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SEC Reproposes Rules for Resource Extraction Issuers

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The Proposed Rules call for enhanced disclosures by companies in the oil, natural gas, and mining industries.

On December 11, the ***Securities and Exchange Commission*** (SEC or the Commission) reproposed rules (the Proposed Rules) [1] that would require certain publicly traded oil, natural gas, and mining companies to provide disclosure relating to payments made to US federal and foreign governments for the commercial development of oil, natural gas, or minerals.

Background

The resource extraction disclosure rules were proposed pursuant to section 1504 of the Dodd-Frank Wall Street Reform and Consumer Protection Act, which added section 13(q) of the Exchange Act. Section 1504 directs the Commission to issue rules requiring resource extraction issuers to include in an annual report information relating to any payment made by an issuer, a subsidiary of an issuer, or an entity under the control of an issuer to the US federal government or a foreign government in connection with the commercial development of oil, natural gas, or minerals.

Description of Proposed Rules

Definitions of Key Terms

Understanding the terms used in the Proposed Rules is important for issuers to determine if and the extent to which the rules and related disclosures will apply to them.

> *Resource Extraction Issuer*: The Proposed Rules would apply to any issuer that (i) is required to file an annual report with the Commission pursuant to section 13 or section 15(d) of the Exchange Act (i.e., issuers that file annual reports on Forms 10-K, 20-F, and 40-F) and (ii) engages in the commercial development of oil, natural gas, or minerals. Resource extraction issuers also must disclose payments made by a subsidiary or other controlled entity (as determined by reference to the financial consolidation principles used by an issuer in its audited financial statements).[2] If a resource extraction issuer is controlled by another resource extraction issuer that has filed a Form SD disclosing the required information for the

controlled entity, the controlled entity would not be required to file separate disclosure. In such circumstances, the controlled entity must file a notice on Form SD indicating that the controlling entity filed the required disclosure, identifying the controlling entity, and the date of the filed disclosure. Additionally, the controlling entity must note that it is filing the required disclosure for a controlled entity and must identify the controlled entity on its Form SD filing.

Commercial Development of Oil, Natural Gas, or Minerals: "Commercial development of oil, natural gas, or minerals" means the exploration, extraction,[3] processing,[4] and export[5] of oil, natural gas, or minerals or acquiring a license for any such activity.

The Proposed Rules expressly state that commercial development of oil, natural gas, or minerals is not intended to capture activities that are ancillary or preparatory to such commercial development. Accordingly, the Commission would not consider an issuer that provides only services that support the exploration, extraction, processing, or export of such resources to be "resource extraction issuers," such as an issuer that manufactures drill bits or provides hardware to help companies explore and extract. Similarly, an issuer engaged by an operator to provide hydraulic fracturing or drilling services, thus enabling the operator to extract the resources, would not be considered a "resource extraction issuer."[6]

Types of Payments: "Payment" means an amount that (i) is made to further the commercial development of oil, natural gas, or minerals; (ii) is "not de minimis"; and (iii) is one or more of the following—taxes,[7] royalties, fees,[8] production entitlements,[9] bonuses,[10] dividends, and payments for infrastructure improvements.[11] A "not de minimis" payment is one that equals or exceeds $100,000 (or its equivalent in an issuer's reporting currency) during the fiscal year covered by Form SD, whether made as a single payment or in a series of related payments.

Payment Disclosure at a Project Level: The Proposed Rules would require payment disclosure on a project-level basis. "Project" means operational activities governed by a single contract, license, lease, concession, or similar legal agreement, which form the basis for payment liabilities with a government. Agreements that are both operationally and geographically interconnected may be treated by the resource extraction issuer as a single project.

Disclosure Scheme

The Proposed Rules would require resource extraction issuers to file an annual report on Form SD with the Commission and include as an exhibit to the Form information relating to any payment made during the fiscal year covered by the annual report by the resource extraction issuer to the US federal government or foreign government (including foreign subnational governments, such as the government of a state, province, country, district, municipality, or territory)[12] for the commercial development of oil, natural gas, or minerals that are "not de minimis." The resource extraction issuer would be required to provide a statement in the body of Form SD that the specified payment disclosure required by Form SD is included in the exhibit.

Scope of Disclosure

The proposed rules would require the following information in the exhibit to Form SD, which would have to be presented in the eXtensible Business Reporting Language (an electronic format):

- The 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
- The type and total amount of such payments for all projects made to each government
- The total amounts of the payments by specific type of payment category (e.g., taxes, royalties, etc.)
- The currency[13] 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 governments that received the payments, and the country in which the applicable 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
- The project's subnational geographic location

A resource extraction issuer may satisfy the above-described disclosure obligations by including as an exhibit to Form SD a report that complies with the reporting requirements of any alternative reporting regime deemed by the Commission to be substantially similar to the reporting requirements of Rule 13q-1 of the Exchange Act if the issuer states in the body of Form SD that it is relying on this provision and identifies the alternative reporting scheme for which the report was prepared. The resource extraction issuer would further have to state that the payment disclosure required by Form SD is included in an exhibit to the Form and state where the report originally was filed.[14]

Proposed Timeframe for Compliance

Form SD would need to be filed with the Commission within 150 days of the resource extraction issuer's fiscal year end. The requirement would take effect for fiscal years ending no earlier than one year after the adopted rules' effective date. For example, if the effective date is June 17, 2016, a resource extraction issuer with a fiscal year end of December 31 would be required to file Form SD within 150 days of December 31, 2017.

