

## EXPERT ANALYSIS

### UK Issues Proposed Rule to Implement EU Extractive and Logging Industry Reporting Requirements

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The U.K. government recently announced the publication of draft legislation, provisionally titled "Reports on Payments to Governments Regulations 2014," that would require mining, quarrying and logging companies registered in the U.K. to report payments they make to governments in all countries where they operate.<sup>1</sup> The proposed regulation is subject to parliamentary approval, which is anticipated in the coming months. The proposed changes would apply in fiscal years beginning on or after Jan. 1, 2015. The U.K.'s Financial Conduct Authority has also published a consultation paper regarding the proposed implementation of transparency rules for companies that publicly list their securities on U.K. markets.

The proposed measures would bring the U.K. into compliance with extractive industry transparency provisions required under amendments made in June 2013 to the EU Accounting Directive and Transparency Directive, also known as the "EU directives." All EU member states are required to implement those amendments into national law by July 20, 2015, and Nov. 26, 2015, respectively.

The U.K.'s proposed rule arises in the midst of uncertainty surrounding the implementation of extractive industry reporting regimes both in Europe and the United States. In the EU, other member states have debated in recent months how — and particularly how broadly — to implement extractive industry transparency measures in light of the EU directives. In the United States, the Securities and Exchange Commission is expected to issue new reporting rules in 2015 following the U.S. District Court for the District of Columbia's July 2013 decision to vacate Rule 13q-1. *Am. Petroleum Inst. v. SEC*, 953 F. Supp 2d 5 (D.D.C 2013).

That rule was the SEC's first effort to adopt reporting rules for resource extraction payments.<sup>2</sup>

The U.K.'s proposed implementation of the EU directives represents an initial step toward a broader expansion of regulatory transparency requirements in the extractive and logging sectors. Similar regulations are expected to be proposed and implemented in other jurisdictions in months to come.

In light of these impending developments, affected companies should familiarize themselves with the proposed U.K. reporting standards. Some of these standards may require new internal accounting and reporting protocols that have not characteristically been used in the extractive industry in the past. Companies also may wish to take part in the consultation process underway in the U.K. and engage in dialogue with other member state regulators who are considering similar reporting standards.

#### IMPLEMENTATION OF THE EU DIRECTIVES

The draft U.K. Reports on Payments to Governments Regulations 2014, also known as the reporting regulation, would impose obligations that are broadly similar to those set forth in the EU directives.

*The proposed regulations would require mining, quarrying and logging companies registered in the U.K. to report on payments they make to governments in all the countries in which they operate.*

The draft regulations would apply to “large undertakings” and “public interest entities” that engage in the extraction of oil or gas, or in any other mining, quarrying or logging activities as defined by the legislation.

A “large undertaking” refers to any U.K. entity that meets at least two of the following three criteria:

- A balance sheet total exceeding 18 million pounds (about \$28.4 million).
- A net turnover on its balance sheet exceeding 36 million pounds.
- An average annual number of employees exceeding 250 (during the financial year to which the balance sheet relates).

A “public interest entity” includes:

- An entity whose securities are admitted to trading on an EU-regulated market.
- A credit institution.
- An insurance undertaking.
- An entity that is otherwise specifically designated by the U.K. government as a public interest entity.

Companies implicated by the reporting regulation would be required to disclose payments of 86,000 pounds or more within a financial year (in relation to the extractive or logging activities),<sup>3</sup> in money or in kind, to all levels of government (including state-owned enterprises) across the world. The disclosures must specify:

- The government to which each payment is made.
- The total amount of payments made to each government.
- The total amount per type of payment made to each government.
- The total amount per type of payment made for each project together with the total amount of payments for each project (where payments were attributed to a specific project).

“Government” means any national, regional or local authority of a country, and it includes a department, agency or undertaking that is a subsidiary undertaking where the authority is the parent undertaking.

“Payment” is defined broadly. It includes an amount paid, whether in money or in kind, for product entitlements; taxes levied on income, production or profits of companies (excluding taxes levied on consumption); royalties; and dividends (other than dividends paid by an undertaking to a government as an ordinary shareholder of that undertaking) in connection with activities in the oil or gas, or in any other mining, quarrying or logging industries. However, as noted above, any payment, whether made as a single payment or as a series of related payments within a financial year, need not be taken into account in the report if it is below 86,000 pounds.

