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AS FAR AS THE EYE CAN SEE

A LOOK AT TRANSPARENCY REGIMES FOR EXTRACTIVE INDUSTRIES IN THE US AND EU

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In late August, the US Securities and Exchange Commission (SEC) adopted disclosure and reporting rules for companies engaged in the development of oil, natural gas and minerals (collectively called "extractive industries").

These rules, formulated under powers mandated by the 2010 Dodd-Frank Act, were followed in September by news from the European Union (EU) that similar proposed transparency legislation was progressing through the European Parliament for consideration by the European Council.

The two transparency regimes share many similarities - indeed, the European Commission cited the Dodd-Frank act as influential when it presented its pair of draft directives for extractive industry transparency in October 2011.

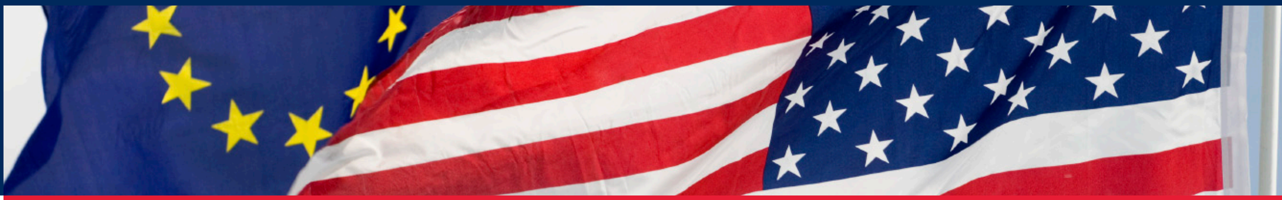
Both US and EU lawmakers have in turn drawn inspiration from the decade-old Extractive Industries transparency Initiative (EITI), a non-government organisation set up to improve accountability and good governance for both governments and businesses in resource-rich developing countries.

Common components

At the heart of both US and EU regimes is the essential obligation that companies operating in extractive industries publicly report all payments made to governments at home or abroad.

Under the US rules, operations which are deemed directly related to extractive industries would be exploration, extraction, processing, export and 'other significant actions' involving oil, gas or minerals. Similarly, the EU directives detail activities involving the exploration, prospecting, discovery and development of these raw materials.

Companies must disclose the total amount of payments made to each government and the total amount paid to each government by type. Types of payments under both regimes include (among others) taxes on profits, royalties, licence fees, production entitlements and payments in kind.



Further, both regimes impose a *de minimis* limit for payments. In the US, a company will not be obliged to report payments, or a series of related payments, amounting to US$100,000 or less per financial year. Under the EU directives, this figure will be €80,000 (US$105,000).

Perhaps the most controversial aspect of the two transparency regimes has been the prescribed manner in which companies will have to analyse and arrange payment data.

Reports must be compiled on a country-by-country and project-by-project basis. It is the project element of a company's report that is expected by many to be highly onerous to produce. the latest draft accounting Directive has defined a project as "based on a single or series of agreements with a government upon which payment liabilities arise". In essence, this is the contract at the heart of a company's operations in an area confined to one country. the Dodd-Frank rules have consciously not defined the term project, although the release notes make comparable references to single/connected contracts with governments.

Differences

Aside from their differing approaches to the definition of project, there are a handful of small variations between the Dodd-Frank rules and the EU directives, the majority of which concern the minutiae of payments and reporting methods. For example, the US regime does not class signature payments bonuses as a separate payment type, and excludes social and community payments (for example, the building of a community school or hospital) from disclosure.

The most noticeable divergence between the two regimes is that the EU directives intend to encompass a broader range of businesses.

European companies engaged in the logging of primary forests will be subject to the same reporting requirements as those faced in extractive industries. telecoms, banking and construction companies will also be under reporting obligations, solely on a country-bycountry basis. also, the EU directives will apply to large unlisted companies, as well as listed companies, whereas the US regime is restricted to listed companies only.

Practicalities

Those situated or operating in the US and Europe involved in extractive industries can prepare themselves for the new reporting requirements they may face in the near future.

Scope: Companies should seek to ascertain whether they will fall under either (or both) of the two regimes.

In the US, a "resource extraction issuer" is a company that engages in any of the activities detailed above, and that is required to file an annual report with the SEC.

Any large or listed company situated in the EU that undertakes one or more of the above-referenced activities will fall under the ambit of the EU directives. 'large' is defined as: a total balance sheet of €20 million; net turnover of €40 million; or an average number of employees during the financial year numbering 250 or more. It should also be noted that both regimes seek to encompass groups of companies.

Preparation: To ensure that a company complies with either of the transparency regimes, its officers should ensure that it has an accounting framework that is sophisticated enough to differentiate, tally and aggregate payments under the different payment types listed above.

In the US, the SEC has already published the standard 'Form SD' with which firms are required to file their reports. those in charge of reporting should familiarise themselves with the form's content. In addition, previously published EITI reports may help to establish suitable criteria for country-by-country reporting.

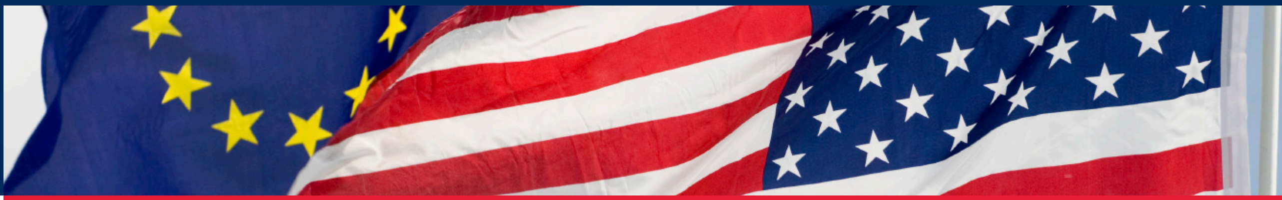
Finally, if it has not done so already, the institution of a robust and demonstrable compliance policy, along with the employment of professional compliance officers, is a major factor for a company to consider.

Timing: The US regime will apply for company fiscal years ending after September 30, 2013. the latest date that a company's Form SD may be filed is 150 days after the end of that fiscal year.

In the EU, the directives are still at the first reading stage. Depending on the level of political resistance, they could conceivably be agreed by 2014. Once finalised, each EU Member State will be required to transpose the requirements into their national law.

Consequences

It remains to be seen what effects the transparency regimes will have on governments and industry. early commentators have cited the lack of



corresponding reforms in economic powers including China and Russia as a sign that US and european companies will be put at a distinct competitive disadvantage. Others have stated that reporting on a project basis could result in firms being obligated to disclose sensitive financial data.

What seems perhaps more certain is that increased transparency, as the fledgling efforts of EITI have shown already, will help to achieve increased government accountability in developing countries and better governance in multinational enterprises.

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