SULLIVAN & CROMWELL LLP

December 22, 2015

SEC Re-Proposes Resource Payments Disclosure Rules

Re-Proposed Rules are Substantially Similar to the Original Resource Extraction Disclosure Rules, with Certain Distinctions

INTRODUCTION

On December 11, 2015, the Securities and Exchange Commission ("SEC"), responding to both a 2013 court ruling vacating its previously finalized resource extraction payment disclosure rules and a separate 2015 court order compelling it to take steps to replace the vacated rules, re-proposed rules that would require resource extraction issuers (any issuer that files annual reports pursuant to the Securities Exchange Act ("Exchange Act") and engages in the commercial development of oil, natural gas or minerals) to disclose, on Form SD, payments to either the U.S. Federal Government or a foreign government related to the commercial development of oil, natural gas or minerals, subject to a limited *de minimis* exception. The re-proposed rules, which were mandated by the Dodd-Frank Wall Street Reform and Consumer Protection Act ("Dodd-Frank Act"), would replace and, subject to a few distinguishing elements, are substantially similar to the vacated Rule 13q-1 that was originally adopted by the SEC in 2012 (the "2012 Rules"). As noted by the SEC in its proposing release, the goal of the disclosure is to help combat global corruption and empower citizens of resource-rich countries to hold their government accountable for the wealth generated by those resources.

Many of the modifications as compared to the 2012 Rules are designed to harmonize the SEC's approach with approaches taken by the European Union and Canada with regard to similar disclosure, including: (i) permitting "substituted compliance" (or satisfaction of SEC reporting requirements by satisfying the requirements of other regimes) in certain instances; (ii) a new definition of the term "project" that is similar to that set forth in the EU Directives (as defined below); (iii) defining "control" and "subsidiary" by reference to accounting principles (instead of by reference to the definitions in Exchange

Act Rule 12b-2), which also complements the EU and Canadian requirements; and (iv) the ability of issuers to seek, on a case-by-case basis, exemptions from the reporting requirements based on, for example, confidentiality concerns or restrictions under host country law.

The SEC has provided two comment periods for the proposal. Initial comments are due on January 25, 2016. Reply comments, which may respond only to issues raised in the initial comment period, are due on February 16, 2016. The SEC has stated that in developing final rules, it may rely on both new comments as well as comments that have been previously received, including those provided in connection with 2012 Rules.

HISTORY AND CONTEXT OF THE RULES

The SEC is proposing Rule 13q-1 and a related amendment to Form SD in order to implement Section 1504 of the Dodd-Frank Act, which added Section 13(q) to the Exchange Act and required the SEC to promulgate rules requiring resource extraction issuers to include information in their annual report relating to any payment made by the issuer, a subsidiary of the issuer, or an entity under the control of the issuer, to a foreign government or the Federal Government, for the purpose of the commercial development of oil, natural gas or minerals.

The SEC originally adopted Rule 13q-1 on August 22, 2012, requiring the applicable disclosure be made by resource extraction issuers on Form SD.[1] Soon after adoption, the 2012 Rules were challenged by various groups, including the Chamber of Commerce and the American Petroleum Institute. On July 2, 2013, the U.S. District Court for the District of Columbia vacated the rules on the grounds that: (1) the SEC misread Section 13(q) as compelling the public disclosure of the issuers' reports; and (2) the SEC's explanation for not granting an exemption for when disclosure is prohibited by foreign governments was arbitrary and capricious.[2]

Following the District Court's decision, the SEC did not act immediately to re-propose or otherwise modify the resource extraction disclosure rules. On September 18, 2014, Oxfam filed suit in the U.S. District Court for the District of Massachusetts to compel the SEC to promulgate a final rule implementing Dodd-Frank Section 1504, and on September 2, 2015, that court issued an order holding that the SEC unlawfully withheld agency action by not promulgating a new rule. As a result, the SEC filed an expedited schedule with the Massachusetts District Court that contemplates the adoption of a final resource extraction payment disclosure rule by June 2016.

---

1 See our memorandum, dated August 31, 2012, titled "SEC Adopts Final Rules to Implement the 'Resource Payments' Disclosure Requirements of the Dodd-Frank Act," available here.

2 For a detailed discussion of the ruling vacating the 2012 Rules, see our memorandum, dated July 2, 2013, titled "Court Vacates SEC Resource Payments Disclosure Rule," available here.

