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REGULATORY

Oil & Gas Regulatory

Oil & Gas Royalties: ONRR seeks to employ Dodd-Frank's oil, gas, and minerals payment disclosure provision to "cross-check" royalty, rent, and bonus payments

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In a little noticed comment belatedly submitted to the Securities and Exchange Commission on August 4, 2011, the Department of the Interior's Office of Natural Resources Revenue (ONRR) has asked the SEC to require federal oil, gas and minerals lessees to report royalty data to the SEC on a lease level if feasible, as part of a proposed rule implementing a minerals payment disclosure provision under the Dodd-Frank amendments. [1]

ONRR described Dodd-Frank's oil, gas, and minerals payment disclosure provision (Section 1504), as potentially "very useful" to the agency's efforts to check that oil, gas, and mining companies are reporting revenues "correctly" to the U.S. federal government.

Dodd-Frank's Payment Disclosure Provision [2]

Section 1504 requires SEC-regulated oil, natural gas, and mining companies to disclose information related to payments made to the federal government or foreign governments in connection with activities that run the gamut from exploration and development to extraction, processing, and export.

Section 1504's purpose is to "support the Federal Government's commitment to international transparency promotion efforts relating to the commercial development of oil, natural gas, or minerals." The transparency promotion efforts are those advocated by an international Extractive Industries Transparency Initiative.

Specifically, Section 1504 applies to "resource extraction issuers" that file Form 10-K, 20-F, or 40-F annual reports ("Issuers"), requiring them to disclose, in their annual reports and electronically, certain information regarding payments to either the U.S. government or a foreign government for the purpose of the commercial development of oil, gas, or minerals.

SEC Proposed Rules

The types of payments subject to these disclosure requirements include: taxes, royalties, fees (including license fees), production entitlements, bonuses, and other material benefits that are part of the commonly recognized revenue stream for the commercial development of oil, natural gas, and minerals. The proposed rules provide that payments of a *de minimis* amount do not require disclosure.

The disclosures must not only be made in the Issuer's annual report, but must also be submitted to the SEC in an interactive data format whereby certain attributes are electronically "tagged." Certain information will be made publicly available on an SEC website. Payment attributes to be identified are:

- The total amounts of the payments, by category;
- The currency used to make the payments;
- 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;
- The project of the company to which the payments relate; and
- Any other information that the SEC deems necessary or appropriate in the public interest or for the protection of investors.

It is significant that these financial disclosures require not only summaries of expenses on a country by country basis, but also disclosure of payments at a project level.

Changes sought by ONRR

ONRR requested that the SEC consider four recommendations in promulgating its final rules:

- Issuers should report data identifying whether the payments they made to the federal government were for oil, natural gas, coal, or other mineral extractions, including renewable energy revenues generated from federal lands;
- Issuers should report to which agency(ies) the payment was made;
- Issuers should also separately identify the types of payments they made to the federal government including royalties, rents and bonus payments; and
- *If feasible, data should be reported at the lease level.*

ONRR suggests that these recommendations apply only to payments made to the United States federal government, and not necessarily to foreign governments.

ONRR believes these changes, if adopted, could allow ONRR to “cross-check” data it receives from lessees.

Confidentiality of Lease-Level Information

ONRR stated that it seeks to use the Issuer data to “ensure that energy companies are reporting correctly and paying every dollar due to the American taxpayer.” Yet ONRR’s scheme would appear to jeopardize the confidentiality of lease-level production and royalty information that Congress has separately sought to preserve.

The Outer Continental Shelf Lands Act, for example, requires ONRR to protect the confidentiality of lease-level oil and gas exploration and production information submitted to the agency by a company operating under a federal lease or permit. 43 U.S.C. §1352. The purpose of the Dodd-Frank disclosure provision is public disclosure of payments to governments, but not of the type of lease-level data contemplated by ONRR’s comments.

Furthermore, the notion that company data reported to the SEC under the Dodd-Frank amendments would “provide a valuable cross-check” against confidential data reported to ONRR depends on a problematic assumption that financial accounting data used for royalty reporting would be independent of financial data needed to report lease-level royalty payments to the SEC. Presumably, little purpose would be served by cross-checking the same underlying data.

Final Rules

The SEC has delayed issuance of the final rules interpreting Section 1504 for over four months. Companies that will be affected by these rules should be aware of at least a remote possibility that SEC recordkeeping procedures and practices under the Dodd-Frank amendments could entail lease-level reporting.

[1] Comment by Robert Prael, Financial Management Program Manager, Department of the Interior, Office of Natural Resources Revenue (August 4, 2011), available at <http://www.sec.gov/comments/s7-42-10/s74210-108.pdf>.

[2] For further information on Section 1504, please consult King & Spalding's Client Alert at <http://www.lexology.com/r.ashx?l=7FNG2JN>.



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