James Green – K&L Gates

A trend towards transparency – combating corruption in oil and gas

Recent months have brought two important developments in the global trend towards transparency and accountability in the oil and gas sector. This article reviews two pieces of legislation – in the United States and the European Union – both of which reflect growing international moves to increase disclosure obligations for companies in extractive industries, including the oil and gas sector, in an attempt to prevent bribery and corruption.

On 22 August, the US Securities and Exchange Commission (SEC) adopted new rules relating to disclosure of payments to governments by "resource extraction issuers" pursuant to Section 1504 of the Dodd Frank Wall Street Reform and Consumer Protection Act – the "final rules"[1].

On 18 September, the European parliament's committee on legal affairs voted in favour of proposed EU legislation to impose disclosure obligations on large companies involved in extracting oil, gas and minerals and logging[2]. It is anticipated that the draft EU legislation will be submitted to MEPs for a European parliament plenary vote later this year.

The final rules: section 1504 of the Dodd-Frank Act

The final rules require resource extraction issuers to include in an annual report information relating to any payment made by the issuer (including by any subsidiary or entity controlled by the issuer) equal to or exceeding $100,000 in any fiscal year to a foreign government or the US Federal Government for the purpose of commercial development of oil, natural gas or minerals.

Companies affected by the final rules

The final rules apply to all businesses that are reporting companies, both foreign and domestic, under the Securities Exchange Act of 1934, as amended, that are engaged in the commercial development of oil, natural gas or minerals –"resource extraction issuers". The "commercial development of oil, natural gas or minerals" includes the activities of exploration, extraction, processing and export and the acquisition of licences for any of those activities, but excludes ancillary businesses, such as the manufacturing of equipment used in the commercial development of oil, natural gas or minerals.

Reporting obligations

The final rules provide that any "payment" that is equal to or exceeding $100,000 made by a resource extraction issuer to a foreign government or the US Federal Government must be reported. "Payment" means any transaction that is carried out to further the commercial development of oil, natural gas or minerals, such as taxes, royalties, fees – including licence fees, production entitlements, bonuses, dividends and payments for infrastructure improvements.

The term "foreign government" refers to a foreign national government as well as a foreign subnational government, such as a state, province, county, district, municipality or territory under a foreign national government. Notably, however, the final rules do not require disclosure of payments made to subnational governments in the US, such as states and municipalities, which should reduce the reporting burden for resource extraction issuers that primarily conduct operations in the US.

A functional board is one that engages, debates and decides in a constructive, amicable and engaging manner – and where

Importantly, the final rules do not provide any exceptions from the reporting requirements, even for situations in which foreign law or confidentiality agreements prohibit such disclosure.

Form of report

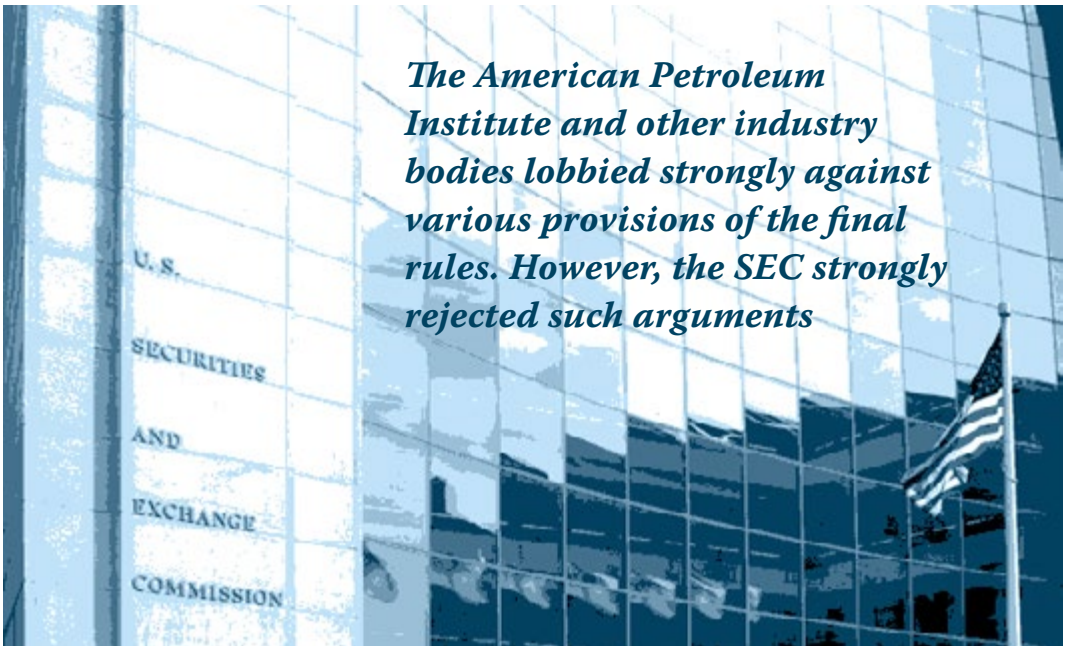
The final rules require resource extraction issuers to make disclosures on form SD no less than 150 days after the end of their most recent fiscal year. Form SD requires disclosure of the following with respect to payments made to a foreign government or the US Federal Government: the total amounts of payments, by category; the currency used to make the payments; the financial period in which the payments were made; the business segment of the resource extraction issuer that made the payments; the government that received the payments; and the project to which the payments relate.