Since the D.C. District Court's ruling in 2013 vacating the originally adopted rules, there have been significant developments in Europe, through the EU Accounting Directive and the EU Transparency Directive (the "EU Directives"), and in Canada, through the Extractive Sector Transparency Measures Act ("ESTMA"), which similarly require resource extraction issuer disclosures. In addition, the Extractive Industries Transparency Initiative (the "EITI"), a voluntary coalition of extraction resource companies, foreign governments and international groups and organizations, has revised its standards in line with the EU Directives and ESTMA. The newly proposed SEC rules reflect consideration of these developments as well as the D.C. District Court's 2013 decision.

SUMMARY OF THE RE-PROPOSED RULES

The proposed rules are substantially similar to the 2012 Rules, with certain distinctions generally designed to address the D.C. District Court's decision and to help harmonize the U.S. disclosure rules with the EU Directives, the ESTMA and the EITI standards, in part to ease the burden of compliance for resource extraction issuers that may be subject to various different regimes. Like the 2012 Rules, the re-proposed rules would require resource extraction issuers to file a Form SD on an annual basis that includes information about payments related to the commercial development of oil, natural gas or minerals that are made to the U.S. Federal Government or foreign governments. Issuers would be required to file their disclosure on Form SD, on the SEC's Electronic Data Gathering, Analysis, and Retrieval System ("EDGAR"), no later than 150 days after the end of their fiscal year. The key terms and definitions of the re-proposed rules are as follows:

- The term "resource extraction issuer" would apply to all U.S. companies and foreign companies that are required to file annual reports pursuant to Section 13 or 15(d) of the Exchange Act and are engaged in the commercial development of oil, natural gas or minerals. The SEC is not proposing any exceptions based on size, ownership, foreign private issuer status, or the extent of business operations constituting commercial development of oil, natural gas or minerals.
- In addition to the payments it makes directly, an issuer would be required to disclose payments made by subsidiaries and other entities under its control. An issuer would be required to disclose those payments made by entities that are consolidated in its financial statements, or proportionately consolidated, as determined by generally accepted accounting principles in the United States ("U.S. GAAP") or International Financial Reporting Standards as issued by the International Accounting Standards Board ("IFRS"). The reference to accounting principles, as discussed below, is a change from the 2012 Rules, which had referenced the traditional SEC definitions of "control" and "subsidiary."
- The term "commercial development of oil, natural gas or minerals" would mean the exploration, extraction, processing and export, or the acquisition of a license for any such activity. It would not include the downstream activities of refining or smelting nor transportation made for a purpose other than the export from the resource country of origin to another.
- The SEC's proposal would require company-specific, project-level public disclosure of payment information. As the SEC stated, this is designed to advance the U.S. Government's interests in reducing corruption and promoting accountability and good governance. The term "project" would be defined, as discussed in greater detail below.

- The term "payment" would mean payments that (1) are made to further the commercial development of oil, natural gas, or minerals and (2) are "not *de minimis*". This includes taxes, royalties, fees (including license fees), production entitlements, and bonuses.[3] Payments would also include dividends and payments for infrastructure improvements but would exclude social or community payments.[4]
- "Not *de minimis*" would be defined to mean any payment, whether a single payment or a series of related payments, that equals or exceeds $100,000 during the most recent fiscal year.
- The term "foreign government" would mean a foreign national government as well as foreign subnational governments, such as the government of a state, province, county, district, municipality, or territory under a foreign national government. The term "Federal Government" would mean the United States Federal Government.
- The proposal also includes provisions that would allow the SEC to permit an issuer to comply with the disclosure rules through alternative reporting, such as through reporting done pursuant to the rules of another jurisdiction, provided that the SEC first deems the alternative reporting requirements to be substantially similar to the proposed rules, as discussed in greater detail below.

The Form SD, as proposed to be amended, would require an exhibit reflecting the following information relating to payments to foreign governments and the Federal Government:

- 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 amount of the payments, organized by type of payment as described above;
- 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 governments that received the payment and the country in which each such government is located;
- the project of the resource extraction issuer to which the payments relate;
- the particular resource that is the subject of the commercial development; and
- the subnational geographic location of the project.

