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SEC Adopts Resource Extraction Issuer Disclosure Rule – Changes From the Proposed Rule and Take-aways for Issuers

On June 27, the SEC adopted Rule 13q-1 under the Exchange Act and related amendments to Form SD. Under the Rule, public companies are required to annually report on payments made to foreign governments and the U.S. federal government relating to the commercial development of oil, natural gas and minerals. Information must be provided concerning the type and total amount of payments made for each covered project and the type and total amount of payments made to each government.

Attorneys
[Michael R. Littenberg](#)

The Rule is intended to help combat global corruption and empower citizens of resource-rich countries to hold their governments accountable for the wealth generated by those resources, by making resource extraction payments more transparent. The Rule is the latest, but certainly not the last, in a growing body of mandatory corporate social responsibility disclosures.

The final Rule is largely the same as the Rule proposed by the SEC last December. This Alert describes the changes made to the proposed Rule. For a more extensive discussion of the Rule as a whole, as well as selected compliance take-aways, also see our earlier Alert [here](#).¹

Due Date of the Initial Filing

Affected issuers must comply with the Rule beginning with their fiscal years ending on or after September 30, 2018. Consistent with the proposed Rule, filings must be made within 150 days after fiscal year end. (*Form SD, General Instruction B.2*) For most resource extraction issuers, this will mean that their initial filing will be due on May 30, 2019.

The final Rule extended the initial filing date contemplated in the proposed Rule by an additional year. However, the Rule does not contain separate phase-ins for smaller reporting companies or foreign private issuers.

In the Adopting Release, the SEC estimated that 755 issuers may be affected by the Rule.

Definition of “Payment” and Related Matters

Corporate Social Responsibility Payments. Based on comments received on the proposed Rule, the SEC expanded the definition of “payment” to include community and social responsibility payments that are required by law or contract. (*Form SD, Item 2.01(d)(8)(iii)(H)*) As part of its rationale for expanding the definition, the SEC indicated in the Adopting Release that these categories of payments also are included in the Extractive Industries Transparency Initiative’s guidelines.

Royalties. Royalties are one of the types of payments required to be disclosed under both the proposed and final Rule. As recommended by some commenters, the SEC added to the Instructions to Form SD a non-exclusive list of the types of royalties that are reportable, to provide additional clarity for resource extraction issuers. The Instructions indicate that royalties include unit-based, value-based and profit-based royalties. (*Form SD, Instruction (9) to Item 2.01*)

¹ In addition, we were one of the few law firms that submitted comments on the proposed Rule, and are pleased that some of our comments made their way into the final Rule. Our comment letter is available [here](#).

Valuing In-kind Production Entitlement Payments. Production entitlements also are one of the types of payments required to be disclosed under both the proposed and final Rule. In the final Rule, the Instructions to Form SD have been revised to indicate how to value in-kind production entitlement payments when the resource extraction issuer subsequently repurchases the resources associated with the production entitlement. The Instructions to Form SD indicate that, if a resource extraction issuer makes an in-kind production entitlement payment under the Rule and then repurchases the resources associated with the production entitlement within the same fiscal year, it must report the payment using the purchase price (rather than at cost or, if cost is not determinable, fair market value). If the in-kind production entitlement payment and the subsequent repurchase are made in different fiscal years and the purchase price is greater than the previously reported value of the in-kind payment, the resource extraction issuer must report the difference in values in the latter fiscal year (assuming the amount of the difference exceeds the de minimis threshold contained in the Rule). In other situations, such as when the purchase price in a subsequent fiscal year is less than the in-kind value already reported, no disclosure relating to the purchase price is required. (*Form SD, Instruction (11) to Item 2.01*)

Calculation of De Minimis Threshold; Currency Conversions Generally. The Instructions to Form SD have been revised to indicate that, when calculating whether the de minimis threshold has been exceeded for purposes of reporting a payment, a resource extraction issuer may be required to convert the payment to U.S. dollars, even though it is not required to disclose those payments in U.S. dollars. The Instructions indicate that, for example, this may occur when the resource extraction issuer is using a non-U.S. dollar reporting currency. The three methods for calculating currency conversions that are described in the proposed Rule also were included in the final Rule. (*Form SD, Instruction (2) to Item 2.01*)

