies under the proposed rule. In addition, the proposed rule applies to government-controlled reporting entities. However, the proposing release seeks comment on whether the SEC should exempt any such entities.

What types of activities are included in the definition of “commercial development”?

“Commercial development” includes the activities of exploration, extraction, processing, export and other significant actions relating to oil, natural gas, or minerals, or the acquisition of a license for any such activity. The proposed rule is not intended to capture activities that are ancillary or preparatory to such commercial development. Accordingly, a manufacturer of drill bits or other machinery used in the

extraction of oil would not fall within the realm of “commercial development” under the proposed rule. Similarly, transportation activities generally would not be included within the proposed definition.

The terms “processing” and “other significant actions” will likely be the focus of many comments as companies struggle to understand specifically what processing and refining activities will trigger disclosure obligations under the new rules, especially across the varied oil, natural gas, and minerals industries.

What types of payments are required to be disclosed?

The proposed rule requires the disclosure of information relating to any payment made by a reporting company, its subsidiaries, or an entity under its control to a foreign government or the U.S. Federal Government for the commercial development of oil, natural gas, or minerals. The definition of the term “payment” is broad and includes taxes, royalties, fees (including license fees), production entitlements, bonuses, and any other material benefits that are part of the “commonly recognized revenue stream” for the commercial development of oil, natural gas, or minerals.

Payments to be disclosed include taxes levied on the corporate profits of companies but exclude taxes levied on consumption, such as value-added taxes, personal income taxes or sales taxes. Payments for infrastructure improvements and “social or community” payments related to the improvement of the host country’s schools or hospitals need not be disclosed under the proposed rule.

The proposed rule also provides that payments to be disclosed should not be *de minimis* but does not define what this threshold is. However, the proposing release makes clear that the *de minimis* exception does not equate to a materiality standard.

What kind of information about the payments needs to be disclosed?

The required information about these payments includes, among other things:

- the type and total amount of payments made for each “project”;
- the type and total amount of payments made to each government;
- the total amount of the payments by category;
- the currency in which the payments were made;
- the financial period in which the payments were made;
- the business segment of the company that made the payments;
- the government that received the payments and the country in which the government is located; and
- the “project” to which the company’s payments relate.

The proposed rule does not define the term “project,” but the proposing release, noting that different industries define the term in different ways, requests comment on whether and how the term should be defined.

Where should the information about the payments be disclosed?

The proposed rule creates a new Item 105 of Regulation S-K which requires that the disclosures be set forth in two exhibits to the company’s annual report on Form 10-K (one in HTML or ASCII format and the other in XBRL format). Item 601 of Regulation S-K is also accordingly amended to add these new exhibits to Form 10-K. In addition, the proposed rule adds a new Item 4(c) to Form 10-K requiring a resource extraction issuer to provide notification in Part I of Form 10-K that the information required is included in exhibits to the filing.

The information required by the proposal would be “furnished” and not “filed” under the Securities Exchange Act of 1934, and accordingly would not be subject to the liability provisions of Section 18 of that act. It also would not be incorporated by reference into filings under the Securities Act of 1933 unless the company elects to do so expressly.

What is the deadline to comment on the proposed rule?

The comment period for the proposed rule expires on January 31, 2011.

When will the final rule be promulgated and become effective?

The final rule is currently expected to be adopted in the first half of 2011. The final rule is expected to apply beginning with the annual report for the first full fiscal year after the enactment of the final rule (which, for a calendar-year company, would be the annual report for the year ended December 31, 2012).

If you have any questions about the content of this client alert, please contact the Pillsbury attorney with whom you regularly work or the authors below.

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