

2 August 2016

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SEC Adopts Payment Disclosure Rules for Resource Extraction Issuers

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Introduction

On June 27, 2016, the U.S. Securities and Exchange Commission (“SEC”) adopted Rule 13q-1 under the Securities Exchange Act of 1934 (the “Exchange Act”) and amendments to Form SD (Specialized Disclosure Report) (See [SEC Release No. 34-78167](#), June 27, 2016). The adopted rule and related amendments to Form SD (collectively, the “Adopted Rules”) require publicly traded companies to file a Form SD annually to disclose certain payments made to the U.S. government or foreign governments for the commercial development of oil, natural gas, or minerals on a project-by-project basis. According to the SEC, the Adopted Rules, implemented as a mandate to Section 1504 of the Dodd-Frank Wall Street Reform and Consumer Protection Act (the “Dodd-Frank Act”), are “intended to further the statutory objective to advance U.S. foreign policy interests by promoting greater transparency about payments related to resource extraction.” The goal of such transparency is to help combat global corruption and empower citizens of resource-rich countries to hold their governments accountable for the wealth generated by those resources. The Adopted Rules take effect sixty (60) days after publication in the Federal Register.

Background

Rule 13q-1 was previously adopted by the SEC in 2012 and later vacated by the U.S. District Court of the District of Columbia in 2013 after being challenged by various industry associations, including the American Petroleum Institute. In September 2014, after several postponements to reimplement rules pursuant to Section 1504 of the Dodd-Frank Act, international relief and development organization, Oxfam America, Inc., filed a lawsuit to compel the SEC to implement Rule 13q-1 of the Exchange Act. The Massachusetts District Court subsequently held the SEC’s delay in adopting final rules constituted a violation of the Administrative Procedure Act and ordered the SEC to file an expedited rulemaking schedule with the court. The SEC filed its expedited schedule with the court in October 2015 and in December 2015, the SEC repropose Rule 13q-1 and the amendments to Form SD.

Applicable Issuers

Pursuant the Adopted Rules, the disclosure requirements apply to all U.S. and foreign companies that (i) are required to file annual reports on Form 10-K, Form 20-F, or Form 40-F with the SEC pursuant to Section 13 or 15(d) of the Exchange Act and (ii) are engaged in the commercial development of oil, natural gas, or minerals. Such companies are referred to as “*resource extraction issuers*” pursuant to the Adopted Rules. Resource extraction issuers are also required to disclose payments made by subsidiaries or entities under the control of the issuer to the U.S. government or a foreign government. The Adopted Rules define “subsidiary” and “control” for reporting purposes in accordance with the generally accepted

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accounting principles in the U.S. (“U.S. GAAP”) and the International Financial Reporting Standards (“IFRS”) issued by the International Accounting Standards Board.

The Adopted Rules do not apply to (i) foreign private issuers that are exempt from the Exchange Act registration and reporting obligations pursuant to Rule 12g3-2(b) of the Exchange Act, (ii) investment companies required to file pursuant to the Investment Act of 1940 and (iii) Regulation A issuers.

“Commercial Development” Activities

The Adopted Rules expressly set forth the following as activities falling within definition of “*commercial development for oil, natural gas, or minerals*”:

- exploration;
- extraction, which includes the production of oil and natural gas and the extraction of minerals;
- processing, which includes, but is not limited to (i) midstream activities such as the processing of gas to remove liquid hydrocarbons, the removal of impurities from natural gas prior to its transport through a pipeline and the upgrading of bitumen and heavy oil through the earlier point at which oil, gas, or gas liquids are either sold to an unrelated third party or delivered to a main pipeline, common carrier or marine terminal and (ii) crushing and processing of raw ore prior to the smelting phase (excluding the downstream activities of refining or smelting);
- export, which includes transporting a resource from its origin country to another country by an issuer with an ownership interest in the resource (excluding transportation activities across international borders by a service provider with no ownership interest in the resource or commodity trading-related activities); or
- the acquisition of a license for any of the referenced activities.

An activity notably excluded by the SEC from the definition of “*commercial development of oil, natural gas, or minerals*” is providing products or services in support of any of the referenced activities. Examples of the excluded activity noted by the SEC include manufacturing or providing equipment to assist companies with exploration and extraction activities and engaging an operating company to provide hydraulic fracturing or drilling services. While the Adopted Rules expressly set forth certain activities as falling within the definition of “*commercial development of oil, natural gas, or minerals*,” the SEC reiterated that whether an issuer is engaged in an activity falling within the prescribed definition would depend on specific facts and circumstances.

