

Memorandum

SEC Re-proposes Rule on Disclosure of Payments by Resource Extraction Issuers

December 30, 2015

On December 11, 2015, the Securities and Exchange Commission (“SEC”) issued a proposed rule 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 by them, their subsidiaries or entities under their control to the U.S. federal government or any foreign government to further the commercial development of oil, natural gas, or minerals.¹

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 rules relating to the disclosure of payments made by resource extraction issuers to “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 the SEC explains, “[i]n recent years, a global consensus has begun to emerge that increasing revenue transparency through the public disclosure of revenue payments made by companies in the resource extraction sector to foreign governments can be an important tool to help combat the corruption that resource-rich developing countries too often experience.”³ Thus, as understood by the SEC, Section 13(q) and the rules it requires “are intended to advance the important U.S. foreign policy objective of

¹ See [Disclosure of Payments by Resource Extraction Issuers](#), Release No. 34-76620; File No. S7-25-15 (Dec. 11, 2015) (hereinafter “Release”).

² Exchange Act §13(q)(2)(E).

³ Release at 25.

combatting global corruption and, in so doing, to potentially improve accountability and governance in resource-rich countries around the world.”⁴

In 2012, the SEC adopted rule and form amendments to implement Section 13(q) of the Exchange Act.⁵ The following year, however, the U.S. District Court for the District of Columbia vacated the rule pursuant to litigation brought by the American Petroleum Institute, the U.S. Chamber of Commerce, and two other industry groups.⁶ The court based its decision on two independent findings:

1. that “the Commission misread the statute to mandate public disclosure of the reports,” and
2. that the SEC’s “decision to deny any exemption [for situations when disclosure is prohibited by foreign governments] was, given the limited explanation provided, arbitrary and capricious.”⁷

On September 18, 2014, Oxfam America filed a lawsuit against the SEC in the U.S. District Court for the District of Massachusetts to compel the Commission to promulgate a final rule implementing Section 1504. On September 2, 2015, the court noted that “[t]he SEC is now more than four years past the deadline set by Congress for the promulgation of the final rule,” concluding that the SEC “unlawfully withheld” agency action.⁸ The court required the SEC to file an “expedited schedule” with the court for its promulgation of the final rule. Pursuant to the SEC’s proposed expedited schedule, the SEC is expected to vote on the adoption of a final rule in June 2016.

II. The Proposed Rule

The SEC is proposing new Rule 13q-1 and an amendment to Form SD (collectively, the “proposed rule”) to implement Section 13(q) of the Exchange Act.

Issuers Subject to the Proposed Rule.

Section 13(q) requires the disclosure of payments by “resource extraction issuers.” The proposed rule would

⁴ *Id.* at 21-22.

⁵ See *Disclosure of Payments by Resource Extraction Issuers*, Release No. 34-67717; File No. S7-42-10 (Aug. 22, 2012).

⁶ See *American Petroleum Institute v. SEC*, 953 F. Supp. 2d 5 (D.D.C. 2013).

⁷ *Id.* at 11.

⁸ *Oxfam America, Inc. v. United States Securities and Exchange Commission*, 2015 WL 5156554 (D. Mass. Sept. 2, 2015).

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 SEC is not proposing any exemptions to this definition based, for example, on size, ownership, foreign private issuer status, or the extent of the issuer’s business operations constituting commercial development of oil, natural gas, or minerals.

Substance of the Disclosure.

Pursuant to Section 13(q), the proposed rule requires 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 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.”⁹

- **Definition of “Commercial Development of Oil, Natural Gas, or Minerals.”** Consistent with Section 13(q), the SEC proposes to 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.”¹⁰ 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.” The SEC is also proposing an anti-evasion provision, which “would require disclosure with respect to an activity (or payment) that, although not within the categories included in the proposed rules, is part of a plan or scheme to evade the disclosure required under Section 13(q).”
- **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. Section 13(q) further provides that “payment” includes “taxes, royalties, fees (including license fees), production entitlements, bonuses, and other material benefits, that the Commission, consistent with the guidelines of the Extractive Industries Transparency Initiative (to the extent practicable), determines are part of the

⁹ Exchange Act §13(q)(2)(A).

¹⁰ Release at 41.

commonly recognized revenue stream for the commercial development of oil, natural gas, or minerals.”¹¹

- **Types of Payments Required to be Disclosed.** The proposed rule would require the disclosure of several categories of payments:
 - **Payments Specifically Enumerated in Section 13(q).** The proposed rule 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, with regard to “taxes,” resource extraction issuers “would be required to disclose payments for taxes levied on corporate profits, corporate income, and production, but would not be required to disclose payments for taxes levied on consumption, such as value added taxes, personal income taxes, or sales taxes.”
 - **Dividends.** In addition to the types of payments specified in Section 13(q), the SEC proposes to require the disclose of “dividends paid to a government in lieu of production entitlements or royalties.” However, resource extraction issuers would not be required to disclose “dividends paid to a government as a common or ordinary shareholder of the issuer as long as the dividend is paid to the government under the same terms as other shareholders,” as these payments are not made in furtherance of the commercial development of oil, natural gas, or minerals.
 - **Payments for Infrastructure Improvements.** The SEC also proposes to add to the list of payments required to be disclosed any payments for infrastructure improvements, “such as building a road or railway to further the development of oil, natural gas, or minerals.” Furthermore, if a resource extraction issuer needs to build the road or other infrastructure rather than paying a government to do so, the issuer would be required to disclose the cost of the infrastructure improvement as a payment to the government.

Under the proposed rule, resource extraction issuers would be required to disclose payments of the types listed above 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 “may report in-kind payments at cost, or if cost is not determinable, fair market value, and provide a brief description of how the monetary value was calculated.”