The Instructions also have been revised to indicate that a resource extraction issuer must choose a consistent method for all currency conversions within a particular Form SD filing. (*Form SD, Instruction (2) to Item 2.01*)

Excluded Payments. In the Adopting Release, the SEC indicated that resource extraction issuers are required to disclose only payments that fall within the enumerated list of payment types contained in the Rule. Clarifying language also was added to the Rule. (*Form SD, Item 2.01(a)(1) and (2)*) The SEC specifically noted in the Adopting Release that the following types of payments are outside the scope of the Rule: (1) commodity trading-related payments (other than those that come within the definition of “export” and in-kind payments of production entitlements); (2) payments for government expenses, providing jobs or tuition to persons related to government officials, investing in companies created by officials or related persons, or other similar payments (although the Adopting Release notes that, when these payments are made to further the commercial development of oil, natural gas or minerals, they are covered by the anti-evasion provision of the Rule); and (3) fines and penalties.

Basis of Presentation. The final Rule confirms that payment information must be provided on a cash basis. This was a clarifying change to reflect prior SEC staff guidance. (*Form SD, Item 2.01(a)*)

Audit Not Required. The final Rule confirms that a resource extraction issuer is not required to have the payment information presented in its filing audited. This also was a clarifying change to reflect prior SEC staff guidance. (*Form SD, Item 2.01(a)*)

Definition of “Export”

The term “export” is used in the Rule in the defined term “commercial development of oil, natural gas, or minerals.” In the final Rule, the definition of “export” was narrowed to exclude the movement of a resource across an international border by an issuer that (1) is not engaged in the exploration, extraction or processing of oil, natural gas or minerals and (2) acquired its ownership interest in the resource directly or indirectly from a foreign government or the U.S. federal government. (*Form SD, Item 2.01(d)(4)*) The SEC noted in the Adopting Release that “export” was not intended to capture activities with little relationship to upstream or midstream activities, such as commodity trading-related activities. Consistent with the proposed Rule, the final Rule also continues to exclude from the definition of “export” cross-border transportation activities by an issuer that is functioning solely as a service provider, with no ownership interest in the resource being transported.

The SEC noted in the Adopting Release that the definition of “export” does, however, cover the purchase of government-owned resources by an issuer otherwise engaged in resource extraction, due to the stronger link between the movement of the resource across an international border and the upstream development activities. The SEC indicated in the Adopting Release that this link would be particularly strong in instances where the issuer is repurchasing government production entitlements that it originally extracted.

Reporting Under an Approved Alternative Reporting Regime

Resource extraction issuers can meet the requirements of the Rule by complying with alternative disclosure regimes that are deemed to be “substantially similar” by the SEC. (*Form SD, Item 2.01(c)(1)*)

Pursuant to a separate Order issued on the same day as the final Rule, the SEC has determined that the EU Accounting Directive and Transparency Directive, Canada’s Extractive Sector Transparency Measures Act and the U.S. Extractive Industries Transparency Initiative (the “USEITI”) are substantially similar to the final Rule. In the Adopting Release, the SEC estimated that 192 issuers may be able to report under one of these approved alternative reporting regimes.

In order to report under an approved alternative reporting regime, a resource extraction issuer must meet the following conditions (*Form SD, Item 2.01(c)(1)-(5)*), which were new to the final Rule:

- The resource extraction issuer must be subject to that regime.
- The alternative report must be the same as the one prepared and made publicly available pursuant to the requirements of the approved alternative reporting regime, subject to changes necessary to comply with any conditions to alternative reporting set forth by the SEC.
- The resource extraction issuer must: (1) state in the body of the Form SD that it is relying on the alternative reporting provision; (2) identify the alternative reporting regime for which the report was prepared; (3) describe how to access the publicly filed report in the alternative jurisdiction; and (4) specify that the payment disclosure required by Form SD is included in an exhibit to the Form.
- The alternative report must be XBRL tagged.
- A fair and accurate English translation of the entire report must be filed if the report is in a foreign language. However, project names may be presented in their original language, in addition to the English translation of the project name, if the resource extraction issuer believes that approach would facilitate identification of the project by users of the disclosure. The Adopting Release notes that a summary is not permitted in lieu of a translation.

