

## E-ALERT | Anti-Corruption

November 3, 2011

### EU PROPOSES MANDATORY DISCLOSURE RULES FOR EXTRACTIVE INDUSTRIES

The EU Commission proposed mandatory disclosure requirements last week for payments to governments by companies in the energy, mining and logging sectors.

The disclosure requirements are [in a proposed directive that would amend the Transparency Directive \(2004/109/EC\)](#) and [in a proposed directive that would replace the current Accounting Directives \(78/660/EC\) and \(83/349/EEC\)](#).<sup>1</sup>

The Commission's proposed disclosure requirements for the energy, mining and logging sectors follow the adoption of similar disclosure requirements in the US Dodd-Frank Act last year (see the Covington Advisory [New Disclosure Rules Relating to Extractive Industries](#)). Implementing rules for the US requirements have not yet been issued.

In a [joint statement](#) accompanying the EU Commission's proposals, Internal Market Commissioner Michel Barnier and Development Commissioner Andris Piebalgs stated that "[t]oday, the Commission establishes itself as an avant-garde in promoting transparency and goes well beyond the US Dodd-Frank Act, putting the interest of developing countries at the forefront \* \* \*."

#### THE PROPOSALS

The Commission's proposed disclosure requirements, while similar to those in the Dodd-Frank Act, do have a broader application. First, the EU requirements would apply to logging companies in addition to the oil, gas and mining companies that are subject to the disclosure requirements of the Dodd-Frank Act.<sup>2</sup> Second, the EU requirements would apply to any company in the relevant sectors if it (i) has publicly traded securities in the EU or (ii) is a "large undertaking" registered in the EU. By contrast, the Dodd-Frank Act is limited to companies with publicly traded securities.

A "large undertaking" is defined in the Commission's proposals as a business that meets two of the following criteria: (i) turnover exceeding €40 million; (ii) balance sheet assets exceeding €20 million; (iii) more than 250 employees.<sup>3</sup> Extending the disclosure requirements to both listed and non-listed companies would help, in the Commission's view, create a level playing field.

The proposed requirements would require preparation of an annual report – that would be disclosed publicly – on payments to governments on a country-by country and per project basis.

Specifically, the measures would require reporting "when material to the *recipient government*" (emphasis added):

- the total amount of payments, including payments in kind, to each government within a financial year;

---

<sup>1</sup> As of the date of this alert, the Commission's web page indicated that the proposed directive amending the Transparency Directive was a provisional version.

<sup>2</sup> Proposed Articles 36 and 37(1) of the new Accounting Directive.

<sup>3</sup> Proposed Article 3(3) of the new Accounting Directive.

- the total amount per type of payment, including payments in kind, to each government within a financial year;
- whenever the foregoing payments have been attributed to a specific project, the amount per type of payment, including payments in kind, for each such project within a financial year and the total amount of payments for each such project.

The following types of payments would be subject to the proposed reporting requirements:

- production entitlements;
- taxes on profits;
- royalties;
- dividends;
- signature, discovery and production bonuses;
- license fees, rental fees, entry fees and other considerations for licences and/or concessions;
- other direct benefits to the government concerned.<sup>4</sup>

The Commission would be authorized to issue rules on how to determine materiality for purposes of the proposed disclosure requirements.<sup>5</sup> Publicly traded companies would be required to make the report available at the latest 6 months after the end of the financial year and to keep it publicly available for 5 years.<sup>6</sup>

## THE COMMISSION'S OBJECTIVE

According to the Commission, the proposed reporting requirements have a two-fold purpose. First, they are intended to provide civil society in resource-rich countries information needed to monitor how governments utilize the money earned from the extraction of such resources. Second, they are intended to promote the adoption of the Extractive Industries Transparency Initiative ("EITI") in such countries. The EITI is a program sponsored by a coalition of governments, NGOs and companies pursuant to which participating governments publish information about funds they receive from businesses engaged in extractive industries.

