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SEC Proposes Revised Rules to Implement "Resource Payments" Disclosure Requirements of the Dodd-Frank Act

Proposed Rules Seek to Address Issuers' Concerns About Cost of Compliance and Potential Competitive Harm

SUMMARY

The SEC has re-proposed rules under the Securities Exchange Act of 1934 that would require an issuer who engages in the commercial development of oil, natural gas or minerals to disclose information on an annual basis relating to any payment made during the fiscal year to a foreign government or the U.S. federal government for the purpose of the commercial development of oil, natural gas or minerals. The proposed rules, released in December 2019, are mandated by the Dodd-Frank Wall Street Reform and Consumer Protection Act of 2010. The SEC notes that one of Congress' goals in requiring such rules is to increase the transparency of such payments made by resource extraction issuers and to help empower citizens to hold their governments accountable for decisions made in the management of valuable resources and the revenues they generate.

Congress invalidated previous disclosure rules that had been adopted by the SEC in 2016. The new proposed rules are intended to address concerns expressed by past commenters and members of Congress regarding the previous rules' compliance costs, inflexibility and the potential competitive harm caused by the disclosure of covered payments. The SEC has requested comments on all aspects of the proposals. Comments are due no later than March 16, 2020.

HISTORICAL CONTEXT OF THE PROPOSED RULES

The SEC is re-proposing Rule 13q-1 and an amendment to Form SD to implement Section 1504 of the Dodd-Frank Act, which added Section 13(q) to the Exchange Act and directed the SEC to issue rules that would require resource extraction issuers to report annually on payments made to a foreign government or the U.S. federal government for the purpose of the commercial development of oil,

natural gas or minerals, including information on the type and total amount of payments made for each project and to each government.

The re-proposed rules are the third time the SEC has attempted to implement this mandate. Rules adopted in August 2012 were vacated by a July 2013 district court ruling. A second set of rules adopted in June 2016 was disapproved by a joint resolution of Congress in February 2017 pursuant to the Congressional Review Act. The SEC nonetheless remains obligated under Section 13(q) of the Exchange Act to issue new rules.

The proposed rules reflect similar regulatory frameworks in Europe (the EU Accounting Directive and the EU Transparency Directive), and in Canada (the Extractive Sector Transparency Measures Act). The rules also incorporate certain principles and concepts developed by the Extractive Industries Transparency Initiative ("EITI"), a voluntary coalition of resource extraction companies, governments and international organizations, which publishes standards for corporate and public sector transparency related to the resource extraction industry. Although the United States formally withdrew as an EITI candidate country in November 2017, it has maintained its status as a supporting country of the EITI.

1. Key Differences from 2016 Rules

The SEC significantly changed certain core provisions of the 2016 rules to respond to concerns raised by commenters and members of Congress about their economic costs and potential competitive harm. The principal changes—many of which were considered but not included in the 2016 rules—are as follows:

- ***Definition of "project":*** The proposed rules define a project with respect to the type of resource being commercially developed, the method of extraction and the jurisdiction in which the operations occur. The 2016 rules had defined a project as an activity governed by a single contract that formed the basis for a payments liability with a government.
- ***De minimis definition:*** The proposed rules raise the *de minimis* threshold to require disclosure of only those payments that equal or exceed $150,000 and are made in respect of a project when the total amount of payments related to such project equals or exceeds $750,000. The 2016 rules required disclosure of any payments above $100,000.
- ***Exemptions and relief from reporting requirements:*** The SEC added new conditional exemptions for conflicts with foreign law and pre-existing contracts prohibiting the required disclosure, as well as exemptions for smaller reporting companies and emerging growth companies. The SEC also added transitional relief that allows issuers following an IPO and newly acquired companies to delay submission of the required Form SD.
- ***Definition of control:*** The proposed rules define control based on established financial reporting principles, as under the 2016 rules, but an issuer is no longer required to disclose payments made by entities it only proportionately consolidates.
- ***Liability:*** The proposed rules require that disclosures on Form SD be furnished, rather than filed, with the SEC. This change eliminates potential Section 18 liability.
- ***Aggregation of payments:*** Under the proposed rules, issuers may aggregate payments made at a level below the major foreign subnational government level without identifying the particular payee, whereas previously more detailed disclosure would have been required.
- ***Timing:*** The deadline for furnishing the payment disclosures has been extended.

2. Summary of Proposed Rules

Resource Extraction Issuer. Under the proposed rules, a "resource extraction issuer" is defined as an issuer that is required to file annual reports on Form 10-K, 20-F or 40-F and that engages in the commercial development of oil, natural gas or minerals. The proposed definition would therefore exclude issuers subject to Tier 2 reporting obligations under Regulation A and those filing annual reports pursuant to Regulation Crowdfunding. In a change from the 2016 rules, the SEC has proposed excluding smaller reporting companies and emerging growth companies from the obligation to comply with the proposed rules. However, the SEC has not proposed an exemption for foreign private issuers.

