SULLIVAN & CROMWELL LLP

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SEC Adopts Rules Implementing "Resource Payments" Disclosure Requirements of the Dodd-Frank Act

Final Rules Require Oil, Gas and Mining Companies to Disclose Payments Made to Governments for Resource Development

SUMMARY

The SEC has adopted final rules under the Securities Exchange Act of 1934 to require issuers engaged 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 final rules, which were adopted by a vote of 3 to 2 (Commissioners Lee and Crenshaw dissenting), are substantially similar to the rules proposed in December 2019. Our Memorandum to Clients, published on January 15, 2020, summarized key aspects of the proposed rules.

The adoption of the rules on December 16, 2020 follows ten years of controversy over how the SEC should implement the "resource payments" disclosure requirement, which was mandated by the Dodd-Frank Wall Street Reform and Consumer Protection Act of 2010. The unusually long time required to adopt final rules has stemmed, in part, from the difficulty faced by the SEC in reconciling the mandate of the Dodd-Frank Act, which was to provide additional transparency around resource extraction payments to governments and thus help citizens hold their governments accountable for how they spend the money received, with the SEC's statutory duty in a public rulemaking to consider investor protection concerns and whether an action would promote efficiency, competition and capital formation.

The final rules will come into effect 60 days following their publication in the Federal Register. Registrants will have a two-year transition period before they will be required to provide disclosure under the final rules.

BACKGROUND

The SEC has adopted 17 C.F.R. 240.13q-1 ("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 requiring 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.

This is the third time that the SEC has attempted to implement this Dodd-Frank Act 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 remained obligated under Section 13(q) of the Exchange Act to issue new rules. The final rules reflect the SEC's efforts to respond to concerns raised by commenters and members of Congress about the economic costs and potential competitive harm under the 2016 rules.

1. Summary of the Final Rules

Resource Extraction Issuer. The final rules define "resource extraction issuer" — i.e., those subject to the rules — as an issuer that is required to file an annual report on Form 10-K, 20-F or 40-F and that engages in the commercial development of oil, natural gas or minerals, including foreign private issuers. The definition therefore excludes issuers subject to Tier 2 reporting obligations under Regulation A and those filing annual reports pursuant to Regulation Crowdfunding. As described below, smaller reporting companies and emerging growth companies are exempt from the final rules.

Payment Information with Respect to Each "Project." The final 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 and the body of water in which the project is located.

This definition is a substantial change from previous versions of the rules that had defined "project" as the operational activities governed by a single contract, license, lease, concession or similar agreement forming the basis for payment liabilities with a government. While the prior definition was largely favored by transparency advocates—and more aligned with analogous non-U.S. reporting regimes—the SEC determined that such granular disclosure would result in substantial compliance costs for registrants and risk of competitive harm.

However, in adopting the final rules, the SEC noted that the adopted definition of project establishes only the minimum level of disclosure that a resource extraction issuer must provide concerning its projects and that some issuers have already committed to following the more granular model of reporting adopted by the EU countries, Norway and Canada. The SEC further noted that the final rules

do not preclude issuers from providing additional disclosure concerning their projects on an issuer's website, in annual or periodic reports, or in a Form 8-K or on a Form 6-K.

Foreign Government and Federal Government. The SEC's final definitions of "foreign government" and "Federal Government" are consistent with Section 13(q) and largely the same as proposed. Under the final rules, a "foreign government" means the national government of a foreign country, as well as any department, agency or instrumentality of the national government, or a company at least majority-owned by the national government of a foreign country. The term "foreign government" also includes subnational governments of a foreign country, such as a provincial or district government. The SEC noted specifically that companies controlled by, rather than majority-owned by, foreign governments do not fall within this definition, due in part to the difficulty issuers may face in determining when a government has control over a particular entity outside of a majority-ownership context. "Federal Government" is defined as the U.S. federal government and does not include state or local governments.

Issuers will be required to identify the particular recipient of payments at each level of government but will be permitted to aggregate payments by payment type when disclosing payments rather than disclosing each payment individually. This is a change from the proposed rules, which would have permitted issuers to omit disclosing the identity of payees below the major subnational level.