Finally, as noted above, the proposed rule would also mandate disclosure of any payment that, while not within the categories enumerated in the proposed rule, is part of a plan or scheme to evade Section 13(q)’s disclosure requirements.

- **“Not De Minimis.”** Under the proposed rule, a “not de minimis” payment would be defined as “one that equals or exceeds \$100,000, or its equivalent in the issuer’s reporting currency, whether made as a

¹¹ Exchange Act §13(q)(1)(C)(ii).

single payment or series of related payments.”

- **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 a subsidiary or an entity under the control of the issuer to a foreign government or the Federal Government relating to the commercial development of oil, natural gas, or minerals. The proposed rule “would 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 the approach proposed by the SEC, “a resource extraction issuer would have ‘control’ of another entity when the issuer consolidates that entity or proportionately consolidates an interest in the entity or operation under the accounting principles applicable to its financial statements included in the 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 entity would be required to disclose that entity’s eligible payments on a proportionate basis, listing the proportionate interest.
- **Definition of “Project.”** As required by Section 13(q), the proposed rule would require disclosure of covered payments by type and total amount per project. The SEC proposes to 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.” The proposed rule would 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.” The SEC proposes to include, in an instruction to the proposed rule, a list of non-exhaustive factors for resource extraction issuers to consider in evaluating whether agreements are “operationally and geographically interconnected.” Another proposed instruction would clarify that issuers need not disaggregate payments made pursuant to obligations of the issuer at the entity level rather than on the project level.
- **Definitions of “Foreign Government” and “Federal Government.”**
 - **“Foreign Government.”** Section 13(q) provides that a “foreign government” means “a foreign government, a department, agency, or instrumentality of a foreign government, or a company owned by a foreign government, as determined by the Commission.”¹²
 - **Payment to a Foreign Subnational Government.** The SEC proposes to 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

¹² Exchange Act §13(q)(1)(B).

payment, the issuer would be 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 proposed rule, “a company owned by a foreign government means a company that is at least majority-owned by a foreign government.”
- **Payment to a Third Party to Pass Along to a Foreign Government.** The SEC proposes to require disclosure of a covered payment made to a third party to be paid to a foreign government on the issuer’s behalf.
- **“Federal Government.”** The SEC reads Section 13(q)’s use of the term “federal government” to require disclosure of payments made to the U.S. national government and not to any state or local governments within the U.S.

Form of the Disclosure.

- **Annual Report on Form SD.** The proposed rule would require resource extraction issuers to provide the required disclosure on an annual basis on Form SD. The form, which would apply to the issuer’s fiscal year, would require each issuer to:
 - include a brief statement in the body of the document in an item titled “Disclosure of Payments by Resource Extraction Issuers”, and
 - provide detailed payment information in an exhibit to the form.
- **Alternative Reporting.** The SEC proposes to allow issuers to meet the requirements of the proposed rule 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 (“USEITI”), “if the Commission has determined that those rules or requirements are substantially similar to the rules adopted under Section 13(q).” The SEC proposes to require any resource extraction issuer relying on this accommodation to:
 - file the substantially similar report as an exhibit to its Form SD;
 - indicate in the body of its Form SD filing that it is relying on the alternative reporting accommodation; and
 - identify in the body of its Form SD filing the alternative reporting regime for which the report was prepared.
- **Interactive Data Format Requirements.** Section 13(q) mandates that resource extraction issuers provide the requisite information in interactive data format. Consistent with the statute, the proposed rule requires the payment information in the exhibit to Form SD to be submitted in eXtensible Business

Reporting Language (“XBRL”) using electronic tags that identify, for any payments required to be disclosed:

- the total amount 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 (i.e., the reportable segment used by the issuer for purposes of financial reporting) 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 to these statutorily-mandated tags, the proposed rule would require electronic tags for:

- 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.

A proposed instruction to Form SD would clarify 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.

The SEC also proposes that for any payments made pursuant to obligations levied on the issuer at an entity level (e.g., corporate income taxes and dividends), issuers may omit those tags that are inapplicable (e.g., project tag, business segment tag), so long as they provide all other electronic tags.

Filed, Not Furnished.

The proposed rule would require the requisite payment information submitted on Form SD to be “filed,” rather than “furnished.”

Public Availability of the Disclosure.

The SEC proposes to require the public disclosure of the payment information submitted by resource extraction issuers pursuant to Section 13(q), including the identity of the issuer.

Exemptions from the Disclosure Requirement.

The proposed rule does not provide any exemptions (including with regard to situations where the required disclosure is prohibited by the laws of a foreign country). Instead, the SEC may use its existing authority

under the Exchange Act to provide exemptive relief on a case-by-case basis “at the request of a resource extraction issuer, if and when warranted.”

Timing Considerations.

- **Effective Date.** Section 13(q) requires the SEC’s final rules to take effect “on the date on which the resource extraction issuer is required to submit an annual report relating to the fiscal year of the resource extraction issuer that ends not earlier than 1 year after the date on which the Commission issues [its] final rules.”¹³ Accordingly, the SEC proposes to require compliance with the proposed rule for fiscal years ending no earlier than one year after the effective date of the adopted rules.
- **Timing of Disclosure.** Following one year after the effective date of the SEC’s final rules, resource extraction issuers would be required to file their Form SD on an annual basis, no later than 150 days after the end of their most recent fiscal year.

III. Comment Periods

The SEC provided two comment periods in connection with its proposed rule.

- Initial comments are due January 25, 2016.
- Reply comments, which may pertain only to the issues raised in the initial comment period, are due on February 16, 2016.

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, any other member of the Firm’s Public Company Advisory Practice.

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¹³ Exchange Act §13(q)(2)(F).



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