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SEC Adopts New Rules Requiring Disclosure of Resource Extraction Payments

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Affected Issuers

The new rules apply to a "resource extraction issuer," which is defined as any U.S. or foreign company that is required to file annual reports with the SEC pursuant to Section 13 or 15(d) of the Exchange Act and engages in the commercial development of oil, natural gas or minerals. A resource extraction issuer must disclose any covered payments to governmental entities made by it, its subsidiaries and other "controlled" entities. For these purposes, an issuer has control over another entity if the issuer consolidated that entity, or proportionately consolidated an interest in an entity or operation, under the accounting principles applicable to the financial statements included by such issuer in its Exchange Act reports (i.e., U.S. GAAP or IFRS, as applicable). This formulation of control was adopted over a definition based on Rule 12b-2 under the Exchange Act, which the SEC indicated would have been more costly and time-consuming than the adopted approach. The new rules do not apply to issuers subject to the Regulation A or Regulation Crowdfunding reporting requirements or to investment companies under the Investment Company Act of 1940, as amended; nor do the new rules apply to foreign private issuers that are exempt from Exchange Act registration and reporting obligations pursuant to Rule 12g3-2(b) under the Exchange Act.

Payments Requiring Disclosure

Payments requiring disclosure are those made to the U.S. federal government or a foreign government to further the "commercial development of oil, natural gas and other minerals" (i.e., the exploration, extraction, processing or exporting of such resources, or the acquisition of a license to perform such activities). The rules provide a *de minimis* exception, for a single payment or a series of related payments, of less than $100,000 during a fiscal year. The types

of payments covered by the rules are taxes (including taxes on corporate profits, corporate income and production taxes), royalties (including unit-based, value-based and profit-based royalties), license and other fees, production entitlements, bonuses (including signature, discovery and production bonuses), community and social responsibility (or CSR) payments (to the extent required by contract or law), dividends and infrastructure improvement payments. In addition to cash payments, the new rules cover certain in-kind payments, which are to be valued at cost or, if cost is not determinable, fair market value. Payments of fines and penalties to a government are outside of the scope of the new rules.

To be subject to the new rules, the payments must be made to the U.S. federal government or a foreign government. "Foreign government" is defined broadly to include a foreign government, department, agency or instrumentality of a foreign government, or a company that is majority-owned by a foreign government, and includes a foreign national government, as well as a foreign subnational government, such as the government of a state, province, county, district, municipality or territory. The rules generally require disclosure on a per-project basis, with a "project" being defined as operational activities that are governed by a single contract, license, lease, concession or other similar legal agreement, which form the basis of payment for liabilities with a government. Issuers are permitted to treat multiple agreements that are both operationally and geographically interconnected as a single project, even if the terms of the two agreements are not the same.

During the comment process and in its adopting release, the SEC considered whether the statutory meanings of "extraction," "processing" and "export" set forth in Section 13(q) required further clarification. The SEC declined to elaborate on the meaning of "extraction," which means the production of oil and natural gas, as well as the extraction of minerals. The adopting release did expand, however, on the meaning of "processing," which includes certain midstream activities but does not cover downstream activities, such as refining or smelting. The adopting release also clarifies that "export" was not intended to cover payments related to transportation on a fee-for-service basis by a service provider with no ownership interest in the resource; nor does "export" capture activities with little relationship to upstream or midstream activities, such as commodity trading-related activities. Finally, the SEC noted that the new rules were not intended to capture activities that are ancillary or preparatory to the commercial development of oil, natural gas or minerals. As a result, service providers, such as drill bit manufacturers, hardware providers, and hydraulic fracturing and drilling service providers would not be "resource extraction issuers" for purposes of the new rules.

The rules also include a general anti-evasion provision pursuant to which disclosure is required of any activity or payment that, although not within the categories specified in the rules, is part of a plan or scheme to evade the disclosure requirements under Section 13(q). This provision is designed to cover, for example, situations where an issuer substituted non-reportable payments for reportable payments in an attempt to evade the disclosure rules, as well as payments that were structured, split or aggregated in an attempt to avoid the application of the rules.

Manner and Timing of Disclosure

The required disclosure must be reported on Form SD, which is currently used to file Conflict Minerals reports pursuant to Rule 13p-1 under the Exchange Act. In connection with the new rules, the SEC is adopting amendments to Form SD to accommodate the new required disclosures. The SEC chose to use Form SD for the reporting of resource extraction payments (rather than, for example, requiring such information to be included in the issuer's periodic reports under the Exchange Act) because disclosure on Form SD would facilitate interested parties' ability to locate disclosure and alleviate issuers' concerns associated with the certifications of periodic reports required under Rules 13a-14 and 15d-14 covering such disclosures. Issuers must present the payment disclosure in an eXtensible Business Reporting Language ("XBRL") exhibit to Form SD with all required tags, including tags for:

- the type and total amount of payments made for each project
- the type and total amount of payments made to each government
- the total amounts of payments by category (e.g., bonuses, taxes, fees)
- the particular resource that is the subject of development
- the subnational geographic location of each project.

Issuers are not required to have the payment disclosure audited or reported on an accrual basis. Rather, information is required to be reported only on a cash basis. The information disclosed on Form SD, including voluntary disclosure, will be deemed "filed" (rather than "furnished") and therefore could give rise to liability under Section 18 of the Exchange Act, which relates to material misstatements or omissions in documents filed with the SEC under the Exchange Act.