Covered Payments. As with the proposed rules, the final 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 (including license fees), production entitlements, bonuses, certain dividends, payments for infrastructure and community and social responsibility payments that are required by law or contract.

Issuers will be required to disclose taxes paid on corporate profits, corporate income and production, but not consumption-based taxes, such as value-added or personal income taxes. Dividends must 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. The final rules provide additional guidance on royalties, fees and bonuses, and final guidance includes a non-exhaustive list of such payments to be disclosed. Royalties to be disclosed include unit-based, value-based and profit-based royalties. Fees include license fees, rental fees and other consideration offered for licenses or concessions. Bonuses include signature, discovery and production bonuses.

Under the final rules, the resource payments information does not need to be audited and must be provided on a cash basis, rather than on an accrual basis. Issuers must include in their disclosure the monetary value of any payment made in-kind, such as production entitlement payments, rather than through a monetary payment.

***Not* de minimis**. A payment will be deemed "not *de minimis*"—and thus subject to disclosure—when equal to or greater than $100,000, or its equivalent in the issuer's reporting currency, whether made as a single payment or a series of related payments. This definition is a substantial change from the proposed rules, under which payments would have been deemed "not *de minimis*" only if they were equal to or greater than $150,000 *and* the aggregate payments for the project equaled or exceeded $750,000. The SEC adopted the lower threshold of $100,000 and eliminated the requirement that a project's aggregate payments also be considered to address concerns raised by commenters that the proposed definition could result in a high percentage of projects going unreported.

Commercial Development of Oil, Natural Gas or Minerals. The final 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. 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. While the SEC had discretionary authority to include other significant activities relating to oil, natural gas or minerals, the SEC has sought to limit compliance costs and decided not to impose disclosure obligations beyond those required by Congress in Section 13(q).

Definition of Minerals. The final rules do not define "minerals" outright but refer issuers to the SEC's use of the term in its recently adopted mining disclosure rules to ensure 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, those materials subject to new rules on mining property disclosure.

Payments by a Subsidiary or Other Entity Under Control of Issuer. As with the proposed rules, issuers under the final rules must disclose payments by any "subsidiary" or other entity under its "control," as defined by accounting principles. Issuers are 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. Issuers will not be required to disclose the proportionate amount of payments made by its proportionately consolidated entities or operations, given the high compliance costs associated with disclosing payments made by entities in which an issuer has only a proportionate interest and the potential inability of joint venture partners to obtain ready access to information on payments made by the joint venture operator.

Anti-Evasion. The final rules 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. This principles-based anti-evasion provision, the SEC noted, covers most of the situations raised in past rulemakings by commenters concerned that payments could be structured to avoid triggering a reporting requirement.

2. Public Disclosure

The final rules obligate resource extraction issuers to make the newly required disclosure public, including the name of the issuer, through the SEC's searchable, online EDGAR system. The SEC sought comments on whether to permit registrants to submit their reports on Form SD non-publicly, then using that information to produce an aggregated, anonymized public compilation. However, the final rule retains the public disclosure requirement. The SEC noted that requiring public disclosure by each issuer will more effectively further Section 13(q)'s 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.

3. Alternative Reporting

Resource extraction issuers based outside of the United States will be able to comply with the final rules by providing a copy of reports they are already required to prepare under the laws of their home jurisdiction.

Issuers subject to payment disclosure requirements of a foreign jurisdiction will be able to satisfy their obligations under the new rules by submitting their report compliant with such disclosure requirements, provided that the SEC has determined that the foreign requirements satisfy the transparency objectives of Section 13(q). Concurrent with the release of the final rules, the SEC has determined that Europe's EU Accounting Directive and EU Transparency Directive (as implemented in an EU or European Economic Area member country), the UK's Reports on Payments to Governments Regulations, Norway's Regulations on Country-by-Country Reporting and Canada's Extractive Sector Transparency Measures Act satisfy this requirement.

