July 8, 2016

SEC Adopts Disclosure Rules for Resource Extraction Issuers

On June 27, 2016, the Securities and Exchange Commission (the "SEC") adopted final rules requiring 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 rules are mandated by the Dodd-Frank Act and are intended 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.

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 rules requiring resource extraction issuers to include, in an annual report, information relating to any payment made by the issuer or its affiliates to the U.S. federal government or a foreign government for the purpose of 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 in August 2012. Following a challenge by the American Petroleum Institute, the U.S. Chamber of Commerce and two other industry groups in 2013, these rules were vacated by the U.S. District Court for the District of Columbia. The Court found that the SEC had incorrectly interpreted the statutory requirement, 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.

In December 2015, the SEC re-proposed the resource extraction disclosure rules, in part to address the concerns which led to the original rules being vacated. In addition, to determine how best to achieve the policy objectives of Section 13(q) and to meet the statutory directive "to support" the commitment of the U.S. Government to "international transparency promotion efforts" to the extent practicable, the SEC considered the current state of international transparency efforts in formulating its final rules. In recent years, several important developments have occurred in global efforts to promote the transparency of resource extraction payments. In particular, Canada and the European Union adopted transparency initiatives similar to the SEC's original rules (Canada's Extractive Sector Transparency Measures Act ("ESTMA"), the EU Accounting Directive, and the EU Transparency Directive). Separately, the Extractive Industries Transparency Initiative ("EITI"), a voluntary coalition of oil, natural gas and mining

companies, foreign governments, investor groups and other international organizations dedicated to fostering and improving transparency and accountability in resource-rich countries, has gained influence.

Perhaps in anticipation of a further legal challenge from industry participants, the SEC specifically notes in the release that Section 13(q) provides it with the discretion to require public disclosure of payments by resource extraction issuers or to permit confidential filings, and that it continues to believe that requiring public disclosure of each issuer's specific filings would best accomplish the purpose of the statute.

Final Rules

The final rules were adopted largely as re-proposed in December 2015 with a few key changes noted below.

Payments Subject to Disclosure. Under Rule 13q-1, a SEC reporting issuer (domestic or foreign) that is required to file annual reports on Form 10-K, 20-F or 40-F with the SEC under the Exchange Act and engages in the "commercial development"[1] of oil, natural gas, or minerals is required to disclose in a Form SD filed annually certain payments made to the U.S. federal government or a "foreign government"[2]. The SEC declined to extend the disclosure obligations to foreign private issuers that rely on Exchange Act Rule 12g3-2(b).

The issuer is also required to disclose payments made by a subsidiary or entity controlled by the issuer. For purposes of the rules, control is determined by reference to financial consolidation principles that the issuer applies to the audited financial statements in its Exchange Act annual reports.

Under the final rules, resource extraction issuers are required to disclose payments that are:

- made to further the commercial development of oil, natural gas or minerals;
- not de minimis; and

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[1] "Commercial development" is defined to include exploration, extraction, processing and export, or the acquisition of a license for any such activity. In a change from the re-proposed rules in December 2015, the final rules have narrowed the meaning of 'export' so that a company would not be considered an exporter if it transported a resource acquired from the U.S. federal government or a foreign government over an international border, but is not engaged in exploration, extraction or processing of oil, natural gas or minerals.

[2] "Foreign government" is defined as 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), a department, agency, or instrumentality of a foreign government, or a company at least majority owned by a foreign government.

- one of the types of payments specified in the rules (taxes, royalties, fees, production entitlements, bonuses and other material benefits).

The 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 are required to be disclosed include taxes, royalties, fees (including license fees), production entitlements, bonuses, dividends and payments for infrastructure improvements. This list of payment types is generally consistent with the requirements of Canada's ESTMA, the EU Accounting and Transparency Directives, and the EITI.

In a change from the re-proposed rules in December 2015, payments subject to the rules also include corporate social responsibility ("CSR") payments that are required by law or contract. Although the SEC acknowledges in the adopting release that disclosure of CSR payments appears to be outside of the scope of the more recent international efforts in Canada and the EU, it notes its view that the evidence, on balance, supports the conclusion that such payments are now part of the commonly recognized revenue stream for the commercial development of oil, natural gas, or minerals, and as such, a "material benefit" for purposes of Section 13(q) and therefore subject to the rules.

Information Required to be Disclosed. The rules require a resource extraction issuer to provide the following information about payments made to further the commercial development of oil, natural gas or minerals:

- 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 fiscal year 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.

The final 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 Canada's ESTMA and the EU Accounting and Transparency Directives, could also include operational activities governed by multiple legal agreements.

Exemptions and Alternative Reporting. Although the final rules do not provide for exemptions for countries that prohibit the mandated resource extraction disclosures, the SEC can provide exemptive relief from the requirements of the rules on a case-by-case basis using its existing authority under the Exchange Act. In response to some commenters' request for a blanket exemption for countries where the law may prohibit the disclosure, the SEC notes in the release that it believes that a case-by-case exemptive approach is significantly less likely than a blanket approach to encourage foreign governments to enact laws prohibiting the Section 13(q) disclosures.

In a change from the re-proposed rules in December 2015, and with a view towards preventing the disclosure of commercially sensitive information, issuers will not be required to report payments related to exploratory activities for the fiscal year in which payments are made but can instead delay reporting such payments until the fiscal year following the fiscal year in which the payments were made. In addition, issuers that have acquired or otherwise obtain control over an issuer whose resource extraction payments are required to be disclosed, and that has not previously been obligated to provide such disclosure pursuant to Rule 13q-1, are also permitted to take advantage of a one-year reporting delay.

Significantly, issuers will be able to meet the requirements of the final rules by providing disclosure that complies with a foreign jurisdiction's or the U.S. Extractive Industries Transparency Initiative's ("USEITI") resource extraction payment disclosure requirements if they are deemed equivalent by the SEC. In conjunction with the adoption of the final rules, the SEC issued an order recognizing Canada's ESTMA, the EU Accounting and Transparency Directives, and the USEITI in their current forms as substantially similar disclosure regimes for purposes of alternative reporting under the final rules, subject to certain conditions. In addition, issuers filing an alternative report prepared pursuant to a recognized foreign reporting regime are permitted to follow the reporting deadline in the alternative jurisdiction.

Method of Disclosure. The rules 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 information is required to be included in an exhibit and electronically tagged using the extensible Business Reporting Language ("XBRL") format.

In a change from the re-proposed rules, the final rules add an additional XBRL tag for the subnational geographic location of each project using International Organization for Standardization ("ISO") codes to standardize references to subnational geographic locations. In addition, Form SD has been revised to expressly state that the payment information need not be audited and must be made on a cash basis.

The Form SD must be filed with, rather than furnished to, the SEC. Consequently, filers will have potential liability for false or misleading statements contained therein under Section 18 of the Exchange Act.

Filing Dates. A resource extraction issuer is required to file the Form SD with the SEC no later than 150 days after the end of its fiscal year. Resource extraction issuers are required to comply with the final rules starting with their fiscal year ending on or after September 30, 2018. For issuers with a December 31 fiscal year end, the first filing deadline would be May 30, 2019.

The text of the final rules is available here.

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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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