The SEC is soliciting comment as to whether the definition of "resource extraction issuer" should exclude foreign private issuers and/or any other categories of issuers.

Commercial Development of Oil, Natural Gas or Minerals. The proposed rules define "commercial development of oil, natural gas, or minerals" as the "exploration, extraction, processing, and export of oil, natural gas or minerals, or the acquisition of a license for any such activity", consistent with the statutory definition and the approach taken in the 2016 rules. The definition is intended to capture only those activities directly related to the commercial development of these resources and not activities "preparatory" or "ancillary" to commercial development, such as providing products or services that support the exploration, extraction, processing or export of the resources. "Extraction", "processing" and "export" are defined so as to limit the scope of covered activities to upstream and midstream activities, which the SEC notes are the primary activities necessitating payments by resource extraction issuers to governments. "Extraction" is defined to include the production of oil and natural gas and the extraction of minerals. "Processing" is defined to include, but is not limited to, midstream activities through the earlier of the point at which oil, gas or gas liquids are sold to an unrelated third party or delivered to a main pipeline, common carrier or marine terminal, as well as preparation of raw ore for smelting or refining, but excludes subsequent phases. "Export" is defined to mean the transportation of a resource from its country of origin to another country by an issuer with an ownership interest in the resource, but to exclude transportation by a service provider with no ownership interest in the resource.

Definition of Minerals. The proposed rules include an instruction on the meaning of the term "minerals". The proposed instruction refers issuers to the SEC's use of the term in its other disclosure rules, thus ensuring that the scope of the term in these rules tracks changes that may be made to other disclosure requirements to which registrants are subject. The term covers, at a minimum, materials subject to the SEC's existing disclosure requirements for mining properties. The SEC is soliciting comments as to whether the instruction is sufficiently clear to permit issuers to identify when they are engaged in commercial development of a mineral.

Covered Payments. As with the 2016 rules, the proposed rules define "payment" to mean a payment that:

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

- is one or more of the following: taxes, royalties, fees, production entitlements, bonuses, certain dividends, payment for infrastructure and community and social responsibility payments that are required by law or contract.

The proposed rules provide additional guidance on royalties, fees, bonuses and other categories of payments. Issuers would be required to disclose taxes paid on corporate profits, corporate income and production, but not consumption-based taxes, such as value-added taxes. Dividends would be required to be disclosed if paid in lieu of production entitlements or royalties, but not if paid to a government as a common or ordinary shareholder on the same terms as are paid to other shareholders of the issuer. Royalties to be disclosed would include unit-based, value-based and profit-based royalties. Fees would include license fees, rental fees and other consideration offered for licenses or concessions. Bonuses would include signature, discovery and production bonuses.

Under the proposed rules, the resource payments information would not need to be audited and must be provided on a cash basis, rather than on an accrual basis.

Not de minimis. A payment would be deemed "Not *de minimis*"—and thus subject to disclosure—when equal to or greater than $150,000 (or its equivalent in the issuer's reporting currency) and the aggregate payments for the project equal or exceed $750,000. This is a change from the $100,000 *de minimis* threshold in the 2016 rules. The SEC is soliciting comments on this definition, including whether issuers should instead be allowed themselves to determine which payments are *de minimis* based on the particular facts and circumstances, or whether the SEC should instead base the "not *de minimis*" threshold on an amount that is not *de minimis* relative to a particular issuer, country or project.

Payments by Subsidiary or Entity Under Control of Issuer. Similar to the 2016 rules, issuers under the proposed rules would be required to disclose payments by any "subsidiary" or other entity under its "control", as defined by accounting principles. Under the proposed rules, issuers would be deemed to have "control" of another entity for purposes of reporting resource payments when the issuer consolidates that entity under the accounting principles applicable to the financial statements included in its Exchange Act periodic reports (i.e., US GAAP or IFRS).

In a change from the 2016 rules, an issuer would not be required to disclose the proportionate amount of payments made by its proportionately consolidated entities or operations. The SEC's change is responsive to commenters' concerns regarding the potentially high compliance costs associated with disclosing payments made by entities in which an issuer has only a proportionate interest. The SEC comments that the previous definition could have posed problems for joint venture partners that may lack ready access to information on payments made by the joint venture operator. While the change may reduce availability of information on payments made by joint ventures, the SEC notes its view that this reduction is an appropriate trade-off in light of the compliance burden posed by such a requirement.

