haynesboone

August 2, 2016

Dodd-Frank Rulemaking Redux: The SEC Adopts Again a Resource Extraction Payments Disclosure Rule

By: Bill Nelson and Marc Folladori

On June 27, 2016, the U.S. Securities and Exchange Commission (the "**SEC**," or the "**Commission**") adopted rules authorized under Section 1504 of the Dodd-Frank Wall Street Reform and Consumer Protection Act ("**Dodd-Frank Act**"),[1] requiring extractive industry companies to disclose certain payments they make to governments. These rules (the "**Final Rules**") obligate oil and natural gas producers and mining companies that file annual reports with the SEC under the Securities Exchange Act of 1934 (the "**Exchange Act**") to report annually the payments they make to the U.S. federal government or any foreign government for the commercial development of oil, natural gas or minerals.[2]

The Final Rules are for the most part substantially the same as the rules proposed by the Commission in December 2015 (the "**Proposed Rules**"), described in our Securities Alert: "The SEC's Resource Extraction Payments Disclosure Rule Gets a Do-Over" (Jan. 7, 2016).[3] However, the Final Rules modified certain provisions in the Proposed Rules, and added some new provisions, some of which should prove helpful to hydrocarbon and mining companies required to report under the rules.

The SEC had adopted rules to implement Section 1504 in 2012,[4] but those rules were vacated in 2013 by the U.S. federal district court for the District of Columbia. The court found that the SEC had misread Section 1504 to compel public disclosure of companies' payments in their reports instead of a compilation, and that the SEC's explanation for not granting any exemptions to the disclosure requirements was arbitrary and capricious.[5]

Background. The legislative history for Section 1504 indicates that it was intended to promote increased transparency as to payments made by oil, gas and mining companies, or "resource extraction issuers," to foreign governments for the commercial development of their resources. It was anticipated that providing this transparency would help empower citizens of resource-rich countries to hold their governments accountable for the revenues generated by those resources, and thereby reduce opportunities for corruption by government officials.[6]

Section 1504 added a new Section 13(q)[7] to the Exchange Act, under which the Commission adopted new Exchange Act Rule 13q-1 and its related disclosure form, Form SD. Item 2.01 of Form SD contains the substantive disclosure requirements under the Final Rules, plus definitions of certain terms and instructions that help interpret certain critical terms.

---

1 Dodd-Frank Wall Street Reform and Consumer Protection Act, Pub. L. No. 111-203, § 929-Z, 124 Stat. 1376, 1871 (2010).

2 "Disclosure of Payments by Resource Extraction Issuers," SEC Rel. No. 34-78167 (June 27, 2016) (the "Final Rules Release").

3 " Disclosure of Payments by Resource Extraction Issuers," SEC Rel. No. 34-76620 (Dec. 11, 2015). The Securities Alert can be found at http://www.haynesboone.com/news-and-events/news/alerts/2016/01/07/the-secs-resource-extraction-payments-disclosure-rule-gets-a-do-over.

4 "Disclosure of Payments by Resource Extraction Issuers," SEC Rel. No. 34-67717 (Aug. 22, 2012).

5 *American Petroleum Institute, et al. v. Securities and Exchange Commission and Oxfam America, Inc*., 953 F. Supp. 2d 5 (D.D.C., 2013).

6 156 CONG REC. S3816 (May 17, 2010).

7 15 U.S.C. 78m(q).

Initial Compliance. An issuer subject to the Final Rules will first be required to comply with them with respect to its fiscal year that ends on or after September 30, 2018. A Form SD reporting payments under Rule 13q-1 must be filed within 150 days after the end of the issuer's fiscal year. Thus, barring the unforeseen (such as another challenge to the rules), an issuer having a calendar-year fiscal year will initially be required to comply with the new rules regarding its fiscal year ending December 31, 2018, and must file its first Rule 13q-1 Form SD on or before May 30, 2019.[8]

Developments Since Adoption of the Former Rules. In the Final Rules Release, the SEC cited paragraph (2)(E) of Section 13(q), which provides that "[t]o the extent practicable, the rules . . . shall support the commitment of the federal government to international transparency promotion efforts relating to the commercial development of oil, natural gas, or minerals."[9]

