Client Alert

pillsbury

Foreign Corrupt Practices Act & Global Anti-Corruption
Energy
Corporate Investigations & White Collar Defense
Environmental

July 12, 2016

New SEC Payment Disclosure Rules Raise FCPA Concerns for Energy Companies

By William M. Sullivan, Jr., Reza Zarghamee and Fabio Leonardi

This alert also was published as a bylined article on Corporate Compliance Insights *on July 12, 2016.*

On June 27, 2016, the U.S. Securities and Exchange Commission (SEC) announced that it had adopted final rules requiring public disclosure, among other things, of certain payments made to foreign governments by resource extraction issuers in connection with the commercial development of oil, gas and mineral rights. These new SEC disclosure requirements are expected to raise Foreign Corrupt Practices Act (FCPA) enforcement concerns for energy companies, as both the SEC and the U.S. Department of Justice (DOJ) will scrutinize the new payment information for cause to open parallel investigations and potentially pursue issuers for alleged FCPA violations.

While the new rules are intended to reflect U.S. foreign policy interests in supporting global efforts to improve transparency in the extractive industries, they also raise potential FCPA concerns for both U.S. and foreign energy company issuers. Indeed, as FCPA enforcement remains a top priority for the U.S. government, the DOJ and SEC will actively review resource extraction issuers' annual reports for information regarding payments to foreign government and use such information to identify and investigate energy companies that may have engaged in improper payments or that failed to properly account for them in violation of the FCPA.

Tackling Foreign Corruption through Mandatory Disclosure

The SEC's new rules implement Section 13(q) of the Securities Exchange Act of 1934 (Exchange Act), as amended by Section 1504 of the Dodd-Frank Wall Street Reform and Consumer Protection Act (Dodd-Frank Act). The Dodd-Frank Act amended the Exchange Act by directing the SEC to adopt rules requiring every SEC-registered public oil, natural gas and mining company to submit an annual report, disclosing, among other things, information about payments made to foreign government for developing hydrocarbons or minerals. The SEC initially adopted implementing regulations for Section 13(q) in 2012, but the U.S. District Court for the District of Columbia vacated these rules in 2013 after industry groups and trade

associations successfully challenged the SEC's interpretation of its statutory mandate under the Dodd-Frank Act.

The new SEC rules require the disclosure, in annual reports filed after September 30, 2018, of certain types of payments made to "foreign governments" by issuers engaged in the "commercial development of oil, natural gas, or minerals" (i.e., the exploration, extraction, processing and export of such materials). The rules define "foreign government" broadly to include governmental departments, agencies and instrumentalities, as well as any corporation in which a foreign government has a greater than 50% ownership interest. Furthermore, covered payments are broadly defined to include all payments of $100,000 or more in a given fiscal year in furtherance of mineral and resource extraction, including "taxes, royalties, fees (including license fees), production entitlements, and bonuses, as well as community and social responsibility payments … and payments for infrastructure improvement."

In addition, under the new SEC rules, a resource extraction issuer is required to disclose payments made by its subsidiaries and other entities under its control if those entities' financial information must be consolidated or proportionately consolidated under the accounting principles applicable to the issuer's financial statements included in its SEC reports. Finally, the new SEC rules provide that resource extraction issuers are required to comply with the foregoing disclosure requirements starting in the fiscal year ending on or after September 30, 2018, by publicly disclosing the required information with the SEC annually on Form SD no later than 150 days after the end of the issuer's fiscal year.

Integrating SEC Payment Disclosure and FCPA Compliance Programs

The FCPA currently requires that all issuers, including resource extraction companies, maintain accurate books and records and internal controls to prevent improper payments to foreign government officials. Therefore, the DOJ and SEC are expected to use the new disclosure rules as a basis for launching investigations and potentially commencing prosecutions or bringing enforcement actions under the FCPA. Thus, although the new disclosure requirements do not go into effect until 2018, SEC-registered energy companies should consider incorporating payment disclosure procedures into their own FCPA and anti-corruption processes and compliance framework, as well as those of their subsidiaries and controlled entities.

What this means at a practical level is that subject issuers should adopt and implement generally accepted compliance best practices. In particular, SEC-registered energy companies should:

- Engage legal counsel along with compliance and accounting staff to analyze existing SEC rules to determine the applicability of the new SEC disclosure requirements to the company, its subsidiaries or any controlled entity;
- Implement effective tracking mechanisms among all affected business units for the purpose of identifying and collecting payment information required to comply with the SEC disclosure requirements; and
- Implement internal monitoring protocols and compliance training to instruct compliance personnel on the new SEC disclosure requirements.

While such compliance procedures will help prepare issuers for the new SEC disclosure requirements, issuers should also analyze how increased government scrutiny on payments to foreign governments by both the DOJ and the SEC may affect their worldwide operations from an FCPA enforcement perspective.