Payment Information with Respect to Each "Project". The proposed rules define project by reference to three criteria: (1) the type of resource being commercially developed, (2) the method of extraction and (3) the major subnational political jurisdiction in which the commercial development takes

place or, for offshore projects, the nearest such jurisdiction. This definition departs from the 2016 rules, which defined "project" as the operational activities governed by one legal agreement, such as a contract or a license, that formed the basis for payment liabilities with a government.

The SEC acknowledges that the revised definition may be narrowing the scope of the transparency benefits that the disclosures under Section 13(q) were intended to produce, as compared with the previous contract-based definition. However, the SEC notes that its new definition responds to concerns raised that the requirement to track, record and disclose payment information on a per-contract basis imposed substantial costs and risk of competitive harm. The SEC, by changing to the new definition, aims to reduce the cost of compliance and the likelihood that competitively harmful information would be released, while still providing substantial transparency about the overall revenue flows to foreign governments and the U.S. federal government.

The proposed rules explain how issuers should identify each project for purposes of the rules. The description of each project can be relatively high level. Issuers should identify whether a resource is oil, natural gas or a specified type of mineral and whether the method of extraction is a well, an open pit or underground mining. Further details—such as the subcategory of mineral, or the type of drilling used—are not required. When identifying the project's jurisdiction, issuers are directed to refer to the combined country and subdivision codes of ISO 3166, a widely accepted international standard. Activities within each major subnational political jurisdiction may be treated as a single project, but the issuer must describe each type of resource being commercially developed and each method of extraction in the description of that project. Activities that cross the borders of a major subnational political jurisdiction may not be combined as one project.

The SEC is soliciting comments on whether the proposed definition appropriately balances transparency and cost or whether there would be an alternative to both the proposed definition and the prior contract-based definition that better supports the U.S. government's commitment to promote transparency while limiting covered companies' compliance costs and competitive concerns.

Foreign Government and Federal Government. As with the 2016 rules, the SEC's proposed definitions of "foreign government" and "Federal Government" are consistent with Section 13(q). Under the proposed rules, a "foreign government" would be defined as a foreign government, department, agency or instrumentality of a foreign government, or a company at least majority owned by a foreign government. The term "foreign government" would include both foreign national and subnational governments. The SEC notes specifically that companies controlled by, rather than majority owned by, foreign governments would not fall within this definition, but it has asked for comments as to whether the definition should include companies in which a foreign government is the controlling shareholder. "Federal Government" is defined as the U.S. federal government and does not include state or local governments.

Issuers would be required to identify the particular recipient of payments made at the major subnational government level or above but would be permitted to aggregate payments by payment type and identify

only generically the subnational government payees below the major subnational government level (e.g., as "county" or "municipality"). The ability to aggregate payments and to not disclose names of recipients below the major subnational government level is intended to reduce potential competitive harm from the disclosure. The SEC is soliciting comments as to whether each subnational government payee should be identified and, if so, whether such a requirement could increase the potential for competitive harm.

Anti-Evasion. As under the 2016 rules, the SEC will also require disclosure of payments that, although not in the enumerated list of disclosed payments, are part of a plan or scheme to evade the disclosure requirement. The SEC intends for this provision to emphasize substance over the form or characterization of a payment.

3. Public Disclosure

Noting that Section 13(q) provides the SEC with the discretion to require public disclosure or to permit non-public reporting of payments, the SEC has proposed that issuers be required to publicly disclose payments via the searchable, online EDGAR system. The SEC notes that public disclosure would further the statutory directive to support the commitment of the U.S. government to international transparency promotion efforts relating to the commercial development of oil, natural gas or minerals by increasing the total number of companies that provide public, project-level disclosure. The SEC notes that other changes made by the SEC to the 2016 rules would significantly alleviate, and in some cases eliminate, the concerns of commenters and certain members of Congress as to the rules' potential adverse competitive effects, including the broader definition of "project", the permitted aggregation of payments at the subnational government level, the proposed exemptions for conflicts with foreign law and pre-existing contracts, the proposed targeted exemption allowing delayed reporting for exploratory activities and the extended filing deadlines.

However, the SEC notes that it is considering an alternative approach of permitting issuers to submit their reports on Form SD non-publicly and then using this information to produce an aggregated, anonymized public compilation. The SEC is seeking comments as to whether the proposed rules sufficiently alleviate the concerns about the adverse competitive effects of individualized public disclosure, or whether the SEC should permit non-public submission of the required information.