The Form SD would be "filed" and subject to Exchange Act Section 18 liability for false or misleading statements. Resource extraction issuers would be required to present the payment disclosure using the eXtensible Business Reporting Language ("XBRL") electronic format and the electronic tags identified in

[3] In response to some requests by commenters, the proposed rules clarify that fees include rental fees, entry fees, and concession fees and that bonuses include signature, discovery and production bonuses.

[4] The proposed rules clarify in an instruction that a resource extraction issuer generally need not disclose dividends which are paid to a government as a common or ordinary shareholder under the same terms as other shareholders.

Item 2.01 of the to-be-amended Form SD. This requirement would also apply to foreign private issuers, regardless of whether they report in U.S. GAAP or IFRS.[5]

The SEC is proposing that resource extraction issuers would be required to comply with Rule 13q-1 and Form SD for fiscal years ending no earlier than one year after the effective date of the adopted rules.

KEY DIFFERENCES COMPARED TO THE 2012 RULES

Project. The 2012 Rules required project-level reporting, but left the term "project" undefined. Modeled on the EU Directives and the ESTMA definitions, the proposed rules would define the term "project" as operational activities that are governed by a single contract, license, lease, concession, or similar legal agreement, which forms the basis for payment liabilities with a government.

- The proposed definition would allow issuers to treat multiple agreements that are both operationally and geographically interconnected as a single project. Unlike the EU Directives and ESTMA definitions, the proposed definition of "project" would not include the requirement that the agreements have "substantially similar terms" as the SEC stated that it wished to allow for the situation in which one agreement leads to a second agreement, and so on, for operations in a geographically contiguous area, but where a change in market conditions or other circumstances compels different terms.
- In an instruction to the proposed rule, the SEC sets forth a non-exclusive list of factors by which an agreement would be considered "operationally and geographically interconnected" for purposes of the definition of project, including: (1) whether the agreements relate to the same resource and the same or contiguous part of a field, mineral district or other geographic area; (2) whether they will be performed by shared key personnel or with shared equipment; and (3) whether they are part of the same operating budget.
- As in the 2012 Rules, the proposed rules would contain an instruction clarifying that issuers would not be required to disaggregate payments that are made for obligations levied on the issuer at the entity level rather than the project level. Thus, if an issuer has more than one project in a host country, and that host country's government levies corporate income taxes on the issuer with respect to the issuer's income in the country as a whole, the issuer would be permitted to disclose the resulting income tax payment without specifying a particular project associated with the payment.
- The SEC also discussed, but ultimately rejected, a proposal by the American Petroleum Institute ("API") to define "projects" according to subnational political jurisdictions. Under the API's proposal, all of an issuer's resource extraction activities within a subnational political jurisdiction would be treated as a single "project" to the extent that these activities involve the same resource (*e.g.*, oil, natural gas, coal) and to the extent that they are extracted in a generally similar fashion (*e.g.*, onshore or offshore extraction, or surface or underground mining). In declining to propose to define "project" in this way, the SEC noted that it did not agree that engaging in similar extraction activities across a single subnational political jurisdiction provides the type of defining feature to justify aggregating those various activities together as a solitary project. The SEC also noted that it did not believe the API's proposal would generate the level of transparency that would be necessary and appropriate to achieve the U.S. Government's anticorruption and transparency objectives.

[5] The SEC has specifically requested comment on this issue, asking: "If a foreign jurisdiction requires an interactive data format other than XBRL, but otherwise calls for disclosure substantially similar to our own, should we nonetheless require resource extraction issuers to file these disclosures in XBRL?"

Public Disclosure. A major point of contention concerning the 2012 Rules was the requirement that issuers disclose resource extraction payment information publicly. The D.C. District Court based its invalidation of the 2012 Rules in part on its holding that the SEC misread Exchange Act Section 13(q), as added by the Dodd-Frank Act, to compel public disclosure of resource extraction issuers' reports. Many commenters suggested permitting confidential filings with the SEC providing a public compilation aggregating that information.

In the re-proposed rules, the SEC took a different approach and reviewed what it believes are the objectives of Section 13(q) and provided reasons why it believes public disclosure to be appropriate. Among other things, the proposing release noted that several existing transparency regimes require public disclosure, including the identity of the issuer, and stated that public disclosure would further the U.S. public foreign policy interest in supporting international transparency promotion efforts by enhancing comparability among companies. The proposed rules accordingly retain a requirement for issuers to disclose payment information publicly, but the proposing release states that the SEC, pursuant to its existing exemptive authority under either of Sections 12(h) or 36(a) of the Exchange Act, has the ability to address, on a case-by-case basis, any situations where confidential treatment may be warranted based upon the specific facts and circumstances.

