Simpson Thacher

Memorandum

SEC Issues Final Rules on Disclosure of Payments by Resource Extraction Issuers

July 21, 2016

On June 27, 2016, the Securities and Exchange Commission ("SEC") issued new Rule 13q-1 and an amendment to Form SD (collectively, the "final rules") to implement the Dodd-Frank Act requirement that issuers that engage in the commercial development of oil, natural gas, or minerals ("resource extraction issuers") disclose annually payments made to the U.S. federal government or any foreign government for the purpose of the commercial development of oil, natural gas, or minerals by such resource extraction issuers, their subsidiaries and other entities under their control.[1]

Resource extraction issuers must comply with the final rules commencing with their fiscal year ending on or after September 30, 2018. For resource extraction issuers whose fiscal year ends on December 31, the initial filing required by the final rules will be due on May 30, 2019.

I. Background

Section 13(q) of the Securities Exchange Act of 1934, as amended (the "Exchange Act"), which was added to the Exchange Act by Section 1504 the Dodd-Frank Act, directed the SEC to promulgate a rule requiring the disclosure of payments by resource extraction issuers. This provision of the Dodd-Frank Act reflected Congress's view that the disclosure of payments made by resource extraction issuers would "support the commitment of the Federal Government to international transparency promotion efforts relating to the commercial development of oil, natural gas, or minerals."[2] As explained by the SEC in its release adopting the final rules, "[t]he goal of such transparency is to help combat global corruption and empower citizens of

[1] *See* *Disclosure of Payments by Resource Extraction Issuers*, Release No. 34-78167; File No. S7-25-15 (June 27, 2016) (hereinafter "Release").

[2] Exchange Act §13(q)(2)(E).

resource-rich countries to hold their governments accountable for the wealth generated by those resources."[3]

In 2012, the SEC adopted a rule and form amendments to implement Section 13(q) of the Exchange Act, but these regulations were vacated by the U.S. District Court for the District of Columbia the following year.[4] The SEC re-proposed the rule and form amendments on December 11, 2015, with changes intended to address the infirmities cited by the court.

II. The Final Rules

The final rules are consistent with revised rules and form requirements proposed by the SEC in December 2015, with certain modifications. The final rules also harmonize certain of the new disclosure requirements with international disclosure regimens that have developed since the enactment of the Dodd-Frank Act.[5] The final rules and form requirements are summarized below.

A. Issuers Subject to the Final Rules

Section 13(q) requires the disclosure of payments by "resource extraction issuers." The final rules define a "resource extraction issuer" as an issuer that:

- is required to file an annual report with the Commission pursuant to Section 13 or 15(d) of the Exchange Act, and
- engages in the commercial development of oil, natural gas, or minerals.

The final rules do not allow any exemptions from this definition based, for example, on size, ownership, foreign private issuer status, government control of the issuer or the extent of the issuer's business operations constituting commercial development of oil, natural gas, or minerals. Excluded from the scope of the definition, however, are issuers subject to Tier 2 reporting requirements under Regulation A or subject to Regulation Crowdfunding's reporting requirements, as well as investment companies registered under the Investment Company Act of 1940.

B. Substance of the Disclosure

Pursuant to Section 13(q), the final rules require disclosure of information relating to payments made by a resource extraction issuer, "a subsidiary of the resource extraction issuer, or an entity under the control of the resource extraction issuer to a foreign government or the Federal Government for the purpose of the

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[3] Release at 7.

[4] *See* Disclosure of Payments by Resource Extraction Issuers, Release No. 34-67717; File No. S7-42-10 (Aug. 22, 2012). *See also American Petroleum Institute* v. *SEC*, 953 F. Supp. 2d 5 (D.D.C. 2013).