Payments

“*Payments*” requiring disclosure under the Adopted Rules are defined as payments that (i) are made to further the commercial development of oil, natural gas, or minerals; (ii) are *not de minimis*; and (iii) are taxes, royalties, fees (including license fees), production entitlements, bonuses, dividends, payments for infrastructure or if required by law or contract, community and social responsibility payments. Such payments are disclosed on a project-by-project basis. The Adopted Rules define “*not de minimis*” as any payment, whether a single payment or a series of payments, which equals or exceeds \$100,000 or its

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equivalent in the issuer's reporting currency, during the same fiscal year. The SEC cited \$100,000 to be a threshold well-established in other jurisdictions and noted that adopting the same or similar threshold would potentially diminish additional compliance and competitive harm that would otherwise arise from mandating a threshold that varied significantly from the standard threshold of other jurisdictions. In-kind payments valued (at cost) at \$100,000 or more also require disclosure. In-kind payments could include activities such as building a road or school or refurbishing a government building or any other activities that do not involve providing monetary payments to the host country government.

The anti-evasion provision included in the Adopted Rules requires disclosure of payments made in an attempt to evade disclosure rules that are otherwise reportable payments, as well as payments that are structured, split, or aggregated in an attempt to avoid application of the Adopted Rules. Similarly, payments made by a resource extraction issuer to a third party or a service provider to be paid to the U.S. government or foreign government on its behalf also require disclosure under the Adopted Rules.

Exemptions

The Adopted Rules provide two narrow exemptions to the disclosure requirements that provide for delayed or transitional reporting in limited circumstances. The first exemption provides for a one-year delay in reporting payments related to exploratory payments. The second exemption allows resource extraction issuers that have recently acquired a company not previously subject to the Adopted Rules (or substantially similar disclosure reporting requirements) to avoid reporting obligations for the acquired company for the first fiscal year following the acquisition.

In addition to the two narrow exemptions provided for in the Adopted Rules, resource extraction issuers may apply for exemptive relief with the SEC as it relates to other situations. The SEC will consider such situations on a case-by-case basis using its existing authority under the Exchange Act.

Required Filing

Resource extraction issuers must file required disclosures on a Form SD on an annual basis no later than 150 days after its fiscal year end. As a required filing under the Exchange Act, disclosures made on a Form SD will be subject to liability for misleading statements pursuant to Section 18 of the Exchange Act. The disclosed information must be included in exhibit form and electronically tagged using eXtensible Business Reporting Language (XBRL) format. The following information must be disclosed on a Form SD:

- the type and total amount of payments made for each project;
- the type and total amount of payments made to each government;
- the total amount of payments made by category;
- the currency used to make the payments;
- the fiscal year in which payments were made;
- the company's business segment that made the payments;

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- 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 SEC did not offer guidance in the Adopted Rules regarding penalties for failing to timely file a Form SD. However, the staff of the SEC expressly noted in its previously published Frequently Asked Questions that failure to timely file a Form SD will not affect the issuer's eligibility to use a Form S-3.

Resource extraction issuers must comply with the Adopted Rules for fiscal years ending on or after September 30, 2018.

Alternative Reporting

Resource extraction issuers can also meet their reporting obligations under the Adopted Rules by complying with a foreign jurisdiction's or the U.S. Extractive Industries Transparency Initiative's resource extraction payments disclosure requirements to the extent such requirements are deemed "substantially similar" by the SEC. This alternative reporting measure allows a resource extraction issuer that has already prepared a report with another jurisdiction having "substantially similar" requirements as the SEC to avoid costs associated with having to prepare a separate report pursuant to the Adopted Rules. Pursuant to a separate order issued on the same day as the Adopted Rules, the SEC issued an order recognizing the EU Accounting Directive and the EU Transparency Directive, Canada's Extractive Sector Transparency Measures Act and the U.S. Extractive Industries Transparency Initiative in their current forms as disclosure rules "substantially similar" to the Adopted Rules for the purposes of alternative reporting. In order to utilize the alternative reporting measures under the Adopted Rules, the resource extraction issuer must meet the following requirements:

- the resource extraction issuer must be subject to an alternative jurisdiction's reporting requirements;
- the report filed under the Adopted Rules must be the same report filed and made publicly available in accordance with the alternative jurisdiction's reporting requirements, subject to changes necessary to comply with the SEC's alternative reporting conditions;
- the resource extraction issuer must include in the body of the Form SD that (i) it is relying on the alternative reporting provision of the Adopted Rules and (ii) identify the alternative reporting jurisdiction for which the report was prepared;
- the report must be XBRL formatted; and
- a fair and accurate English translation of the entire report must be filed if the report is in a foreign language.

Under the Adopted Rules, a resource extraction issuer may follow the submission deadline of an approved alternative jurisdiction, provided, that the issuer file a notice on Form SD-N on or before the due date of its Form SD indicating its intent to file the alternative report using the alternative jurisdiction's timeline. To deter abuse of this accommodation, the

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Adopted Rules provide that if an issuer fails to submit such notice on a timely basis, or submits such notice but fails to submit the alternative report within two (2) business days of the alternative jurisdiction's deadline, it will be ineligible for the alternative reporting accommodation for the following fiscal year.

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