Alternative Reporting. In light of recent developments in the European Union and Canada, as well as the developments with the U.S. Extractive Industries Transparency Initiative ("USEITI"), the proposal provides that issuers could meet the requirements of the proposed rules, in certain circumstances, by providing disclosures that comply with a foreign jurisdiction's rules or meet the USEITI, provided that the SEC deems the foreign jurisdiction's applicable requirements or the USEITI reporting regime to be substantially similar to the proposed rules. The SEC did not make any such finding in the proposing release.

- The SEC indicates that it would consider, among other factors, the following criteria in making a determination whether USEITI or a foreign jurisdiction's reporting requirements are substantially similar to the proposed rules: (1) the types of activities that trigger disclosure; (2) the types of payments that are required to be disclosed; (3) whether project-level disclosure is required and, if so, the definition of "project;" (4) whether the disclosure must be publicly filed and whether it includes the identity of the issuer; and (5) whether the disclosure must be provided using an interactive data format that includes electronic tags.
- When considering whether to allow substituted reporting based on a foreign jurisdiction's reporting requirements, the SEC would also consider whether disclosure of payments to subnational governments is required and whether there are any exemptions allowed and, if so, whether there are any conditions that would limit the grant or scope of the exemptions.
- Without providing for a specific review process and projected timeline, the proposal notes that the SEC anticipates that it could make determinations about the similarity of a foreign jurisdiction's[6] disclosure requirements either unilaterally or pursuant to an application submitted by an issuer or

[6] The SEC proposal noted that current payment disclosure rules are in place in the United Kingdom, Norway and Canada.

a jurisdiction, and the proposal also notes that the SEC anticipates following the same process in determining whether USEITI disclosures are substantially similar.

Exemption Where Disclosure Prohibited by Host Country Law. The 2012 Rules did not provide exemptions from compliance where such disclosure is prohibited by host country law. Consistent with the EU Directives and ESTMA, the SEC has again declined to provide for such an exemption. Instead, the SEC will consider using its existing exemptive authority to provide relief at the request of an issuer, if and when warranted. The SEC stated that it believes such a case-by-case approach is preferable as it would permit the SEC to tailor the exemptive relief to the particular facts and circumstances presented, such as by permitting alternative disclosure or by phasing out the exemption over an appropriate period of time.[7]

Subsidiary; Control. As noted above, Section 13(q) requires a resource extraction issuer to disclose payments made by a subsidiary or an entity under the control of the issuer. The 2012 Rules defined the terms "subsidiary" and "control" using the definitions of those terms provided in Exchange Act Rule 12b-2. In a change from the 2012 Rules, the proposed rules would define the terms "subsidiary" and "control" based on accounting principles. The SEC noted its view that this approach would complement the EU Directives and ESTMA, which were not in place when the 2012 Rules were adopted and should therefore support international transparency efforts by fostering greater consistency and comparability of payments disclosed by resource extraction issuers.

- Under the proposed approach, a resource extraction issuer would have "control" of another entity when the issuer consolidates that entity, or proportionately consolidates an interest in an entity or operation, under the accounting principles applicable to its financial statements included in the periodic reports filed pursuant to Section 13(a) or 15(d) of the Exchange Act. Thus, for purposes of determining control, the resource extraction issuer would follow the consolidation requirements under U.S. GAAP or under the IFRS, as applicable.[8]
- The extent to which the controlled entity is consolidated would determine the extent to which payments made by that entity would need to be disclosed. For example, a resource extraction issuer that proportionately consolidates an entity would have to report that entity's eligible payments on a proportionate basis, listing the proportionate interest.

---

[7] An issuer seeking an exemption would be required to submit a written request for exemptive relief to the SEC, describing the payment disclosures it wishes to omit and the facts and circumstances that would support an exemption. The SEC would then be able to consider factors such as whether the disclosure is already publicly available and whether (and how frequently) similar information has been disclosed by other companies, under the same or similar circumstances.

[8] The SEC noted that a foreign private issuer that prepares financial statements according to a comprehensive set of accounting principles, other than U.S. GAAP or IFRS, and files with the SEC a reconciliation to U.S. GAAP would be required to determine whether or not an entity is under its control using U.S. GAAP.