Unless the SEC provides otherwise in an exemptive order, a resource extraction issuer may follow the submission deadline of an approved alternative jurisdiction if it files 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 deadline. To deter abuses of this accommodation, the final Rule provides that, if a resource extraction issuer fails to file the notice on a timely basis, or files the notice but fails to file the alternative report within two business days of the alternative jurisdiction’s deadline, it will become ineligible for the alternative reporting accommodation for the following fiscal year. (*Form SD, Item 2.01(c)(6)*)

Although the SEC has recognized the USEITI’s requirements as substantially similar, it was mindful of the more limited scope of the USEITI. For example, the USEITI does not cover payments to foreign governments and currently uses calendar year reporting instead of fiscal year reporting. Accordingly, as indicated in the SEC’s Order, USEITI reports will satisfy the disclosure requirements of the Rule only for payments made by a resource extraction issuer to the U.S. federal government, not to foreign governments. A resource extraction issuer will need to supplement its USEITI report by disclosing in its Form SD all payment information to foreign governments required by the Rule, to the extent applicable. In addition, a resource extraction issuer may not follow the USEITI submission

deadline to the extent it differs from the 150-day deadline in the Rule and it must provide the required payment information on a fiscal-year basis.

Applications to have additional alternative reporting regimes designated as substantially similar may be submitted by resource extraction issuers, governments, industry groups and trade associations in accordance with the procedures set forth in Rule 0-13 of the Exchange Act. (*Rule 13q-1(c)*) The Adopting Release reiterates the same non-exhaustive criteria contained in the Proposing Release that the SEC may use in making its determination (these factors are listed in our earlier [Alert](#)).

Transition Exemptions

Two new transition exemptions were added to the final Rule.

Payments Relating to Exploratory Activities. The SEC added to the final Rule a temporary exemption for payments relating to exploratory activities. Resource extraction issuers may delay reporting these payments until the fiscal year following the fiscal year in which the payments were made. (*Form SD, Item 2.01(b)(1)*)

Payments are considered to be related to exploratory activities if they are made as part of (1) the process of identifying areas that may warrant examination, (2) the process of examining specific areas that are considered to have prospects of containing oil and gas reserves or (3) a mineral exploration program. However, exploratory activities are limited to activities commenced prior to any development or extraction activities on the property, any adjacent property or on any property that is part of the same project.

Acquired Entities. Under the Rule, a resource extraction issuer that has acquired or otherwise obtained control over another entity that was not obligated in its last full fiscal year to provide disclosure pursuant to the Rule or another substantially similar jurisdiction's requirements, is not required to commence reporting payment information for the acquired entity until the Form SD filing for the fiscal year immediately following the effective date of the acquisition. The resource extraction issuer must disclose that it is relying on this accommodation in the body of its Form SD filing. (*Form SD, Item 2.01(b)(2)*)

XBRL Tagging

Geographic Location Tagging. The final Rule has been revised to indicate that, when identifying the country in which a government is located, a resource extraction issuer must use the code provided in ISO 3166, if available. In addition, when identifying the subnational geographic location of the project, a resource extraction issuer must include the subdivision code provided in ISO 3166, if available. (*Form SD, Instruction (3) to Item 2.01*) The final Rule continues to contain the other geographic location tagging requirements contained in the proposed Rule.

Inline XBRL Not Required. The Adopting Release indicates that Inline XBRL is not required. Inline XBRL is a format that allows filers to embed XBRL data directly into an HTML document. Given the nature of the disclosure required by the Rule, which is primarily an exhibit with tabular data, the SEC did not believe that Inline XBRL would improve the usefulness or presentation of the required disclosure.