Ultimately proving beneficial for the SEC in its rulemaking were the international legislative developments and other initiatives supporting global transparency occurring over the six-year period during which the SEC had proposed, adopted and litigated its Section 13(q) rules. Since 2012, international transparency legislation has taken effect in the European Union, Canada and other countries, and the scope of the Extractive Industries Transparency Initiative ("**EITI**") has been expanded.[10] The Final Rules Release notes that one or more of these laws or initiatives already apply to a significant percentage of the issuers covered by the Final Rules.[11]

European Union. In 2013, the European Parliament and Council of the European Union adopted the EU Accounting Directive and EU Transparency Directive (the "**EU Directives**"), which include payment disclosure rules similar to the 2012 rules that had been adopted by the SEC, but were subsequently vacated.[12] In fact, in many respects the EU Directives were modeled on these former 2012 rules.[13] The EU Directives apply their disclosure requirements to all "large" companies incorporated under the laws of a European Economic Area member state, and to all companies listed on EU-regulated securities markets, even if not incorporated in an EU member country.[14] Notably, the EU Directives require annual public disclosures on a per-government and per-project basis, without exemptions.[15]

---

[8] Of course, Form SD is already in use by companies required to report under the conflict minerals disclosure rules adopted under Section 1502 of the Dodd-Frank Act. *See* Exchange Act Rule 13p-1.

[9] 15 U.S.C. 78m(q)(2)(E).

[10] *See* https://eiti.org/. The Extractive Industries Transparency Initiative is an international voluntary coalition formed in 2002, comprised of oil, natural gas and mining companies, foreign governments, investor groups, civil society and other international organizations. It describes itself as an organization dedicated to fostering transparency and accountability in resource-rich countries by publishing and verifying oil, gas and mining companies' payments, and the government revenues therefrom.

[11] The Final Rules Release indicates that approximately 31 percent of the SEC-registered likely covered issuers would be subject to disclosure requirements in foreign jurisdictions having disclosure regimes that are substantially similar to the Final Rules. *See* note 618 and accompanying text of the Final Rules Release.

[12] *See* note 4 supra and ac companying text.

[13] *See, e.g.,* comment letter from Publish What You Pay UK (July 9, 2015) at http://www.sec.gov/comments/df-title-xv/resource-extraction-issuers/resource-extraction-issuers.shtml.

[14] The EU Directives came into legal force in the United Kingdom in late 2014. As a result, an estimated 220 UK-incorporated and UK-listed oil, gas and mining companies will be required to issue publicly-available annual reports of all payments (above a certain threshold amount) made to governments for extractive activities, beginning in 2016 for most covered companies.

[15] The EU Directives also apply to logging companies, which are not covered by Section 13(q). According to the Final Rules Release, as of June 16, 2016, 26 EU companies (including Germany, Italy, Spain and the UK) had filed notifications of full transposition of the Accounting Directive with the European Commission. In addition, Norway, which is not a member of the EU, has adopted legislation that similar to the EU Directives.

Canada. Canada has adopted the Extractive Sector Transparency Measures Act ("**ESTMA**"), a resource extraction payments disclosure law that is similar to the EU Directives and the SEC's former 2012 rules. The ESTMA came into force on June 1, 2015, and ESTMA Guidance and ESTMA Technical Reporting Specifications have been finalized.[16]

EITI. In the Final Rules Release, the SEC said that it had looked to the EITI in drafting its rules because the EITI is (i) a "significant international transparency framework," (ii) mentioned in the legislative history of Section 13(q) and (iii) explicitly referenced in the definition of "payment" in Section 13(q).[17] Currently, 51 countries are EITI-implementing countries.[18] The United States Extractive Industries Transparency Initiative ("**USEITI**") issued its first report in December 2015, reporting on payments made to the U.S. federal government.[19] More than 90 of the world's largest oil, gas and mining companies are EITI "supporting companies." Since 2012, each country's report must disclose information on individual projects and payments by each company, presented by each individual payment type and each governmental agency.