REQUEST FOR COMMENTS

The SEC is providing two comment periods for this proposal. Initial comments are due on January 25, 2016. Reply comments, which may respond only to issues raised in the initial comment period, are due on February 16, 2016.

* * *

ABOUT SULLIVAN & CROMWELL LLP

Sullivan & Cromwell LLP is a global law firm that advises on major domestic and cross-border M&A, finance, corporate and real estate transactions, significant litigation and corporate investigations, and complex restructuring, regulatory, tax and estate planning matters. Founded in 1879, Sullivan & Cromwell LLP has more than 800 lawyers on four continents, with four offices in the United States, including its headquarters in New York, three offices in Europe, two in Australia and three in Asia.

CONTACTING SULLIVAN & CROMWELL LLP

This publication is provided by Sullivan & Cromwell LLP as a service to clients and colleagues. The information contained in this publication should not be construed as legal advice. Questions regarding the matters discussed in this publication may be directed to any of our lawyers listed below, or to any other Sullivan & Cromwell LLP lawyer with whom you have consulted in the past on similar matters. If you have not received this publication directly from us, you may obtain a copy of any past or future related publications from Stefanie S. Trilling (+1-212-558-4752; trillings@sullcrom.com) in our New York office.

CONTACTS

New York		
Robert E. Buckholz	+1-212-558-3876	buckholzr@sullcrom.com
Catherine M. Clarkin	+1-212-558-4175	clarkinc@sullcrom.com
Jay Clayton	+1-212-558-3445	claytonwj@sullcrom.com
Donald R. Crawshaw	+1-212-558-4016	crawshawd@sullcrom.com
Robert W. Downes	+1-212-558-4312	downesr@sullcrom.com
John E. Estes	+1-212-558-4349	estesj@sullcrom.com
Sergio J. Galvis	+1-212-558-4740	galviss@sullcrom.com
David B. Harms	+1-212-558-3882	harmsd@sullcrom.com
Christopher L. Mann	+1-212-558-4625	mannc@sullcrom.com
Scott D. Miller	+1-212-558-3109	millersc@sullcrom.com
Inosi M. Nyatta	+1-212-558-7822	nyattai@sullcrom.com
Richard A. Pollack	+1-212-558-3497	pollackr@sullcrom.com
Robert W. Reeder III	+1-212-558-3755	reederr@sullcrom.com
Glen T. Schleyer	+1-212-558-7284	schleyerg@sullcrom.com
Washington, D.C.		
Eric J. Kadel Jr.	+1-202-956-7640	kadelej@sullcrom.com
Robert S. Risoleo	+1-202-956-7510	risoleor@sullcrom.com
Los Angeles		
Patrick S. Brown	+1-310-712-6603	brownp@sullcrom.com
Alison S. Ressler	+1-310-712-6630	resslera@sullcrom.com

Palo Alto			
	Sarah P. Payne	+1-650-461-5669	paynesa@sullcrom.com
	John L. Savva	+1-650-461-5610	savvaj@sullcrom.com
London			
	Kathryn A. Campbell	+44-20-7959-8580	campbellk@sullcrom.com
	Oderisio de Vito Piscicelli	+44-20-7959-8589	devitopiscicellio@sullcrom.com
	Stewart M. Robertson	+44-20-7959-8555	robertsons@sullcrom.com
	David Rockwell	+44-20-7959-8575	rockwelld@sullcrom.com
	George H. White III	+44-20-7959-8570	whiteg@sullcrom.com
Paris			
	Krystian Czerniecki	+33-1-7304-5880	czernieckik@sullcrom.com
Frankfurt			
	Krystian Czerniecki	+49-69-4272-5525	czernieckik@sullcrom.com
Melbourne			
	Robert Chu	+61-3-9635-1506	chur@sullcrom.com
Sydney			
	Waldo D. Jones Jr.	+61-2-8227-6702	jonesw@sullcrom.com
Tokyo			
	Izumi Akai	+81-3-3213-6145	akaii@sullcrom.com
Beijing			
	Garth W. Bray	+852-2826-8691	brayg@sullcrom.com
Hong Kong			
	Garth W. Bray	+852-2826-8691	brayg@sullcrom.com
	Chun Wei	+852-2826-8666	weic@sullcrom.com