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SEC Re-Proposes Rules for Resource Extraction Issuers Under Dodd-Frank Act

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On December 11, 2015, the Securities and Exchange Commission (the “SEC”) proposed rules required under Section 1504 of the Dodd-Frank Wall Street Reform and Consumer Protection Act (the “Act”). Section 1504 of the Act added Section 13(q) to the Securities Exchange Act of 1934 (the “Exchange Act”), which directs the SEC to issue rules requiring resource extraction issuers to include in an annual report information 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 purposes of the commercial development of oil, natural gas, or minerals.

The proposed rules are subject to two comment periods. Initial comments are due on January 25, 2016. Reply comments, which may only respond to issues raised in the initial comment period, are due on February 16, 2016. In developing the final rules, the SEC will rely on both new comments and comments that have been received to date, including those which were provided in connection with the prior rules that the SEC issued under Section 13(q) (as described below).

BACKGROUND OF THE PROPOSED RULES

The SEC has previously proposed rules on this topic. On August 22, 2012, the Commission adopted final rules and related amendments (the “2012 Rules”) to implement Section 13(q) of the Exchange Act. The 2012 Rules were vacated by the U.S. District Court for the District of Columbia, which based its decision on two findings: first, that the SEC misread Section 13(q) to compel the public disclosure of the issuers’ reports; and second, the SEC’s explanation for not granting an exemption for when disclosure is prohibited by foreign governments was arbitrary and capricious. In 2014, Oxfam America, Inc. filed suit in the U.S. District Court for the District of Massachusetts to compel the SEC to promulgate a final rule implementing Section 1504. On September 2, 2015, the court issued an order holding that the SEC unlawfully withheld agency action by not promulgating the final rule, and the SEC filed an expedited schedule for promulgating the final rule; pursuant to that proposed expedited schedule, the SEC would vote on the adopting of a final rule in June 2016.

Several international developments have occurred since the 2012 Rules were vacated. The European Parliament and Counsel of the European Union have adopted two directives that include payment disclosure rules similar to the guidelines of the 2012 Rules. Canada also adopted a federal resource extraction disclosure law. In addition, there has been significant progress in the approach of the Extractive Industries Transparency Initiative, which is a global standard – implemented by several countries worldwide – to promote open and accountable management of natural resources. Further, since the 2012 Rules were vacated, numerous parties have also submitted comment letters to the SEC that provide recommendations on how the SEC could structure the rules required by Section 13(q) in light of the court’s findings and international developments. These developments were considered in connection with the framing of the proposed rules.

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The 2012 Rules and the proposed rules differ in a number of ways. First, the proposed rules would define the terms “subsidiary” and “control” based on accounting principles rather than using the definitions of those terms provided in Rule 12b-2 of the Exchange Act. Second, the proposed rules would define the term “project” – modeled on the definition found in EU directives and other specifications – to afford resource extraction issuers additional flexibility on how to treat operations involving multiple, related contracts, rather than leave it undefined. Third, the proposed rules would allow resource extraction issuers to apply for exemptive relief with the SEC, to be granted on a case-by-case basis. Fourth, under the proposed rules, a resource extraction issuer may be deemed to be in compliance if it files on Form SD a report providing disclosures that comply with a foreign jurisdiction’s rules or that meet the USEITI reporting requirements (as described below), if the SEC has determined that those rules or requirements are substantially similar to the rules adopted under Section 13(q).

OPERATION OF THE PROPOSED RULES

Form SD. In general, Section 13(q) requires a “resource extraction issuer” to file a Form SD on an annual basis that includes information about “payments” to a foreign government or the federal government made for each “project” related to “the commercial development of oil, natural gas, or minerals” and the type and total amount of payments made to each government.

XBRL. In addition, Section 13(q) requires a resource extraction issuer to provide information about those payments in an interactive data format.

“Resource Extraction Issuers” Subject to the Proposed Rules

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.

Required Disclosures of “Payments”

Section 13(q) defines “payment” to mean a payment that:

- Is made to further the commercial development of oil, natural gas, or minerals;
- Is not *de minimis* (i.e., any payment, whether a single payment or a series of related payments, that equals or exceeds \$100,000 during the most recent fiscal year); and
- Includes taxes, royalties, fees (including license fees), production entitlements, bonuses, and other material benefits that the Commission determines are part of the commonly recognized revenue stream for the commercial development of oil, natural gas, or minerals. The proposed rules include dividends and payments for infrastructure improvements in this definition.

The proposed rules would also require disclosure of activities or payments that, although not within the categories included in the proposed rules, are part of a plan or scheme to evade the disclosure requirements under Section 13(q).

