SEC Finalizes Disclosure Rules for Payments by Resource Extraction Issuers

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Spurred by a provision in the Dodd-Frank Act of 2010, in August 2012 the SEC adopted rules requiring companies to disclose payments made to governments in order to further oil, natural gas or mineral developments. As explained by the SEC, the Dodd-Frank provision reflected "U.S. foreign policy interests in supporting global efforts to improve transparency in the extractive industries," with the goal of "help[ing] combat global corruption and empower[ing] citizens of resource-rich countries to hold their governments accountable for the wealth generated by those resources." Challenged by industry groups, the rules were vacated in July 2013 by the federal district court in Washington, D.C., which concluded that the SEC had misread the Congressional mandate. In December 2015 the SEC proposed new rules in a process intended to address the shortcomings identified by the court, and on June 27 the SEC **adopted those rules** substantially as proposed, with a handful of significant changes (our memo describing the December 2015 proposal is available **here**).

The final rules, like those originally adopted in 2012 and then re-proposed in 2015, continue to require public disclosure (rather than confidential submission) of payments and do not provide a blanket exemption for disclosures prohibited under applicable law – grounds on which the original rules were challenged. Instead, the final rules allow companies to apply for exemptive relief on a case-by-case basis, tailored to their individual facts and circumstances.

A covered company is required to comply with the rules starting with its fiscal year ending on or after September 30, 2018. Barring another successful challenge to the rules, a calendar-year company will be required to make its initial filing on Form SD disclosing 2018 resource extraction payments no later than May 30, 2019 (oddly, a day earlier than the conflict minerals Form SD due date).

Covered Companies

Any company required to file an annual report on Form 10-K, 20-F or 40-F that is engaged in the "commercial development" of oil, natural gas or minerals is subject to the disclosure requirement. Foreign private issuers (including those with government ownership), emerging growth companies and smaller reporting companies are covered, although Regulation A issuers, crowdfunded issuers and registered investment companies are not.

The SEC adopted its proposed definition of "commercial development" – exploration, extraction, processing and export, or the acquisition of a license for any such activity – but narrowed the meaning of the term "export" within the definition. As proposed, a company transporting a resource across an international border would have been considered an exporter unless it had no ownership interest in the resource. Under the final rules, as long as the company transporting the resource is not otherwise engaged in exploration, extraction or processing, it is not considered an exporter if it acquired its ownership interest in the resource from a foreign government or the U.S. federal government.

Covered Payments

Payments are covered by the disclosure requirement if made by a covered company (or an entity under its control) to a foreign government or to the U.S. federal government to further the commercial development of oil, natural gas or minerals. Like the proposal, the final rules contain an exception for *de minimis* payments of less than $100,000.

The rules as proposed contained a comprehensive list of the types of payments that are covered (including taxes, royalties, fees, production entitlements, bonuses, dividends and infrastructure improvement payments); the final rules augment this list by adding community and social responsibility (CSR) payments that are required by law or contract, such as funding for a hospital or school. Although in proposing the rules the SEC stated that it was following the approach of the European Union and Canada by not requiring the disclosure of CSR payments, in the adopting release the SEC reversed course, noting that commenters had mixed views on whether CSR payments should be included. The final rules also define "royalties" to include unit-based, value-based and profit-based royalties, and provide specific instructions for how to value in-kind production entitlement payments when the company later repurchases the resources associated with the production entitlement.

The SEC adopted the definition of "foreign government" as proposed. As a result, payment to an entity majority-owned by a foreign government (national or subnational) is considered payment to a foreign government.

Form SD

Required disclosures are substantially as proposed, at both the project and government level, and the SEC was not moved by competitive concerns over granularity ("we were mindful of the potential economic consequences that issuers might experience"). A covered company must provide the following information in an exhibit to Form SD, prepared in XBRL format –

- the type and total amount of payments, by payment type, for each project,
- the type and total amount of payments, by payment type, for all projects made to each government,
- the total amounts of the payments, by payment type,
- the currency of payment,
- the fiscal year in which the payments were made,
- the company's business segment that made the payments,
- the governments that received the payments and the country in which each such government is located,
- the specific project 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 make clear that they do not require payment information to be audited or provided on an accrual basis. Information is required on a cash basis only.

Delayed Reporting for Exploratory Activities

In a change from the proposal intended to address some competitive concerns, the final rules allow companies latitude to delay reporting payments relating to exploratory activities until the Form SD filed for the fiscal year after the fiscal year in which the payments were made. Payments eligible for delayed reporting include the following, but only where the exploratory activities in question were begun before any development or extraction activities on the property, any adjacent property or any property that is part of the same project –

- payments made as part of the process of identifying areas that may warrant examination,

- payments made as part of the process of examining specific areas that are considered to have prospects of containing oil and gas reserves and
- payments made as part of a mineral exploration program.

Transition Period for Acquisitions

The final rules also provide a phase-in period for acquisitions, in order to address concerns over the difficulty of retroactive application. If a covered company acquires an entity that was not obligated to provide payment disclosure under the SEC's rules (or another substantially similar jurisdiction's requirements) in the entity's last full fiscal year, the covered company is not required to report payment information for the target until the Form SD filed for the fiscal year following the effective date of the acquisition.

Liability

Although the SEC could have allowed companies to "furnish" Form SD and avoid liability for false or misleading statements under Section 18 of the Securities Exchange Act of 1934 (similar to the treatment of earnings releases under the Form 8-K rules), the final rules, like the proposal, require Form SD to be "filed." The SEC observed that "Form SD disclosure, including any voluntary disclosure, will benefit from potential Section 18 liability by providing issuers with further incentive to submit complete and accurate information."

Alternative Reporting

The final rules expand on the alternative reporting concept included in the proposal, under which the SEC would accept, in place of a report meeting SEC requirements, a report complying with the requirements of an alternative regime, if the SEC has found the regime to be substantially similar to the SEC's. The final rules state that companies, governments, industry groups and trade associations may apply for alternative reporting regime recognition.

The alternative report must be the same (though translated to English and XBRL-formatted if necessary) as the report made publicly available under the rules of the alternative regime, subject to changes necessary to comply with any conditions prescribed by the SEC. A company is generally permitted to follow the timing requirements of the alternative regime if more generous than the SEC's deadline, but must nevertheless file a notice on Form SD-N by the Form SD deadline indicating that it intends to use the alternative deadline. If the company fails to file the Form SD-N on a timely basis, or fails to file the alternative report within two business days of the alternative regime deadline, it will lose its ability to use alternative reporting in the next fiscal year.

In a companion **order** issued on June 27, the SEC announced that the EU Accounting Directive and the EU Transparency Directive, in each case as implemented in a European Union or European Economic Area member country, Canada's Extractive Sector Transparency Measures Act (ESTMA) and the U.S. Extractive Industries Transparency Initiative (USEITI) are each substantially similar to the new rules and therefore may be used for alternative reporting. However, companies using the USEITI reporting regime may only use it for payments to the U.S. federal government, and must nevertheless comply with the Form SD deadline and reporting year requirements.

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If you have any questions regarding the matters covered in this publication, please contact any of the lawyers listed below or your regular Davis Polk contact.

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