[5] *See* Disclosure of Payments by Resource Extraction Issuers, Release No. 34- 76620; File No. S7-25-15 (December 11, 2015).

commercial development of oil, natural gas, or minerals, including—(i) [t]he 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; and (ii) [t]he type and total amount of such payments made to each government."[6]

1. **Definition of "Commercial Development of Oil, Natural Gas, or Minerals."** Consistent with Section 13(q) of the Exchange Act, the final rules define "commercial development of oil, natural gas, or minerals" to include "exploration, extraction, processing, export and the acquisition of a license for any such activity."[7] According to the SEC, this definition is "intended to capture only activities that are directly related to the commercial development of oil, natural gas, or minerals" – not activities that are "ancillary or preparatory to such commercial development." In other words, an issuer that only provides products or services that support the exploration, extraction, processing or export of covered resources – "such as an issuer that manufactures drill bits or provides hardware to help companies explore and extract," or one that provides hydraulic fracturing or drilling services to enable resource extraction – is not engaged in the "commercial development" of the resources. If, however, a service provider makes a "payment" (as defined by the rule) to a government on behalf of a resource extraction issuer, the issuer must disclose such payment.

2. **Definition of "Payment."** Section 13(q) defines "payment" as a payment that is made to further the commercial development of oil, natural gas, or minerals and is not de minimis, which the final rules define as less than $100,000 (or its equivalent in the issuer's reporting currency).[8] Section 13(q) further provides that "payment" includes "taxes, royalties, fees (including license fees), production entitlements, bonuses, and other material benefits, that the [SEC], consistent with the guidelines of the U.S. Extractive Industries Transparency Initiative (the 'USEITI') (to the extent practicable), determines are part of the commonly recognized revenue stream for the commercial development of oil, natural gas, or minerals."[9]

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[6] Exchange Act §13(q)(2)(A).

[7] The final rules further define the terms "extraction," "processing," and "export."

[8] The "de minimis" exception is tested by reference to any single payment or series of related payments.

[9] Exchange Act §13(q)(1)(C)(ii). The Extractive Industries Transparency Initiative ("EITI") is a voluntary coalition of oil, natural gas, and mining companies, foreign governments, investors groups, and other international organizations, which "was formed to foster and improve transparency and accountability in resouce-rich countries through the publication and verification of company payments and government revenues from oil, natural gas, and mining." There are currently 51 countries that implement EITI. Release at 21-22.

- **Types of Payments Required to be Disclosed**. The final rules require disclosure of several specific categories of payments:
  - **Payments Specifically Enumerated in Section 13(q).** An instruction adopted by the SEC clarifies that "fees" include (but are not limited to) "rental fees, entry fees, and concession fees" and that "bonuses" include (but are not limited to) "signature, discovery, and production bonuses." Additionally, under the final rules, "royalties" include (but are not limited to) "unit-based, value-based, and profit-based royalties." Finally, with regard to "taxes," resource extraction issuers must disclose payments for taxes levied on corporate profits, corporate income, and production, but are not required to disclose payments for "taxes levied on consumption, such as value added taxes, personal income taxes, or sales taxes."
  - **Community and Social Responsibility ("CSR") Payments.** In addition to the types of payments specified in Section 13(q), the final rules require the disclosure of "CSR payments that are required by law or contract." The SEC believes that such payments are "part of the commonly recognized revenue stream for the commercial development of oil, natural gas, or minerals."
  - **Dividends.** The final rules further require the disclose of dividends paid to a government "in lieu of production entitlements or royalties." However, "[d]ividends paid to a government as a common or ordinary shareholder of the resource extraction issuer that are paid to the government under the same terms as other shareholders need not be disclosed," as these payments are not made in furtherance of the commercial development of oil, natural gas, or minerals.
  - **Payments for Infrastructure Improvements.** Under the final rules, resource extraction issuers must also disclose any payments for infrastructure improvements, such as payments made in relation to the construction of roads or railways to further the development of oil, natural gas, or minerals.