Disclosures by Companies. The Final Rules Release also indicates that numerous companies have already been disclosing their resource extraction payments to governments, either as required or voluntarily. Notably, Royal Dutch Shell, Total, Tullow Oil, BHP Billiton, Statoil and Kosmos Energy have disclosed their payment information on a per-project basis.[20]

This evolution in global transparency efforts served to reinforce the SEC's views expressed in the Final Rules Release that public disclosure of all of the information required to be submitted under Section 13(q) was the correct reading of the statute, instead of merely a compilation summarizing that information.

Commercial Development of Oil, Natural Gas or Minerals. Companies engaged in the "commercial development of oil, natural gas or minerals" that file Form 10-K, 20-F or 40-F annual reports with the SEC are subject to Section 13(q)'s reporting obligations. Like the Proposed Rules, the Final Rules adopted Section 13(q)'s definition of "commercial development of oil, natural gas or minerals," to mean "exploration, extraction, processing and export of oil, natural gas or minerals, or the acquisition of a license for any such activity."

The Final Rules Release confirms that the definition is focused only on issuers engaged in the extraction or production of oil, natural gas or minerals. Ordinary operations of oilfield service and equipment companies and their counterparts in the mining industry are not intended to be covered by Section 13(q). However, where an oilfield services provider, on behalf of a resource extraction issuer, pays a sum to a government meeting the definition of "payment," the resource extraction issuer (not the service provider) will be required to disclose those payments.

The Final Rules provide additional clarification regarding what constitutes a covered "export." The movement of a resource across an international border by an issuer that (i) is not engaged in the exploration, extraction or

---

[16] Extractive Sector Transparency Measures Act ("ESTMA"), 2014 S.C. 2014, ch. 39, S. 376 (Can.); *see* https://www.nrcan.gc.ca/acts-regulations/17727 .

[17] *See* note 10 *supra*, and note 39 of the Final Rules Release and accompanying text. Section 13(q)'s definition of "payment" includes "other material benefits" that the SEC, "consistent with the guidelines of the Extractive Industries Transparency Initiative (to the extent practicable), determines are part of the commonly recognized revenue stream for the commercial development of oil, natural gas or minerals."

[18] When becoming an EITI candidate, a country must establish a multi-stakeholder group that includes representatives of civil society, industry, and government, to oversee implementation of the EITI in that country. The United States became a member country in 2014, and its implementing group is the United States Extractive Industries Transparency Initiative. *See* https://useiti.doi.gov/; *see also* Final Rules Release at note 87 and accompanying text.

[19] USEITI 2015 Report at https://useiti.doi.gov/about/report/

[20] *See* Final Rules Release at note 302 and accompanying text.

processing of hydrocarbons or minerals and (ii) acquired its ownership interest in the resource directly or indirectly from a foreign government or the U.S. federal government is not covered by the rules. Transportation of resources on a fee-for-service basis by a service provider having no ownership interest in the resources being transported is not intended to be captured by the rules.

Rule 13q-1(b) includes an anti-evasion provision stating that any attempts to re-characterize an otherwise-disclosable activity or payment as one that is not required to be disclosed may be considered to be part as of a plan or scheme to evade the rules' disclosure requirements.

Payment. "Payment" is defined in Form SD as an amount that:

- Is made to further the commercial development of oil, natural gas, or minerals;
- Is not *de minimis*; and
- Falls into one or more of the following categories:
    - Taxes;
    - Royalties;
    - Fees;
    - Production entitlements;
    - Bonuses;
    - Dividends;
    - Payments for infrastructure improvements; and
    - Community and social responsibility payments that are required by law or contract.

The definition of payment is identical to that found in the Proposed Rules, except that the Final Rules added the category of "community and social responsibility" ("**CSR**") payments (such as payments by an issuer to build a hospital or school) required by law or contract. The Proposed Rules did not require disclosures of CSR payments.

Persuaded by disclosure proponents' comments and other factors, the SEC determined that CSR payments paid by an issuer to a government are part of the commonly recognized revenue stream for the commercial development of hydrocarbons or minerals, so long as the payments are legally obligated to be made by law or by contract.[21] The SEC noted that CSR payments are included as one of the types of payments covered under the EITI guidelines (although the EU Directives and ESTMA do not include CSR payments as a covered payment type).