Issuers using this alternative reporting option will be required to submit the alternative report as an exhibit to Form SD. The alternative report must already have been made publicly available prior to submission to the SEC. To submit the report to the SEC, it must be translated into English in its entirety, if prepared in another language, and be tagged using XBRL. To the extent that the submission deadline of the approved alternative jurisdiction differs from that of the final rules, the issuer may follow such alternative deadline if it submits a notice on or before the due date of its Form SD indicating its intent to submit the report using the alternative jurisdiction's deadline.

4. Exemptions

Exemption for Foreign Law Conflicts. Under the final rules, resource extraction issuers will be exempt from disclosing information on payments if the law of the jurisdiction where the project is located prohibits the required disclosure, subject to certain conditions. However, an issuer seeking to rely on the exemption will be required to take certain measures to qualify, including taking reasonable steps to seek and use exemptions under the applicable foreign law and furnishing a legal opinion as an exhibit to Form SD on its inability to provide the otherwise required disclosure. Issuers' reliance on this

exemption will also be subject to Commission staff review, which the SEC noted should discourage potentially inappropriate uses of the exemption.

Exemption for Conflicts with Pre-existing Contracts. Issuers will also be exempt from disclosing payments when a contract prohibits such disclosure, provided that the contract is in effect as of the effective date of the final rules. Similar to the process of obtaining an exemption for disclosure that would conflict with foreign law, the issuer must take certain additional measures to qualify for relief, including taking reasonable steps to seek and use any contractual exemptions or other contractual relief (such as attempting to obtain the consent of the relevant contract counterparty) to permit disclosure of the payment information. The issuer will also be required to provide a legal opinion on the issuer's inability to provide the required disclosure, in addition to other disclosures about the contractual terms and relevant jurisdiction.

Smaller Reporting Companies, EGC and Transitional Exemptions. As with the proposed rules, smaller reporting companies and emerging growth companies are exempt from the final rules. However, in a change from the proposed rules, this exemption does not apply to such companies if they are subject to an alternative reporting regime, such as the EU or Canadian reporting requirements. Such companies will be required to comply with the final rules by submitting to the SEC their report complying with that alternative jurisdiction's reporting requirements.

The SEC has also adopted the 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 will be required to begin reporting payment information for the acquired issuer starting with the Form SD submission for the first full fiscal year immediately following the effective date of acquisition. In addition, a newly public reporting company in the United States will not be required to comply with the final rules until the first full fiscal year following the fiscal year in which it completes its IPO.

Exploratory Activity Exemption. The final rules provide that issuers may delay reporting payments related to exploratory activities. In order to mitigate potential competitive harms, issuers will not be required to report such exploratory payments until submitting a Form SD for the fiscal year following the fiscal year in which the payments were made. Payments are considered to be related to exploratory activities if made as part of the process of: (1) identifying areas that may warrant examination; (2) examining specific areas considered to have prospects of containing oil and gas reserves; or (3) conducting a mineral exploration program, in each case prior to commercial development of such resources.

5. Liability

The final rules treat the disclosure on Form SD as furnished to, but not filed with, the SEC. This approach means that Section 18 liability will not apply to the disclosure on Form SD, and the Form SD would not 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. The SEC decided that limiting issuers' potential liability for their disclosure would be a reasonable and appropriate policy choice as the disclosure is not for investor protection purposes.

However, Section 13(q) disclosures are still subject to the Exchange Act's general antifraud provisions.

6. Form, Location and Timing of Disclosures

Issuers will be required to disclose the required payment information annually on Form SD covering payments made in the last fiscal year. Issuers must submit Form SD no later than 270 days following the end of their most recently completed fiscal year, a shorter timeline than the SEC had initially proposed. The final rules require disclosure in XBRL interactive data format.

The SEC has adopted a two-year transition period before issuers must comply with the final rules such that issuers will be required to comply with the final rules for fiscal years ending no earlier than two years after the effective date of the final rules. The final rules will be effective 60 days after their publication in the Federal Register. Assuming the rules would come into effect on or prior to March 1, 2021, an issuer whose fiscal year ends on December 31 would be required to provide their initial disclosure covering payments made in their fiscal year ending December 31, 2023, and the deadline for such disclosure would be 270 days later.

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