4. Exemptions

Exemption for Foreign Law Conflicts. Under the proposed rules, resource extraction issuers may exclude the proposed disclosure of information on payments if the law of the jurisdiction where the project is located prohibits the required disclosure, subject to certain conditions. The 2016 rules, by contrast, would have required issuers to seek individual relief on a case-by-case basis in such situations. The proposed exemption is designed to alleviate legal uncertainty and the administrative difficulties issuers would have faced under the 2016 approach. However, an issuer seeking to rely on the exemption will be required to take certain steps to qualify for the exemption to ensure that it is used only in cases of a legitimate conflict of law. The issuer will be required to take reasonable steps to seek

and use exemptions or relief under the applicable foreign law and, failing that, provide specific disclosures about the law preventing the disclosure, the issuer's efforts to seek and use exemptions or other relief and a legal opinion on its inability to provide the otherwise required disclosure, among other qualifying requirements.

Exemption for Conflicts with Pre-existing Contracts. Issuers will also not be required to disclose payments when a contract prohibits such disclosure, provided that the contract is in effect as of the effective date of Rule 13q-1 and the issuer takes certain additional steps to qualify for relief. The issuer would be required to take reasonable steps to obtain the consent of the relevant parties or to seek other contractual exceptions or relief to permit the disclosure and, failing that, would be required to disclose the particular contractual terms that prohibit disclosure and the efforts undertaken to obtain consent. In addition, the issuer would be required to provide a legal opinion on the issuer's inability to provide the required disclosure. While the exemption applies only to contracts already in effect when the rules come into effect and thus does not cover future contracts, the SEC is soliciting comment as to how to treat amendments or extensions to such pre-existing contracts after the effective date.

Smaller Reporting Companies, EGC and Transitional Exemptions. In another change from the 2016 rules, smaller reporting companies and emerging growth companies will be exempt from the proposed rules, which the SEC notes will eliminate the compliance burden on companies least able to afford it and address congressional concerns as to the overall cost of the rules. The SEC notes that such measure furthers its statutory duty to not just protect investors but also to promote efficiency, competition and capital formation, and is consistent with other recent rules that affect smaller reporting companies and emerging growth companies.

The SEC has also proposed transitional relief for recently acquired companies not previously subject to Section 13(q) or an equivalent alternative reporting regime, and for companies that had recently completed an initial public offering in the United States. For recently acquired companies, the acquirer would be required to begin reporting payment information starting with the Form SD submission for the first full fiscal year immediately following the effective date of acquisition. A newly public company would not be required to comply with the proposed rules until the first full fiscal year following the fiscal year in which it completed its IPO.

Exploratory Activity Exemption. As with the 2016 rules, issuers may delay reporting payments related to exploratory activities. Issuers would not be required to report such payments until submitting a Form SD for the fiscal year following the fiscal year in which the payments were made. The SEC notes that any diminished transparency resulting from this one-year delay is justified by the potential competitive harms that may be avoided as a result of the exemptive relief.

5. Alternative Reporting

Under the proposed rules, an issuer subject to resource extraction payment disclosure requirements of an alternative reporting regime may satisfy its disclosure obligations by furnishing on Form SD a report complying with the alternative reporting regime, provided the SEC has determined that the alternative

reporting regime satisfies the transparency objectives of Section 13(q). In such cases, issuers may submit the foreign report, which must itself have already been publicly released in the alternative jurisdiction, on its Form SD.

The SEC has already, in a 2016 order, stated that resource extraction issuers that file reports satisfying the requirements of the EU Directives, Canada's ESTMA and the United States EITI would satisfy the obligations of Section 13(q). The SEC states that it will make additional determinations as to the suitability of foreign reporting requirements on its own initiative and pursuant to application by an issuer.

6. Liability

The proposed rules would treat the proposed disclosure on Form SD as furnished, not filed, with the SEC. This approach eliminates the possibility of Section 18 liability for the disclosure. It also eliminates the possibility that the disclosure would be incorporated by reference into a filing under the Securities Act and thus potentially be subject to strict liability under Section 11, unless the issuer expressly incorporates the information. However, Section 13(q) disclosures would still be subject to the Exchange Act's general antifraud provisions.

7. Form, Location and Timing of Disclosures

Under the proposed rules, issuers will be required to disclose the required payment information annually on Form SD. Resource extraction issuers would be required to comply with Rule 13q-1 and Form SD for fiscal years ending no earlier than two years after the effective date of the final rules.

The SEC has proposed extending the annual submission deadline for each Form SD beyond the deadline provided in the 2016 rules. The proposed rules would require an issuer with a fiscal year ending on or before June 30 to submit the Form SD no later than March 31 in the following calendar year. For issuers with fiscal years ending after June 30, the deadline would be no later than March 31 in the second calendar year following its most recent fiscal year.

The proposed rules require disclosure in XBRL interactive data format, including alternative reports satisfying the Rule 13q-1 disclosure obligation.

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