Anti-Evasion Provision

An anti-evasion provision was added to the final Rule. This provision indicates that disclosure is required under the Rule in circumstances in which an activity related to the commercial development of oil, natural gas or minerals, or a payment or series of payments made by a resource extraction issuer to a foreign government or the U.S. federal government for the purpose of the commercial development of oil, natural gas or minerals, is not, in form or characterization, within one of the categories of activities or payments specified in Form SD, but is part of a plan or scheme to evade the disclosure required under the Rule. (*Rule 13q-1(b)*)

Applying for Exemptive Relief

Various commenters requested blanket exemptions from compliance to the extent required payment disclosure would (1) be prohibited under the host country's laws, (2) conflict with the terms of existing contracts, (3) reveal commercially sensitive information, (4) jeopardize the safety of a resource extraction issuer's personnel or (5) jeopardize the national security of a host nation.

The SEC declined to adopt blanket exemptions covering any of the foregoing circumstances. However, resource extraction issuers may apply for exemptive relief on a case-by-case basis using the procedures in Rule 0-12 of the Exchange Act. (*Rule 13q-1(d)*)

The Adopting Release provides additional color on this process in the context of the Rule. The Adopting Release notes that particular documentation is not required as part of the application process. It is up to the applicant to determine what to provide, although the burden is on the applicant to demonstrate that relief is necessary and appropriate in the public interest. The Adopting Release also indicates that the SEC may request additional supporting documentation, such as a legal opinion, the text of applicable foreign laws, representations as to the public availability of the information in question or a description of the steps taken by the resource extraction issuer to obtain permission to disclose that information.

Rule 0-12 allows the SEC to provide notice in the Federal Register and receive public comments on applications for exemptions when it deems that to be appropriate. However, in the Adopting Release, the SEC indicated that it does not believe it is appropriate to require a resource extraction issuer to reveal the information it seeks to protect in order to apply for an exemption. Although an applicant would need to describe the particular payment disclosure it seeks to omit and the specific facts and circumstances that warrant an exemption, it would not be required to include specific payment amounts to support its application.

Rule 0-12 also allows applicants to request temporary confidential treatment to the extent provided under Rule 81, which would delay public access to the exemptive application for up to 120 days from the time of the SEC's response. The Adopting Release notes that a resource extraction issuer will be permitted to withdraw its application if it appears to the SEC staff that the request for confidential treatment should be denied, in which case the application would remain in the SEC's files but would not be made public. The information could be requested by third parties under the Freedom of Information Act ("FOIA"), although FOIA contains exceptions from public release that may apply.

Public Compilation by the SEC of Filed Information

In the Adopting Release, the SEC indicated that it appreciated that some commenters had asserted that the statutory language requiring the adoption of the Rule could be read to require the SEC to periodically make available its own compilation of the information that resource extraction issuers provide on Form SD. In furtherance of these comments, the Rule includes a provision indicating that the SEC will, to the extent practicable, periodically make available online a separate public compilation of the payment information submitted to it. Under the Rule, the SEC staff may determine the form, manner and timing of each compilation, except that the information included in the compilation may not be anonymized. (*Rule 13q-1(e)*)

Take-aways and Next Steps

Now that the final Rule has been adopted, please see the suggested action items discussed in our earlier Alert, which is available [here](#).

Potential Challenges to the Rule

As discussed in our earlier Alert, this is the SEC's second attempt at a resource extraction issuer disclosure rule. A rule was adopted during August 2012, but was subsequently challenged in court by the American Petroleum Institute ("API"). That rule was vacated by the U.S. District Court for the District of Columbia during July 2013 on two

grounds. First, the District Court concluded that the SEC misread the statute to require public filing of the payment disclosures made by resource extraction issuers. Second, it concluded that the SEC's failure to include an exemption for countries that prohibit payment disclosure was "arbitrary and capricious" within the meaning of the Administrative Procedure Act.

Although the final Rule continues to require resource extraction issuers to publicly file information and does not include an exemption for countries that prohibit payment disclosure, the SEC has attempted to justify its rule-making decisions on those aspects of the Rule in both the Proposing and Adopting Releases.

Not surprisingly, API has been critical of the new Rule, noting that its concerns remain the same given the similarities between it and the vacated rule. Whether API or other constituencies will again challenge the Rule remains to be seen. To the extent that the Rule is challenged in court, we think it is unlikely that the SEC will in the interim suspend the application of the Rule, in part given the length of time until the first filings are due. This would be consistent with its approach in the still ongoing litigation relating to the Conflict Minerals Rule.

For Further Information

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