A "not *de minimis*" payment is one that equals or exceeds $100,000, or its equivalent in the issuer's reporting currency, whether made as a single payment or a series of related payments.

Instruction 2 to Item 2.01 allows an issuer to choose among several methods to calculate currency conversions for payments not made in U.S. dollars or the issuer's reporting currency, so long as the method used for such conversions is disclosed and that method is applied with respect to all such currency conversions in the Form SD.

Payments made for taxes on corporate profits, corporate income and production must be disclosed. However, disclosure is not required for taxes levied on consumption, such as value-added taxes, personal income taxes,

[21] *See* Final Rules Release note 207 and accompanying text.

or sales taxes. If a government levies a tax or other payment obligation at the entity level instead of with regards to a particular project, the issuer may disclose that payment at the entity level only, and omit disclosing items that are not applicable (such as project, business segment, etc.).[22]

The Final Rules add a new instruction that provides a non-exclusive list of the types of royalties that must be disclosed, which include unit-based, value-based and profit-based royalties.[23] Dividends need not be disclosed where they are received by a government as a common or ordinary shareholder of the issuer on the same terms as other shareholders. However, any dividends paid by the issuer in lieu of production entitlements or royalties must be disclosed. Payments for infrastructure improvements, such as constructing a road or railway to further the development of the subject resource, must be disclosed.

As the case with the Proposed Rules, payments covered by the definition that are made "in-kind," such as payments to a government in crude oil, must be disclosed. The monetary value of an in-kind payment may be reported at cost (or its fair market value if cost is not determinable), and must be accompanied by a brief description of how the monetary value was calculated. The Final Rules contain clarifying guidance on how to report an in-kind production entitlement that is subsequently purchased by the issuer.

Payments Made by Subsidiaries and "Controlled" Entities. Disclosure is required for payments made by a subsidiary of the issuer or another entity under the control of the issuer. The Final Rules, like the Proposed Rules, define the terms "subsidiary" and "control" by reference to accounting principles rather than to Exchange Act Rule 12b-2.[24] "Control" is defined in Item 2.01 of Form SD to mean that the resource extraction issuer consolidates the entity, or proportionately consolidates its interest in the entity, under accounting principles applicable to the issuer's financial statements included in its periodic reports filed with the SEC. "Subsidiary" is defined applying the same contextual meanings. This definitional concept is consistent with the EU Directives and ESTMA, and should provide more clarity in preparing Form SDs.

Form SD. The provisions of the Final Rules concerning the content of the required annual disclosures on Form SD were adopted substantially as proposed.[25] The required information would be included in an exhibit to the Form SD and electronically tagged using the extensible Business Reporting Language ("**XBRL**") electronic format.

Information submitted in a Form SD will be deemed "filed" rather than "furnished," making the disclosures subject to Exchange Act liability under Section 18. However, the information filed in the Form SD will not be incorporated by reference into any filings made under the Securities Act of 1933 or the Exchange Act unless the issuer specifically incorporates it by reference into the filing.

Item 2.01 of Form SD defines "foreign government" as including a department, agency or instrumentality of a foreign government, or an entity that is majority-owned by a foreign government (such as a state-owned oil company). Foreign subnational governments such as states, provinces, counties, municipalities or territories are intended to be included.

The information that must be included in the Form SD exhibit and presented in XBRL electronic format is the same as that contained in the Proposed Rules:

---

[22] Instruction 4 to Item 2.01 of Form SD.
[23] *See* Instruction 9 to Item 2.01 of Form SD.
[24] The terms "control" and "subsidiary," as defined in Rule 12b-2, apply the traditional federal securities laws' notion of "control" – *i.e.*, possessing the power to direct or cause the direction of the management and policies of a person, whether through the ownership of voting securities, by contract, or otherwise.
[25] The separately-filed Form SD will not require officer certifications under Rules 13a-14 and 15d-14 under the Exchange Act as in the case of annual reports on Form 10-K, 20-F or 40-F.