“Project” means operational activities that are governed by a single contract, license, lease concession or similar legal agreement, if it forms the basis for payment liabilities with a government. While “project” is not further defined in the reporting regulation, the EU Accounting Directive states that a “project” should be defined as the operational activities that are governed by a single contract, license, lease, concession or similar legal agreement and form the basis for payment liabilities to a government. Nonetheless, if multiple such agreements are substantially interconnected, those agreements should be considered a project.

“Substantially interconnected” legal agreements are understood to be a set of operationally and geographically integrated contracts, licenses, leases or concessions or related agreements with substantially similar terms that are signed with a government, giving rise to payment liabilities. Such

agreements can be governed by a single contract, joint venture, production sharing agreement, or other overarching legal agreement.

The draft Reporting Regulation provides that payments, activities and projects may not be artificially split or aggregated to avoid the application of the regulations. It further provides that the disclosure of payments must reflect the substance rather than the form of each payment, activity or project.

### DUTY TO PREPARE A CONSOLIDATED REPORT

The proposed Reporting Regulation provides that for affiliated companies, a parent undertaking (meaning a limited company, limited liability partnership or unlimited company) must prepare a consolidated report on payments made to governments where the parent undertaking is obligated to prepare group accounts and is otherwise governed by the Reporting Regulation (because it is a large undertaking or public interest entity and is a mining or quarrying or logging undertaking). In such cases, subsidiaries whose payments to governments in connection with extractive activities are included in a consolidated report — either under the Reporting Regulation or other equivalent measures implemented by other member states — are exempt from any separate obligation to submit their own reports.

Notably, a parent undertaking is considered to be a mining, quarrying or logging undertaking if any of its subsidiaries is such an undertaking.

The proposed regulation exempts certain small and medium-sized groups (as defined in the legislation) from the disclosure obligations described above and sets forth limited exemptions from the duty to draw up a consolidated report for small and medium-sized groups as defined in the legislation. The proposed regulation also includes several other limited exemptions, including one that applies if the shares of a subsidiary undertaking are held exclusively with a view to resale and another that applies if subsidiary payment information could not be obtained “without disproportionate expense or undue delay.”

### EQUIVALENT REPORTING REQUIREMENTS EXEMPTION

The Reporting Regulation exempts a regulated company from the disclosures described above if it is subject to “equivalent reporting requirements” and the payments made by the company are included in a report prepared in accordance with those requirements. That exemption also applies to any subsidiary whose parent company is subject to and has complied with equivalent reporting obligations. There is no definition of “equivalent reporting requirement.”

The Accounting Directive empowers the European Commission to identify and apply criteria for assessing the equivalence of third-country reporting requirements, and it stipulates certain mandatory criteria that must be considered in the commission’s evaluation process. The reporting requirements embodied in the SEC’s Rule 13q-1 were potentially consistent with the mandatory criteria to be applied by the commission, although equivalency with those standards was not tested before Rule 13q-1 was vacated.

It remains to be seen how the European Commission will apply the “equivalent reporting” exemption to the SEC’s forthcoming reporting rules under the Dodd-Frank Wall Street Reform and Consumer Protection Act as well as to the various reporting rules due to be implemented by other member states in accordance with the EU directives.

### TIMING OF REPORTING REQUIREMENTS

An undertaking that is subject to the regulations will be required to file the required reports with the Registrar of Companies within 11 months after the end of the undertaking’s financial year. An undertaking that is subject to equivalent reporting requirements in another member state may instead file the equivalent report to the Registrar of Companies within 28 days after it becomes publicly available under the equivalent reporting requirements.

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*A failure to file a compliant report will be a criminal offense punishable with unlimited fines or possible jail terms for directors who cannot show they took all reasonable steps to comply.*

## **PENALTY REGIME AND IMPACT REVIEW**

The penalty regime under the Reporting Regulation is broadly consistent with the one that was incorporated in the Companies Act 2006. A failure to file a compliant report will be a criminal offense punishable by unlimited fines and possible jail terms for directors who cannot show they took all reasonable steps to comply. The government has not proposed a late filing penalty regime along the lines of that which applies to late filing of financial accounts.

The government has committed to review the impact of the Reporting Regulation within three years of its effective date. This will allow the U.K. to feed into the broader review scheduled to be conducted by the European Commission in 2018.

## **EARLY IMPLEMENTATION OF THE EU TRANSPARENCY DIRECTIVE**

The EU Transparency Directive (as amended in June 2013) extends extractive industry reporting requirements to all issuers active in extractive industries with securities admitted to trading on an EU-regulated market. The Transparency Directive (as amended) must be implemented by all member states by Nov. 26, 2015.