  Under the final rules, resource extraction issuers must disclose payments of the types identified in the final rules even if they are made in-kind (e.g., payments made in oil rather than monetary payments). Issuers would need to determine the monetary value of any in-kind payments; they are "required to report in-kind payments at cost," but "if historical costs are not reasonably available or determinable," they may report in-kind payments using fair market value.[10]
- **Anti-Evasion Provision.** Finally, the final rules mandate the disclosure of any payment that, while not within the categories specifically enumerated the rules, is part of a plan or scheme to

[10] An instruction to the rule provides guidance on how to report payments that are made to a foreign government or the federal government "to purchase the resources associated with production entitlements that are reported in-kind."

evade Section 13(q)'s disclosure requirements. According to the SEC, this requirement is "intended to emphasize substance over form or characterization and to capture any and all payments made for the purpose of evasion."[11]

3. **Definition of "a Subsidiary . . . or an Entity Under the Control of the Resource Extraction Issuer."** Section 13(q) requires a resource extraction issuer to disclose not only its own payments, but those made by its subsidiaries and entities under its control. The final rules define the terms "subsidiary" and "control" based on accounting principles rather than using the definitions of those terms provided in Rule 12b-2 under the Exchange Act. Under this approach, "a resource extraction issuer would have 'control' of 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 it includes in periodic reports filed pursuant to Section 13(a) or 15(d) of the Exchange Act" (e.g., U.S. generally accepted accounting principles ("U.S. GAAP") or the International Financial Reporting Standards ("IFRS")). An issuer that proportionately consolidates an interest in an entity would be required to disclose the issuer's proportionate amount of that entity's relevant payments, specifying the issuer's proportionate interest.

4. **Definition of "Project."** As required by Section 13(q), the final rules require disclosure of covered payments by type and total amount per project. The final rules define "project" as "operational activities that are governed by a single contract, license, lease, concession, or similar legal agreement, which form the basis for payment liabilities with a government." In the adopting release, the SEC indicates that it believes that the disaggregated and granular disclosures regarding transactions between governments and resource extraction issuers required as a result of this contract-based definition will minimize the potential that corruption will go undiscovered.[12] Nonetheless, the final rules allow multiple agreements to be treated as a single project, regardless of whether they have substantially similar terms, so long as the agreements are "both operationally and geographically interconnected." An instruction to Form SD provides a list of non-exhaustive factors for resource extraction issuers to consider in evaluating whether agreements are "operationally and geographically interconnected."

5. **Definitions of "Foreign Government" and "Federal Government."**

   - **"Foreign Government."** Section 13(q) defines "foreign government" to mean "a foreign government, a department, agency, or instrumentality of a foreign government, or a company

[11] Examples include "activities and payments that were structured, split, or aggregated in an attempt to avoid application of the rules," recharacterizing a payment that would otherwise be covered by the final rules, or making a payment via a third party.

[12] Release at 86-87.

owned by a foreign government, as determined by the Commission."[13]

- **Payment to a Foreign Subnational Government.** The final rules define "foreign government" to include not only a foreign national government, but also "a foreign subnational government, such as the government of a state, province, county, district, municipality, or territory under a foreign national government." In disclosing the "foreign government" that received the payment, the issuer is required to identify "the administrative or political level of subnational government that is entitled to [the] payment under the relevant contract or foreign law."
- **Payment to a Company Owned by a Foreign Government.** Under the final rules, "a company owned by a foreign government means a company that is at least majority-owned by a foreign government."
- **Payment by a Third Party on the Resource Extraction Issuer's Behalf.** The final rules require the disclosure of any covered payment made to a third party to be paid to a foreign government on the issuer's behalf.

- **"Federal Government."** The final rules require disclosure of payments made to the U.S. national government but not to any state or local governments within the United States.

C. Form of the Disclosure

1. **Annual Report on Form SD.** The final rules direct resource extraction issuers to provide the required disclosures on an annual basis in an SEC filing on Form SD. Issuers are required to provide, in an exhibit to the form, detailed payment information relating to any covered payment made during the fiscal year covered by the annual report.

2. **Alternative Reporting.** The final rules allow resource extraction issuers to meet their reporting obligations by providing disclosures that either comply with a foreign jurisdiction's rules or that meet the reporting requirements of the U.S. Extractive Industries Transparency Initiative, "if the Commission has determined that those rules or requirements are substantially similar to the rules adopted under Section 13(q)."[14] An issuer subject to the final rules may rely on this accommodation only if it is subject to the resource extraction payment disclosure requirements of the jurisdiction or

[13] Exchange Act §13(q)(1)(B).