- The total amounts of the payments, by category;
- The currency used to make the payments;
- The financial period in which the payments were made;
- The business segment of the issuer that made the payments;
- The government receiving the payments and the country where the government is located;
- The project of the resource extraction issuer to which the payments relate;
- The type and total amount of payments made for each project;
- The type and total amount of payments for all projects made to each government;
- The particular resource that is the subject of commercial development; and
- The subnational geographic location of the project.

Paragraph (a) of Item 2.01 now makes clear that the payment information is not required to be audited, and that the payment information must be provided on a cash basis and not on an accrual basis.

An instruction to Item 2.01 is intended to assist issuers in describing the "subnational geographic location" of the project. The Final Rules added a requirement for companies to use the country codes and subdivision codes provided in ISO 3166 (if available) to identify the particular country in which a government is located and the subnational geographic location of the project.[26]

Per-Project Reporting. One of the topics generating the highest volume of comments was the degree of granularity required to identify each project. Many industry commentators, including the American Petroleum Institute, objected to the proposed definition of "project" on various grounds, including that it would increase the potential for competitive harm. The Final Rules Release states the SEC's belief that the potential for competitive harm is lessened by the fact that since 2012, the EITI, EU Directives and ESTMA have required project-level disclosures and have adopted definitions of the term "project" similar to that contained in Item 2.01.

The definition of project under the Final Rules is the same as proposed, meaning operational activities governed by a single contract, license, lease, concession or similar legal agreement, which forms the basis for payment liabilities with a government. Agreements "operationally and geographically interconnected" may be treated by the issuer as a single "project."[27]

Instruction 12 to Item 2.01 of Form SD provides a non-exclusive list of factors to consider when determining whether agreements are "operationally and geographically interconnected" when identifying a project. The factors are whether the agreements (i) relate to the same resource and the same or contiguous part of a field, mineral district or other geographic area, (ii) will be performed by shared key personnel or with shared equipment, and (iii) are part of the same operating budget.

Exemptions. The Final Rules, like the Proposed Rules, contain a provision permitting issuers to request, on a case-by-case basis, exemptions from Rule 13q-1's reporting requirements in accordance with existing authority

[26] Instruction 3 to Item 2.01 of Form SD. ISO 3166 is a standard published by the International Organization for Standardization (ISO) that defines codes for the names of countries, dependent territories, special areas of geographical interest and their principal subdivisions (*e.g.*, provinces or states).

[27] In order for operationally and geographically interconnected multiple agreements to be considered a single project under the EU Directives and the ESTMA Guidelines, the agreements must have "substantially similar terms." The definition of "project" in the Final Rules contains no such requirement.

under the Exchange Act.[28] Industry commenters had argued for a number of blanket exemptions (particularly where disclosures are prohibited by law or contract), but the SEC continued to believe that a case-by-case approach is preferable.

However, to meet the concerns of certain commenters, the Final Rules (in Item 2.01(b) of Form SD) feature two limited exemptions to the reporting obligations:

- An issuer that has acquired or obtains control over a company not previously subject to the rules (or another "substantially similar" jurisdiction's requirements) will not be required to report payment information for the acquired company until the filing of the Form SD for the fiscal year immediately following the effective date of the acquisition. In that case, the issuer must disclose that it is relying on this accommodation in the body of its Form SD.
- An issuer may delay reporting payments related to exploratory activities until the filing of the Form SD for the fiscal year immediately following the fiscal year in which the payment was made. "Exploratory activities" include identifying prospective areas or examining areas that have prospects of containing oil and gas reserves, or being a part of a mineral exploration program. In each case, the exemption is not available 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.

Alternative Reporting. If the issuer is subject to resource extraction payment disclosure requirements under another reporting regime, the issuer may satisfy the disclosure requirements under the Final Rules by filing a report that complies with the requirements of the alternative regime, so long as the SEC has determined that the regime is "substantially similar" to the SEC's. [29]

The issuer must provide the alternative report in XBRL format and translate the alternative regime report to English if the report is in is a foreign language. Otherwise, the alternative report must be the same as the report made publicly available in the alternative regime's jurisdiction, and will be subject to any changes necessary to comply with any conditions to alternative reporting set by the SEC. Additionally, the issuer must state in its Form SD that it is relying on the alternative reporting provisions, identify the alternative reporting regime and describe how to access the report in the alternative jurisdiction.