Auditing Internal Anti-Corruption Policies and Procedures

As the new SEC disclosure requirements will put payments to foreign governments in the spotlight once again, U.S. and foreign resource extraction issuers operating in countries with a high risk of corruption should take immediate steps to ensure the effectiveness of their FCPA and anti-corruption compliance programs, policies, trainings and internal controls. In particular, among other things, SEC-registered energy companies should audit existing compliance policies and procedures, from both a programmatic and implementation perspective, and review:

- Existing anti-bribery policies and procedures for compliance with the FCPA and other applicable laws;
- Existing internal controls, with an emphasis on areas of concern from an anti-corruption perspective, such as signature authorities and spending limits;
- The company's existing code of conduct and whistleblower policy and procedures to determine whether additional enhancements would strengthen its anti-corruption framework and messaging;
- Anti-corruption due diligence protocols and procedures with respect to acquisitions, ventures and third parties; and
- Existing anti-corruption or compliance certifications from directors, officers, employees or agents, along with certifications that the issuer may have requested from business partners.

As resource extraction issuers' payments to foreign governments and state-controlled entities are going to be carefully examined by the Department of Justice and the SEC, it is paramount that SEC-registered energy companies implement all the necessary compliance policies, procedures, trainings and internal controls to prevent and promptly detect FCPA violations.

Performing an Internal Review for Potential FCPA Violations

Although the new SEC disclosure requirements and FCPA's anti-bribery provisions are generally meant to achieve similar public policy goals, SEC-registered resource extraction companies must continue to identify and review payments to foreign governments and state-controlled entities, along with individuals closely associated with such entities, for potential FCPA violations regardless of whether the payments at issue must be disclosed pursuant to the new SEC disclosure rules. For this purpose, resource extraction issuers should, among other things, proactively conduct an internal inquiry to identify high-risk countries and projects, isolate payments to foreign government entities and foreign state-owned or controlled entities, and analyze facts and circumstances surrounding each potentially problematic payment.

In addition, SEC-registered energy companies should also take steps to ensure that they are in compliance with the FCPA's accounting provisions. Indeed, in addition to preventing improper payments, the FCPA generally requires issuers to maintain books and records that accurately and fairly reflect the transactions of the company in reasonable detail, and design a system of internal accounting controls reasonably calculated to ensure that the company's financial statements are accurately and fairly stated. Therefore, resource extraction issuers should review high-risk payments to foreign government entities and associated individuals and, among other things, analyze related company books and records to determine whether such payments are properly accounted for. In fact, potential inconsistent information regarding certain payments made to foreign government entities (e.g., community payments recorded for internal accounting purposes as taxes or fees) could indicate ineffective internal controls or inadequate accounting procedures.

Conducting FCPA Due Diligence in M&A Transactions

The new SEC rules establish provisions that may impact due diligence practices in M&A transactions. Specifically, under the new payment disclosure requirements, a resource extraction issuer that has acquired a company not previously subject to the new SEC rules is exempt from reporting payment information for the acquired company until the filing of an SEC Form SD for the first fiscal year following the acquisition. Therefore, SEC-registered issuers should conduct an effective FCPA due diligence at the time of the acquisition and promptly implement any needed anti-corruption and FCPA policies and procedures to prevent any post-acquisition improper payments to continue, especially after the filing of Form SD for the first fiscal year following the acquisition. In particular, among other things, resource extraction issuers potentially acquiring an energy company should:

- Submit questionnaire to key personnel of the target energy company, interview select persons knowledgeable about the target's overall operations, sales and marketing activities, as well as its accounting procedures and financials;
- Review the target energy company's code of conduct, anti-corruption policies and procedures, trainings, background check procedures, and reporting hotline;
- Sample the target company's contracts with third parties, agents and distributors;
- Analyze profit and loss statements, financials, general ledgers and expense and reimbursement data, including accounts payable procedures; and
- Scrutinize information about government agencies and foreign officials with which the target company regularly does business or makes payments to, including a list of governmental permits and approvals that allow the target company to do business in the country or region.

In sum, because the new disclosure requirements are expected to increase FCPA scrutiny, SEC-registered energy companies within the extractive industry should consider integrating new payment disclosure procedures with existing anti-corruption compliance programs, proactively perform an internal review to identify and remediate potential FCPA violations, and conduct effective FCPA due diligence in connection with M&A transactions.

If you have any questions about the content of this alert please contact the Pillsbury attorney with whom you regularly work, or the attorneys below.

William M. Sullivan, Jr. (bio)
Washington, DC
+1.202.663.8027
wsullivan@pillsburylaw.com

Mark R. Hellerer (bio)
New York
+1.212.858.1787
mark.hellerer@pillsburylaw.com

Maria T. Galeno (bio)
New York
+1.212.858.1833
maria.galeno@pillsburylaw.com

Carolina A. Fornos (bio)
New York
+1.212.858.1558
carolina.fornos@pillsburylaw.com

Jeffrey J. Delaney(bio)
New York
+1.212.858.1292
jeffrey.delaney@pillsburylaw.com

Christopher J. McNevin(bio)
Austin
+1.512.580.9620
chrismcnevin@pillsburylaw.com

Reza Zarghamee (bio)
Washington, DC
+1.202.663.8580
reza.zarghamee@pillsburylaw.com

Fabio Leonardi (bio)
Washington, DC
+1.202.663.8713
fabio.leonardi@pillsburylaw.com

Pillsbury Winthrop Shaw Pittman LLP is a leading international law firm with offices around the world and a particular focus on the energy & natural resources, financial services, real estate & construction, and technology sectors. Recognized by Financial Times as one of the most innovative law firms, Pillsbury and its lawyers are highly regarded for their forward-thinking approach, their enthusiasm for collaborating across disciplines and their unsurpassed commercial awareness.