[14] In determining whether another reporting regime is "substantially similar," the SEC may consider the following factors, among others: "(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; . . . (5) whether the disclosure must be provided using an interactive data format that includes electronic tags;" (6) "whether disclosure of payments to subnational governments is required;" and (7) "whether there are any exemptions allowed and, if so, whether there are any conditions that would limit the grant or scope of the exemptions."

regime for which it prepared the report and has made that report publicly available before filing it with the SEC. The final rules require any resource extraction issuer relying on this accommodation to:

- file as an exhibit to its Form SD filing the alternative report that it had previously made publicly available;
- specify in the body of its Form SD filing that the payment disclosure required by the form is included in an exhibit to the form;
- indicate in the body of its Form SD filing that it is relying on the alternative reporting accommodation;
- identify in the body of its Form SD filing the alternative reporting regime for which the report was prepared (e.g., a foreign jurisdiction or the USEITI);
- describe how to access the publicly filed report in the alternative jurisdiction; and
- tag the alternative report using eXtensible Business Reporting Language ("XBRL").

If the alternative report was drafted in a foreign language, an issuer availing itself of the alternative reporting accommodation must also provide "a fair and accurate English translation of the entire report."

In conjunction with its adoption of the final rules, the SEC issued an order recognizing the following regimes, in their current form, as "substantially similar disclosure regimes for purposes of alternative reporting" under the final rules:

- the EU Accounting Directive and the EU Transparency Directive;
- Canada's Extractive Sector Transparency Measures Act ("ESTMA"); and
- the USEITI, but only for payments made by an issuer to the federal government, not to foreign governments. An issuer using a USEITI report will need to provide supplemental disclosure in its Form SD regarding any covered payments to foreign governments. Additionally, to the extent its fiscal year end does not coincide with the end of the calendar year, the issuer will need to supplement its USEITI report so that its disclosures are provided on a fiscal year basis.

3. **Interactive Data Format Requirements.** Section 13(q) mandates that resource extraction issuers provide the requisite information in interactive data format. The final rules require the payment information in the exhibit to Form SD to be submitted in XBRL using electronic tags that identify:
   - the type and total amount of payments, by payment type, made 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 used to make the payments;
- the fiscal year in which the payments were made;
- the business segment of the resource extraction issuer (i.e., the reportable segment used by the issuer for purposes of financial reporting) that made the payments;
- the governments that received the payments and the country in which each government is located;
- the project of the resource extraction issuer to which the payments relate;
- the particular resource that is the subject of commercial development; and
- the subnational geographic location of the project.

An instruction to Form SD clarifies that resource extraction issuers may report payment amounts (i.e., when disclosing payments by category, for each project, and to each government) in U.S. dollars or in the issuer's reporting currency if not U.S. dollars. Issuers may calculate the currency conversion in one of three ways:

- by translating the expenses at the exchange rate existing at the time the payment is made;
- by using a weighted average of the exchange rates during the period; or
- based on the exchange rate as of the resource extraction issuer's fiscal year end.

Issuers must, however, be consistent in the measure they use for all currency conversions within a particular Form SD filing.

D. Status and Availability of Disclosures

1. **Filed, Not Furnished.** Under the final rules, the requisite payment information submitted on Form SD will be "filed," rather than "furnished." Because the required disclosures are made on Form SD rather than in annual reports on Forms 10-K, 20-F, or 40-F, the disclosures are not subject to the officer certifications required by Exchange Act Rules 13a-14 and 15d-14. Liability for defective Form SD filings may attach pursuant to Section 18 of the Exchange Act.

2. **Public Availability of the Disclosure.** The final rules require the public disclosure of the full payment information submitted by resource extraction issuers, including the identity of the issuer. Form SD filings will be publicly available for inspection on the SEC's EDGAR website.

E. Exemptions from the Disclosure Requirements

1. **Case-by-Case Approach.** The SEC may use its existing authority under the Exchange Act to provide exemptive relief from the final rules' requirements on a case-by-case basis "at the request of a resource extraction issuer, if and when warranted." Situations in which resource extraction issuers may petition the SEC for relief include, for example, those in which the required disclosure is prohibited by the laws of a foreign country. The SEC believes that a case-by-case approach will allow it to tailor any exemptive relief to the particular facts and circumstances presented.