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In addition to payments it makes directly, a resource extraction issuer would be required to disclose payments made by its subsidiaries and other entities under its control. An issuer would disclose those payments that are included in its consolidated financial statements made by entities that are consolidated or proportionately consolidated, as determined by applicable accounting principles.

Required Disclosures of Payments for “Projects”

The proposed rules would require a resource extraction issuer to disclose payments made to governments relating to the commercial development of oil, natural gas, or minerals by type and total amount per project. The SEC is defining “project” consistently with EU directives and the Canadian definitions 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.

The definition of “project” would allow issuers to treat multiple agreements that are both operationally and geographically connected as a single project; these agreements need not have substantially similar terms. For purposes of determining whether agreements are “operationally and geographically connected,” issuers may consider a non-exclusive list of factors: whether the agreements relate to the same resource and the same or contiguous part of a field, mineral district, or other geographic area, whether they will be performed by shared key personnel or with shared equipment, and whether they are part of the same operating budget.

Required Disclosure of Projects Related to the “Commercial Development of Oil, Natural Gas, or Minerals”

The term “commercial development of oil, natural gas, or minerals” would mean exploration, extraction, processing, and export, or the acquisition of a license for any such activity.

Payments to “Foreign Government” and “Federal Government”

For purposes of the proposed rules, the term “foreign government” would mean a foreign national government as well as a foreign subnational government, such as the government of a state, province, county, district, municipality, or territory under a foreign national government, consistent with Section 13(q).

The term “federal government” would mean the United States Federal Government.

Disclosure Required and Form of Disclosure

The proposed rules indicate that resource extraction issuers should provide the required disclosure about payments on Form SD. As proposed, Form SD would require issuers to include a brief statement in the body of the form in an item entitled, “Disclosure of Payments by Resource Extraction Issuers,” directing readers to the detailed payment information provided in the exhibits to the form.

The proposed rules would not require the resource extraction payment information to be audited or provided on an accrual basis. In addition, these “payments” need not be included in the financial statements.

As the disclosure under the proposed rules will not be provided in an issuer’s Exchange Act annual reports on Forms 10-K, 20-F, or 40-F, the disclosure will not be subject to the officer certifications required by Exchange Act Rules 13a-14 and 15d-14.

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The proposed rules would require resource extraction issuers to file Form SD publicly on EDGAR no later than 150 days after the end of the issuer's most recent fiscal year.

No Exemptions

The proposed rules would not include any express exemptions. Instead, resource extraction issuers could apply for, and the SEC would consider, exemptive relief on a case-by-case basis.

Alternative Reporting

Several countries have implemented resource extraction payment disclosure laws since the 2012 Rules were vacated. In addition, in 2014, the United States became an EITI candidate country, adopting a standard known as the U.S. Extractive Industries Transparency Initiative ("USEITI").

In light of these developments, the proposed rules would allow, in certain circumstances, resource extraction issuers in a foreign jurisdiction to file the report it prepared under those foreign requirements in lieu of the report that would otherwise be required by the SEC's disclosure rules. The proposed rules would permit compliance under this framework only after the SEC has determined that the foreign disclosure requirements are substantially similar to the requirements of its rules.

The alternative reporting provision would also be extended, to the extent appropriate, to reports submitted in full compliance with the USEITI reporting standards, provided that the SEC has determined that the disclosures required thereunder are substantially similar to the final rules under Section 13(q).

Exhibits and Interactive Data Format Requirements

Resource extraction issuers would be required to present the payment disclosure using the XBRL electronic format and the electric tags identified in Item 2.01 of Form SD. These tags would identify the following for any payment required to be disclosed:

- 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 resource extraction issuer that made the payments;
- The government that received the payments and the country in which the government is located; and
- The project of the resource extraction issuer to which the payments relate.

In addition, a resource extraction issuer would also be required to provide and tag the type and total amount of payments made for each project and the type and total amount of payments for all projects made to each government. These additional tags relate to information that is specifically required to be included in the resource extraction issuer's annual report by Section 13(q).

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Treatment for Purposes of Securities Act and Exchange Act

The information required by Section 13(q) is required to be “filed” and will not be deemed to be furnished. However, Section 18 does not create strict liability for filed information; rather, it states that a person shall not be liable for misleading statements in a filed document if such person can establish that he or she acted in good faith and had no knowledge that the statement was false or misleading.

Effective Date

Resource extraction issuers generally would be required to comply with the rules starting with their fiscal year ending no earlier than one year after the effective date of the adopted rules.

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