The U.K. Financial Conduct Authority recently issued a consultation paper proposing the alignment of the implementation of the new country-by-country reporting requirements in the Transparency Directive (as amended) with those in the Accounting Directive and the proposed U.K. Reporting Regulation. Like the Reporting Regulation, the measures proposed by the FCA would take effect for financial years commencing on or after Jan. 1, 2015.

Under the FCA proposal, a report prepared in accordance with the Reporting Regulation would be treated as complying with the Disclosure Rules and Transparency Rules, which are also referred to as DTRs. The report must be published within six months after the end of the financial year in accordance with the amended Transparency Directive. The FCA proposal would, however, extend reporting requirements to certain entities that are not subject to the Reporting Regulation, such as non-EU entities that list securities on exchanges in the U.K.

EU entities may also be subject to the FCA rules to the extent their member states have not yet implemented standards similar to those in the Accounting Directive and U.K. Reporting Regulation.

The closing date for comments to the FCA consultation paper was Oct. 7. The FCA intends to publish its feedback on the consultation at the end of the year.

## **STATUS OF U.S. REPORTING RULES**

Pursuant to the Securities Exchange Act, as amended by Section 1504 of Dodd-Frank, the SEC must adopt rules requiring SEC-regulated companies that are engaged in the commercial development of oil, natural gas or minerals to disclose information about payments to foreign governments for resource extraction.<sup>4</sup> The Securities Exchange Act provides that these rules must require disclosures regarding the type and total amount of payments made for each project and the type and total amount of payments made to foreign governments.

In August 2012 the SEC adopted Rule 13q-1 with the expectation that companies would begin reporting resource extraction payments for fiscal years ending after Sept. 30, 2013. On July 2, 2013, however, following a challenge made by the American Petroleum Institute, the U.S. District Court for the District of Columbia vacated Rule 13q-1. The court determined that the SEC had erred in its interpretation of the law by mandating public disclosure of the resource extraction reports and had failed to properly consider requests for exemptive relief from public disclosure. In September 2013 the SEC announced that it would not appeal the decision.

The SEC has stated that it plans to redraft its resource extraction rule through a new rulemaking process, taking into account concerns expressed in the District Court's ruling. The precise timing of the SEC's forthcoming rulemaking is not known, although the agency has published an agenda suggesting that it will work to develop its next proposal in the spring of 2015.

Notwithstanding the time frame for action included in the SEC's regulatory agenda, it is unclear when the agency will act; the SEC has not historically adhered closely to the time frames for action included in its regulatory agenda.

It also bears noting that some industry groups have taken steps to force the SEC to act more quickly. For example, Oxfam, an international relief and development organization, recently filed a lawsuit against the SEC to force the agency to take action on the rulemaking. *Oxfam Am. v. SEC*, No. 14-cv-13648, *complaint filed* (D.D.M. Sept. 18, 2014).

It is unclear whether the SEC will respond to the lawsuit.

It remains to be seen whether the rules adopted by the SEC will allow companies subject to those rules to rely on their Rule 13q-1 reports to satisfy the Reporting Regulation or the EU Transparency Directive. Based on the provisions required by the Exchange Act, however, it is likely that the future U.S. rules will be substantially similar to the new U.K. reporting regime.

## NOTES

- <sup>1</sup> See Reports on Payments to Governments Regulations 2014, available at <http://bit.ly/1qEgPvp>.
- <sup>2</sup> Under Rule 13(q), which was added to the Securities Exchange Act of 1934 by Section 1504 of the Dodd-Frank Act of 2010, the SEC must adopt reporting rules for SEC-regulated companies that make payments to foreign governments for the commercial development of oil, natural gas or minerals.
- <sup>3</sup> As mentioned in our alert of June 19, 2013, these activities are covered pursuant to Article 36 of the Accounting Directive, which defines an "undertaking active in the extractive industry" as "an undertaking with any activity involving the exploration, prospection, discovery, development, and extraction of minerals, oil, natural gas deposits or other materials, within the economic activities listed," which include mining of certain metals and minerals,) extraction of crude petroleum and natural gas, quarrying, extraction of peat and salt, and operation of gravel and sand pits. The logging of primary forests is defined to include "naturally regenerated forest of native species, where there is no clearly visible indication of human activities and the ecological processes are not significantly disturbed." See Covington & Burling Advisory, *EU Agrees on Disclosure Rules for Extractive and Logging Industries* (June 19, 2013), available at <http://bit.ly/1EChBMZ>.
- <sup>4</sup> Dodd-Frank Section 1504 does not extend to logging industry payments to governments.



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