When the final rules take effect

Under the final rules, a resource extraction issuer must comply with the reporting requirements of the final rules and form SD for fiscal years ending after 30 September 2013.

1 See Exchange Act Release No. 67717 (August 22, 2012), available at http://www.sec.gov/rules/final/2012/34-67717.pdf

2 JURI/7/07694 and JURI/7/07698.



The American Petroleum Institute and other industry bodies lobbied strongly against various provisions of the final rules. However, the SEC strongly rejected such arguments

The draft EU legislation

The draft EU legislation aims to require companies involved in the exploration, discovery, development and extraction of oil, natural gas and minerals and in the logging of primary forests to publish, on an annual basis, full information on their payments to national governments on both a project-by-project and country-by-country basis.

Companies potentially affected by the legislation

The legislation applies to all EU large[3] companies (whether public or private), to all companies and EU public-interest entities (national public enterprises) whose securities are admitted to trading on a regulated EU market and to all banks and insurance undertakings that are active in the extractive industry (exploration, prospection, discovery, development and extraction of oil, natural gas and minerals), logging of primary forests, banking, construction and telecommunications.

Reporting obligations

The legislation requires disclosure of payments to any government (including any federal, regional or local authority), including any member state government, although payments need not be disclosed if a single payment or multiple related payments do not exceed €80,000. Any fines for violations of environmental and remediation laws must also by disclosed, by country.

The committee deleted a provision in the proposals that would have excluded from the reporting obligation payments made in a country where public disclosure is clearly prohibited by criminal legislation. It also deleted an exemption from reporting information not material to the recipient government.

The amount of each individual payment made to each level of government must be disclosed. Payments in kind must be reported in value and volume.

Implementation of the legislation

The draft EU legislation will now be negotiated between the committee and the Council of the EU, comprising representatives of all 27 member states. Assuming these two arms of the EU legislature agree a final version of the legislation, it will be submitted to all MEPs for a European parliament plenary vote later this year and, in parallel, adopted by the council. The committee regards the approved version as giving it a strong negotiating mandate. However, given the difference in approach between the parliament and the council (in particular regarding the inclusion of the logging sector, project-by-project reporting and payments to member state governments and the derogation where publication would be a criminal offence in the country concerned), agreement on a version including all the above amendments may prove unattainable. >

3 Exceeding at their balance sheet two of the following criteria: (i) balance sheet total €20m; net turnover €40m; average of 250 employees during the financial year.

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Conclusion

There was already some existing regulation in this area before the introduction of this legislation – for example, the rules of the Alternative Investment Market (AIM) of the London Stock Exchange already require resource companies to disclose any payments aggregating over £10,000 made to any government or regulatory authority or similar body in relation to the acquisition or maintenance of its assets as part of the listing process. The Hong Kong Stock Exchange listing rules for mineral companies, meanwhile, include a similar requirement for a mineral company to disclose payments made to host country governments on a country-by-country basis.

However, the final rules and the draft EU legislation go further than such rules – in particular by introducing an ongoing reporting requirement, rather than just an obligation to make disclosure at the time of listing.

Opinions on both the final rules and the legislation are strongly divided. In the US, organisations such as the American Petroleum Institute and other industry bodies lobbied strongly against various provisions of the final rules, arguing for less detailed reporting requirements, a higher "de minimis" threshold and the application of various exemptions, such as circumstances in which the disclosure of payments is prohibited by local law. However, the SEC strongly rejected such arguments.

At the other end of the spectrum, groups such as Transparency International have welcomed the final rules, which it believes set an international benchmark for transparency and mark an important step in the fight against corruption in extractive industries.

The draft EU legislation has faced similar controversy from campaigners and industry bodies in Europe. It remains to be seen whether the legislation will be approved later this year in its present form, which reflects several aspects of the final rules in the US, or whether it will be modified to remove certain of its key provisions and weaken its overall impact.

In practical terms, companies to which either of these pieces of legislation apply will need to implement new systems and financial reporting procedures, if they have not done so already, to enable them to capture the information required in order to meet their reporting obligations.

These changes should also be seen as part of a global trend. As noted above, although there was previously some similar regulation, it is likely that there will be more to come in the future from other governments, regulators and stock exchanges around the world – among them Australia, Norway and South Korea, where similar legislation is currently under review.

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