Comment Period

Initial comments on the Proposed Rules are due January 25, 2016, with reply comments (which may respond only to issues raised during the initial comment period) due on February 16, 2016.

Exemptions

The proposing release indicates that the Commission may use its existing authority under the Exchange Act to provide exemptive relief from the rules' requirements "at the request of a resource extraction issuer, if and when warranted." However, the proposed rules do not provide for bright-line exemptions.

Conclusion

As stated in the Proposed Rules, the rules aim to improve transparency "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 Proposed Rules also follow suit with respect to disclosure regimes that already have been implemented in other countries. However, as with the conflict minerals rules, the implementation of this new disclosure regime will surely contribute to the ever-increasing regulatory burden on issuers.

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[1]. Rule 13q-1 of the Securities Exchange Act of 1934, as amended (the Exchange Act), was initially adopted by the SEC on August 22, 2012, but it was subsequently vacated by the US District Court for the District of Columbia in 2013. In September 2015, a federal judge ruled that the SEC had "unlawfully withheld" agency action, stating that the "SEC is now more than four years past the deadline set by Congress for the promulgation of the final rule" and requiring that the SEC file an expedited schedule to finalize the rule within 30 days of the decision. Read the Reproposed Rules.

[2]. "Control" means that the resource extraction issuer consolidates the entity or proportionately consolidates an interest in an entity or operation under the accounting principles applicable to the financial statements included in the resource extraction issuer's periodic reports filed pursuant to the Exchange Act (i.e., under generally accepted accounting principles in the United States (US GAAP) or International Financial Reporting Standards as issued by the International Accounting Standards Board (IFRS), but not both). A foreign private issuer that prepares financial statements according to a comprehensive set of accounting principles, other than US GAAP or IFRS, and files with the Commission reconciliation to US GAAP must determine

[3]. The Proposed Rules define “extraction” to mean the production of oil and natural gas as well as the extraction of minerals.

[4]. The Proposed Rules provide that “processing” includes, but is not limited to, midstream activities, such as processing gas to remove liquid hydrocarbons, removing impurities from natural gas prior to its transport through a pipeline, and upgrading bitumen and heavy oil through the earlier of the point at which oil, natural gas, or gas liquids (natural or synthetic) are either sold to an unrelated third party or delivered to a main pipeline, a common carrier, or a marine terminal. “Processing” would also include crushing and processing raw ore prior to the smelting phase. However, the Proposed Rules state that processing should not include the downstream activities of refining and smelting.

[5]. The Proposed Rules define “export” to mean the movement of a resource across an international border from the host country to another country by a company with an ownership interest in the resource. Cross-border transportation activities by an issuer that functions solely as a service provider, with no ownership interest in the resource being transported, would not be considered to be export.

[6]. However, where a service provider makes a payment to a government on behalf of a resource extraction issuer that meets the definition of “payment” under the Proposed Rules, the resource extraction issuer would be required to disclose such payments.

[7]. The Proposed Rules clarify that “taxes” include those levied on corporate profits, corporate income, and production, but companies would not be required to disclose payments for taxes levied on consumption, such as value-added taxes, personal income taxes, or sales taxes. The Proposed Rules provide that issuers may disclose certain tax payments at the entity level rather than the project level.

[8]. The Proposed Rules define “fees” to include rental fees, entry fees, and concession fees.

[9] For in-kind payments, the Proposed Rules specify that issuers may report them at cost, or if cost is not determinable, fair market value, and provide a brief description of how the monetary value was calculated.

[10]. The Proposed Rules define “bonuses” to include signature, discovery, and production bonuses.

[11]. The Proposed Rules do not require a resource extraction issuer to disclose social or community payments, such as payments to build a hospital or school, because it is unclear whether these types of payments are part of the commonly recognized revenue stream.

[12]. The Proposed Rules clarify that “foreign government” includes companies owned by a foreign government that are at least majority-owned by such foreign government.

[13]. If an issuer has made payments in currencies other than US dollars or its reporting currency, it may choose to calculate the current conversion between the currency in which the payment was made and US dollars or the issuer’s reporting currency, as applicable, in one of three ways: (i) by translating the expenses at the exchange rate existing at the time that the payment is made, (ii) using a weighted average of the exchange rates during the period, or (iii) based on the exchange rate as of the issuer’s fiscal year end. A resource extraction issuer must disclose the method used to calculate

[14]. This accommodation reflects the Commission’s acknowledgement of recent developments in the European Union and Canada as well as the developments with the US Extractive Industries Transparency Initiative.

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