December 17, 2015

SEC Re-Proposes Rules for Resource Extraction Issuers

On December 11, 2015, the Securities and Exchange Commission (the "SEC") voted 3-1 to re-propose rules that would require resource extraction issuers to disclose payments made to the U.S. federal government or foreign governments for the commercial development of oil, natural gas or minerals. The re-proposed rules, mandated by the Dodd-Frank Wall Street Reform and Consumer Protection Act (the "Dodd-Frank Act"), are intended by Congress to advance U.S. policy interests by promoting greater transparency about payments related to resource extraction, combatting global corruption and empowering citizens of resource rich countries to hold their governments accountable for the wealth generated by those resources. The SEC noted in its release that the use of the federal securities laws to advance foreign policy objectives is not common (the other examples being conflict mineral disclosures and disclosures of specified Iran-related activities), and therefore the SEC looked closely at Congressional intent in re-proposing these disclosure rules.

Background

Section 13(q) was added to the Securities Exchange Act of 1934 ("Exchange Act") in 2010 by Section 1504 of the Dodd-Frank Act. It directs the SEC to issue final rules that require resource extraction issuers to include, in an annual report, information relating to any payment made by the resource extraction issuer, a subsidiary of the resource extraction issuer or an entity under the control of the resource extraction issuer to a foreign government or the federal government for the purpose of the commercial development of oil, natural gas or minerals. Among other things, Section 13(q) specifies that to the extent practicable, the rules support the commitment of the federal government to international transparency promotion efforts relating to the commercial development of oil, natural gas or minerals.

The original Rule 13q-1 implemented the requirements of Section 13(q) and was adopted by the SEC on August 22, 2012 (the "SEC's 2012 rules"). Following a challenge by the American Petroleum Institute, the U.S. Chamber of Commerce and two other industry groups in 2013, the SEC's 2012 rules were vacated by the U.S. District Court for the District of Columbia. The Court found that the SEC had incorrectly interpreted Section 13(q) of the Exchange Act, holding that (i) Congress did not specifically intend that reports filed with the SEC under Section 13(q) be publicly disclosed and (ii) the SEC's denial of any exemption from disclosure in respect of countries that prohibit payment disclosure was arbitrary and capricious.

On September 2, 2015, the United States District Court for the District of Massachusetts ordered the SEC to meet its obligation under Section 1504 and to file an expedited schedule for promulgating final resource

extraction rules. In response to the Court's direction, on October 2, 2015, the SEC filed a proposed schedule to complete the required rulemaking, including re-proposing the resource extraction rules by December 31, 2015 and voting on the adoption of a final rule in June 2016.

Notably, since the adoption of the SEC's 2012 rules, significant developments have occurred in global efforts to promote the transparency of resource extraction payments. For example, Canada and the European Union ("EU") recently have adopted transparency initiatives similar to the SEC's 2012 rules, although not as part of a securities regulatory regime: see Canada's Extractive Sector Transparency Measures Act, the EU Accounting Directive and the EU Transparency Directive.

Proposed Rules

Under Rule 13q-1 as re-proposed, a SEC reporting issuer (domestic or foreign) that is required to file annual reports on Forms 10-K, 20-F or 40-F with the SEC under the Exchange Act and engages in the commercial development of oil, natural gas, or minerals would be required to disclose in a Form SD filed annually certain payments made to the U.S. federal government or a foreign government (including a foreign subnational government, such as the government of a state, province, county, district, municipality or territory under a foreign government). The SEC declined to extend the disclosure obligations to foreign private issuers that rely on Exchange Act Rule 12g3-2(b).

The issuer would also be required to disclose payments made by a subsidiary or entity controlled by the issuer. For purposes of the proposed rules, and in a change from the SEC's 2012 rules, control would be determined by reference to financial consolidation principles that the issuer applies to the audited financial statements in its Exchange Act annual reports.

Under the proposed rules, resource extraction issuers would need to disclose payments that are:

- made to further the commercial development of oil, natural gas or minerals;
- not de minimis; and
- one of the types of payments specified in the rules (taxes, royalties, fees, production entitlements, bonuses and other material benefits).

The proposed rules define commercial development of oil, natural gas or minerals to include exploration, extraction, processing and export, or the acquisition of a license for any such activity. The proposed rules define "not de minimis" as any payment, whether a single payment or a series of related payments, which equals or exceeds U.S. $100,000 during the same fiscal year.