2. **Targeted Exemption for Payments Related to Exploratory Activities.** The only blanket exemption provided in the final rules provides that resource extraction issuers need not report payments related to exploratory activities in the Form SD for the fiscal year in which the payments were made. Instead, they can delay disclosing such payments until the following fiscal year. While acknowledging that the exploratory phase may vary from project to project, the SEC reasoned that a one-year reporting delay is appropriate because "the likelihood of competitive harm (in regards to a new discovery) from the disclosure of payment information related to exploratory activities diminishes over time starting from when the exploratory activities on the property or any adjacent property have begun."

    - Payments will be considered to be related to exploratory activities "if they are made as part of the process of identifying areas that may warrant examination or examining specific areas that are considered to have prospects of containing oil and gas reserves, or as part of a mineral exploration program." Exploratory activities are limited to those that are conducted before the development or extraction of the resource subject to the exploratory activities.
    - The targeted exemption is not available for payments related to exploratory activities "on the property or any adjacent property once 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."

F. Timing Considerations

1. **Initial Compliance.** Compliance with the final rules will be required for fiscal years ending on or after September 30, 2018. A resource extraction issuer's initial Form SD filing, however, will only be due 150 days after the company's fiscal year end. As noted by the SEC, "[s]ince most issuers use a December 31 fiscal year end, the filing deadline would not be until May 30, 2019 for most issuers."

2. **Ongoing Compliance.** Resource extraction issuers are required to file their Form SD on EDGAR on an annual basis, no later than 150 days after the end of their most recent fiscal year.

    - An issuer relying on the alternative reporting exemption may follow the reporting deadline in the

alternative jurisdiction so long as it submits a "notice on Form SD-N on or before the due date of its Form SD indicating its intent to submit the alternative report using the alternative jurisdiction's deadline." If an issuer fails to submit this notice or does not submit the alternative report within two business days of the alternative jurisdiction's deadline, such issuer will become ineligible for the alternative reporting accommodation for the next fiscal year.

3. **Transitional Relief for Certain Recently Acquired Companies.** The final rules provide transitional relief for issuers that "have acquired or otherwise obtain control over an issuer whose resource extraction payments are required to be disclosed under the final rules, and that has not previously been obligated to provide such disclosure pursuant to Rule 13q-1 or another 'substantially similar' jurisdiction's requirements in its last full fiscal year." These issuers are not required to begin reporting payment information for the acquired company "until the Form SD filing for the fiscal year immediately following the effective date of the acquisition."

If you have any questions or would like additional information, please do not hesitate to contact **Yafit Cohn** at +1-212-455-3815 or yafit.cohn@stblaw.com or any other member of the Firm's Public Company Advisory Practice.

Simpson Thacher Worldwide

UNITED STATES

New York
425 Lexington Avenue
New York, NY 10017
+1-212-455-2000

Houston
600 Travis Street, Suite 5400
Houston, TX 77002
+1-713-821-5650

Los Angeles
1999 Avenue of the Stars
Los Angeles, CA 90067
+1-310-407-7500

Palo Alto
2475 Hanover Street
Palo Alto, CA 94304
+1-650-251-5000

Washington, D.C.
900 G Street, NW
Washington, D.C. 20001
+1-202-636-5500

EUROPE

London
CityPoint
One Ropemaker Street
London EC2Y 9HU
England
+44-(0)20-7275-6500

ASIA

Beijing
3901 China World Tower
1 Jian Guo Men Wai Avenue
Beijing 100004
China
+86-10-5965-2999

Hong Kong
ICBC Tower
3 Garden Road, Central
Hong Kong
+852-2514-7600

Seoul
25th Floor, West Tower
Mirae Asset Center 1
26 Eulji-ro 5-Gil, Jung-Gu
Seoul 100-210
Korea
+82-2-6030-3800

Tokyo
Ark Hills Sengokuyama Mori Tower
9-10, Roppongi 1-Chome
Minato-Ku, Tokyo 106-0032
Japan
+81-3-5562-6200

SOUTH AMERICA

São Paulo
Av. Presidente Juscelino
Kubitschek, 1455
São Paulo, SP 04543-011
Brazil
+55-11-3546-1000