Governments, companies, industry groups and trade associations may apply for alternative reporting regime recognition.

On the same day that the Final Rules were announced, the SEC issued an order finding that (i) the EU Directives as implemented in a European Union or European Economic Area member country, (ii) Canada's ESTMA and (iii) the USEITI were "substantially similar" to the Final Rules, and therefore may be relied upon for alternative reporting purposes.[30] Due to its more limited scope, the USEITI disclosure regime may be relied upon only to report payments made to the U.S. federal government, not to foreign governments, and the USEITI report must be supplemented so that the required information can be provided on a fiscal-year basis and meet the Form SD requirements as to reporting years and filing dates.

Practical Take-aways. Although resource extraction issuers are not be required to comply with the disclosure requirements of the Final Rules until 2018 at the earliest, there are some steps that issuers should begin taking now to prepare for their implementation:

---

[28] *See* Section 36(a) of the Exchange Act (15 U.S.C. 78mm(a)) and Exchange Act Rule 0-12.
[29] Item 2.01(c) of Form SD.
[30] SEC Rel. No. 34-78169, "Order Recognizing the Resource Extraction Payment Disclosure Requirements of the European Union, Canada and the U.S. Extractive Industries Transparency Initiative as Substantially Similar to the Requirements of Rule 13q-1 under the Securities Exchange Act of 1934" (June 27, 2016).

- Issuers should examine their relevant contracts, such as leases, concessions and production-sharing agreements, with governments or state-owned enterprises to begin assessing what would be identified as a "project" for reporting purposes.
- If contracts with governments or the laws of a subject country contain provisions that prohibit or restrict disclosures required by the Final Rules, issuers should consider now whether making application to the SEC to seek an exemption from such disclosure is warranted. The time it would likely take for any process of applying for and being granted an exemption should be assumed to be lengthy, particularly before there has been any track record established for issuers dealing with the SEC on this particular topic.
- By 2017, there should be ample examples of country-by-country and project-by-project reporting made publicly available in non-U.S. jurisdictions, such as the UK, other EU countries and Canada. In preparation for reporting, issuers should review and analyze the disclosures in these reports, taking into account each issuer's particular circumstances.
- Finally, issuers should begin now assessing how they will track their payments for reporting purposes under the Final Rules. The release accompanying the Proposed Rules cited comments from issuers claiming that their expected costs to comply with the rules could be significant, given the rules' requirements for cash-basis reporting by project, governmental entity and currency.[31] Whether by 2018 that will still be the case, in light of the other reporting regimes in place requiring payments-to-governments disclosures, remains to be seen.

For more information contact one of the lawyers below:

Brian Barnard +1 817.347.6605 brian.barnard@haynesboone.com	Ryan R. Cox +1 214.651.5273 ryan.cox@haynesboone.com	Marc H. Folladori +1 713.547.2238 marc.folladori@haynesboone.com
Matthew L. Fry +1 214.651.5443 matt.fry@haynesboone.com	Kendall Hollrah +1 713.547.2089 kendall.hollrah@haynesboone.com	Greg Kramer +1 212.835.4819 greg.kramer@haynesboone.com
William B. Nelson +1 713.547.2084 bill.nelson@haynesboone.com	Bruce Newsome +1 214.651.5119 bruce.newsome@haynesboone.com	Gregory R. Samuel +1 214.651.5645 greg.samuel@haynesboone.com
Janice V. Sharry +1 214.651.5562 janice.sharry@haynesboone.com	Alan Talesnick +1 720.484.3712 alan.talesnick@haynesboone.com	Kristina Trauger +1 713.547.2030 kristina.trauger@haynesboone.com
Rick A. Werner +1 212.659.4974 rick.werner@haynesboone.com		

[31] *See* note 356 and accompanying text contained in SEC Rel. No. 34-76620 (cited in note 3 *supra*). Some commenters had said that modifications would be required to their enterprise resource planning and financial reporting systems in order to capture and report, on a cash basis, payment data at the project level for each type of payment, government payee and currency.