The types of payments related to commercial development activities that would be disclosed include taxes, royalties, fees (including license fees), production entitlements, bonuses, dividends and payments for infrastructure improvements. This proposed list of payment types is consistent with the requirements of Canada and the EU and is consistent with the Extractive Industries Transparency Initiative ("EITI").[1]

The proposed rules would require a resource extraction issuer to provide the following information about payments made to further the commercial development of oil, natural gas or minerals:[2]

- the type and total amount of such payments made for each project of the resource extraction issuer relating to the commercial development of oil, natural gas or minerals;
- the type and total amount of such payments for all projects made to each government;
- 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 resource extraction issuer that made the payments;
- the government that received the payments, and the country in which the government is located;
- the project of the resource extraction issuer to which the payments relate;
- the particular resource that is the subject of commercial development; and
- the subnational geographic location of the project.

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[1] The EITI is a voluntary coalition of oil, natural gas, and mining companies, foreign governments, investor groups and other international organizations. The coalition was formed in 2002 with industry participation and describes itself as being dedicated to fostering and improving transparency and accountability in resource-rich countries through the publication and verification of company payments and government revenues from oil, natural gas and mining. The United States became a "candidate country" in March 2014. In re-proposing the disclosure obligations, the SEC considered the guidance in the EITI Standard (which encompassed various documents fundamental to the EITI) and "Implementing EITI for Impact-A Handbook for Policymakers and Stakeholders" (2011) as to what should be included in an EITI plan, as well as reports by EITI member countries.

[2] Resource extraction issuers do not include those companies that support the exploration, extraction, processing or export of resources through manufacturing of drill bits or provision of hardware.

Unlike the SEC's 2012 rules, under which the term "project" was not defined, the proposed rules define "project" as operational activities that are governed by a single contract, license, lease, concession or similar legal agreement which form the basis for payment liabilities with a government. This definition, modeled on the definition found in the corresponding Canadian and EU legislation, could also include operational activities governed by multiple legal agreements.

Although the proposed rules, like the SEC's 2012 rules, do not provide for exemptions for countries that prohibit the mandated resource extraction disclosures, the proposing release notes that the SEC could provide exemptive relief from the requirements of the proposed rules on a case-by-case basis using its existing authority under the Exchange Act. Also, in light of international developments, as well as the progress made by the U.S. Extractive Industries Transparency Initiative ("USEITI"), the proposed rules would allow issuers to use a report prepared for foreign regulatory purposes or for the USEITI to comply with the proposed rules if the SEC determines the requirements are substantially similar to the proposed rules.[3]

The proposed rules would require a resource extraction issuer to publicly disclose the information annually on Form SD. Form SD is also used for conflict mineral disclosure and, by including disclosure in Form SD rather than in a Form 10-K, 20-F or 40-F, the SEC has opted to exclude the disclosure from the coverage of the officer certifications required by Exchange Act Rules 13a-14 and 15d-14. The SEC did request comment, among other things, on whether the disclosure should be subject to those certifications. The information would be included in an exhibit and electronically tagged using the eXtensible Business Reporting Language (XBRL) format to the extent the issuer otherwise incorporates XBRL into its filings. A resource extraction issuer would be required to file the Form SD with the SEC no later than 150 days after the end of its fiscal year. Note that this means that an issuer could be required to file two reports on Form SD in a given year, as the reporting period for conflict mineral reports ends on May 31st.

Initial public comments on the proposed rules are due by January 25, 2016. Comments responding to issues raised in the initial comment period are due on February 16, 2016. Resource extraction issuers generally would be required to comply with the new disclosure rules starting with their fiscal year ending no earlier than one year after the effective date of the adopted rules.

The text of the proposed rule is available here.

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[3] In December 2012, the U.S. government established a multi-stakeholder group, the USEITI Advisory Committee, headed by the Department of the Interior and including the Departments of Energy and Treasury, as well as members of industry and civil society. USEITI's current plans include producing its first report in December 2015, and producing its second report and submitting it to the EITI board in December 2016.

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This memorandum is not intended to provide legal advice, and no legal or business decision should be based on its content. Questions concerning issues addressed in this memorandum should be directed to:

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