When releasing the proposals, [the Commission stated](#) that "[a]n EU mandatory disclosure requirement would complement the EITI efforts by legally requiring companies registered in the EU to disclose payments to governments along the same lines as EITI." The Commission added that its "ultimate objective [is] to contribute to the strengthening of the EITI and to extend its scope to all resource-rich countries."

## ISSUES

Some in industry have questioned whether EITI will be undermined by mandatory disclosure requirements. Concerns also have been expressed that the proposed measures could harm the competitiveness of European companies by jeopardizing commercial confidentiality and placing European firms at a disadvantage against companies not subject to the regime. The cost of compliance also could be substantial.

Furthermore, a proposed carve out that would exempt companies from reporting on payments in countries where such disclosures are illegal seems too narrow, limiting the exemption to cases

---

<sup>4</sup> Proposed Article 38(1) and (2) of the new Accounting Directive.

<sup>5</sup> Proposed Article 38(4) of the new Accounting Directive.

<sup>6</sup> Proposed Article 6 of the Transparency Directive.

where it is “clearly prohibited” by the “criminal” law of the country. A company still would need to identify the pertinent country in the report.<sup>7</sup>

On the other hand, some transparency advocates have argued that the Commission’s proposals do not go far enough. It has been suggested that the proposals should include an audit requirement. It also has been suggested that the definition of “project” is too general, giving companies excessive leeway to determine what qualifies as a project for reporting purposes.<sup>8</sup>

## NEXT STEPS

The Commission proposals must progress through the EU’s legislative process, which could take one to two years. The EU’s legislative process should present ample opportunity for amendments to be introduced to the proposals, which are part of a broader package on company reporting requirements. Both the European Parliament and the EU Council will consider the legislation, and both bodies must be in agreement for it to be approved.<sup>9</sup>

As noted above, if the legislation is approved, the Commission subsequently will develop rules on determining “materiality” for purposes of the reporting requirement. This will be done under the procedure for adopting delegated acts.

## WHAT SHOULD COMPANIES DO?

- 1. Assess the impact of the proposed measure on compliance, accounting and internal control procedures.** The measure would require the publication of all pertinent payments to a government that would be deemed material to that government.
- 2. Closely monitor the legislative process.** Both Members of Parliament and Member States are able to offer amendments at several stages of the legislative process, which can present both threats and opportunities.
- 3. Develop a strategy for engagement as soon as possible.** Early movers generally have the greatest impact on proposed EU legislation.

---

If you would like to discuss the proposals described in this alert, please contact one of the following lawyers in our firm:

**John P. Rupp**  
**David Fink**

+44.(0)20.7067.2009  
+32.2.549.5266

[jrupp@cov.com](mailto:jrupp@cov.com)  
[dfink@cov.com](mailto:dfink@cov.com)

This information is not intended as legal advice. Readers should seek specific legal advice before acting with regard to the subjects mentioned herein.

Covington & Burling LLP, an international law firm, provides corporate, litigation and regulatory expertise to enable clients to achieve their goals. This communication is intended to bring relevant developments to our clients and other interested colleagues. Please send an email to [unsubscribe@cov.com](mailto:unsubscribe@cov.com) if you do not wish to receive future emails or electronic alerts.

© 2011 Covington & Burling LLP, 265 Strand, London WC2R 1BH. All rights reserved.

---

<sup>7</sup> Proposed Article 38(5) of the new Accounting Directive.

<sup>8</sup> Proposed Article 36(4) of the new Accounting Directive defines “project” as follows: “‘Project’ is equivalent to a specific operational reporting unit at the lowest level within the undertaking at which regular internal management reports are prepared to monitor its business.”

<sup>9</sup> In September 2011, the European Parliament adopted a [resolution](#) calling on the Commission to propose legislation mandating country by country and project by project reporting for extractive industry payments to governments.