The report is due within 150 days of the end of the issuer's fiscal year. The new rules are effective for fiscal years ending on or after September 30, 2018, meaning that, for issuers with a December 31 fiscal year-end, their first Form SD with resource extraction payment disclosure

will be due on May 30, 2019. The rules do not provide for any phase-in period or other accommodation for smaller reporting companies, emerging growth companies or other types of issuers subject to the rules.

Delayed Reporting and Exemptions from Reporting

The new rules allow for delayed reporting in two specified situations. First, if an issuer acquires a company that was not subject to the reporting requirements under the new rules during its last full fiscal year, then the issuer would not be required to commence reporting payment information for the acquired company until the second Form SD filing after the effective date of the acquisition. No such relief exists, however, for acquired companies that were previously subject to the resource extraction payment rules or for companies conducting initial public offerings. This accommodation must be disclosed in the body of the Form SD.

Second, the rules permit an issuer to delay the reporting of payments related to "exploratory activities" until the filing of the Form SD for the fiscal year following the fiscal year in which the payments are made. This delayed reporting accommodation is intended to alleviate issuers' concerns regarding the competitive harm that could result from the disclosure of commercially sensitive information about a new development target. Specifically, among other concerns, industry participants argued that disclosure of payments under the contract-based definition of "project" would allow competitors to derive important information about new areas under exploration for potential resource development, the value that the issuer places on such resources and the costs associated with acquiring the right to develop such resources. This information could give other market participants a competitive advantage in future bids for additional opportunities in the same area or allow competitors to reverse-engineer proprietary commercial information regarding the issuer's bidding and contracting strategies and other matters. Payments are related to "exploratory activities" if they are made as part of the process of identifying or examining areas that may have prospects of containing oil and gas reserves, or as part of a mineral exploration program. In no event, however, will payments be deemed to relate to exploratory activities if they are made after the development or extraction of the oil, natural gas or minerals that are the subject of the exploratory activities, or if the issuer has commenced development or extraction activities anywhere on the property, on any adjacent property or on any property that is part of the same project.

The SEC will also consider exemptive relief from reporting for other situations on a case-by-case basis pursuant to Rule 0-12 of the Exchange Act. During the comment period prior to issuance of the final rules, the SEC considered numerous requests from industry participants for a blanket exemption from the disclosure requirements if such disclosure would be prohibited under applicable foreign law. During the comment period, some commentators initially asserted that the disclosure required under Section 13(q) would be prohibited under the laws of Qatar, China, Angola and Cameroon (although later comment letters suggested that the laws of Angola and Cameroon would not actually prohibit such disclosure). Due to, among other reasons, the uncertainty regarding the existence and scope of laws prohibiting disclosure of Section 13(q) information and the likelihood that the SEC would have more information regarding such laws in the future as more companies begin to report under the EU Directives (defined below) and ESTMA (defined below), the SEC rejected a blanket exemption and instead determined that any such exemption would be considered on a case-by-case basis.

Alternative "Substantially Similar" Reporting Requirements

In an effort to decrease compliance costs for issuers that are cross-listed or incorporated in foreign jurisdictions, the SEC will permit certain issuers to comply with the new rules by filing alternative reports if the requirements of such reports are "substantially similar" to those under the new rules, as determined by the SEC.

An issuer may use an alternative report for an approved foreign jurisdiction or regime only if the issuer is subject to the resource extraction payment disclosure requirements of that jurisdiction and has made the required report publicly available. Then, the issuer must file the alternative report as an exhibit to Form SD and note in the body of the Form SD that the issuer is taking advantage of this alternative reporting accommodation and identifying the applicable alternative reporting regime. In addition, the alternative report must be tagged using XBRL, and it must be accompanied by a fair and accurate translation if originally prepared in a language other than English.

In a companion order issued on June 27, 2016, the SEC recognized the EU Accounting Directive and the EU Transparency Directive (collectively, the EU Directives) adopted by the European Parliament and Council of the European Union, Canada's Extractive Sector Transparency Measures Act (ESTMA) and the U.S. Extractive Industries Transparency Initiative (USEITI) as "substantially similar" disclosure regimes for purposes of alternative reporting under the final rules, subject to certain conditions. USEITI, in its current form, will only satisfy the disclosure

requirements under the new rules for payments made to the U.S. federal government, and not with respect to payments to foreign governments.

Disclosures Publicly Available

During the comment period in advance of issuing the final rules, the SEC considered the argument of various industry participants that the resource extraction payment disclosures should not be publicly available. Instead, those commenters suggested that payment information should be made to the SEC on a confidential basis, to be aggregated and anonymized before becoming publicly available. The SEC rejected those arguments, finding that public release of issuers' payment information was consistent with legislative history and necessary to achieve the U.S. interest in providing a level of payment transparency that will assist in combating corruption and promoting accountability in resource-rich countries. Public disclosure of company-specific, project-level payment information, the SEC noted, may help assist citizens, civil society groups and others in monitoring an individual issuer's contributions to the public finances and ensure that firms are meeting their payment obligations, among other benefits.

Separately, the rules require the SEC's staff to periodically publish compilations of the payment information submitted in issuers' Forms SD. The staff is entitled to determine the form, manner and timing of each compilation, except that no information included therein may be anonymized. The adopting release noted that the SEC did not expect the staff to issue such compilations more frequently than annually.

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