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The SEC's New Resource Extraction Payment Disclosure Rules – A Deep Dive

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On December 16, 2020, the Securities and Exchange Commission adopted new resource extraction payment disclosure rules. The rules were adopted almost a year to the day after they were proposed, and they largely track the rules proposed by the SEC in December 2019. If the adoption of resource extraction payment disclosure rules sounds familiar, that is because it is not the first time the SEC has done so. This is the SEC's third time adopting resource extraction payment disclosure rules, in fulfillment of its mandate under 2010's Dodd-Frank Act.

Section 1504 of the Dodd-Frank Act added Section 13(q) to the Exchange Act. Section 13(q) in turn directs the SEC to issue rules requiring resource extraction issuers to include in an annual report information relating to payments made to a foreign government or the U.S. Federal government for the purpose of the commercial development of oil, natural gas or minerals. The intent of Section 1504 is 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.

New Rule 13q-1 under the Exchange Act and related amendments to Form SD will require public companies 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. This Alert describes the new rules in detail, including how they differ from 2019's proposed rules. The Alert also discusses next steps for relevant issuers.

A Brief History of the Resource Extraction Payment Disclosure Rules

As noted above, the current Rules are the third set of resource extraction payment disclosure rules adopted by the SEC. Rules were first adopted by the SEC in August 2012, but were subsequently challenged in court – like some other Dodd-Frank rulemaking initiatives – and then vacated by the U.S. District Court for the District of Columbia in July 2013. The District Court vacated the 2012 Rules on two grounds. First, the District Court concluded the SEC misread the statute to require the public filing of the payments disclosure to be made by issuers. Second, it concluded the SEC's failure to include an exemption in the 2012 Rules for countries that prohibit payment disclosure was "arbitrary and capricious" within the meaning of the Administrative Procedure Act.

Unhappy that the SEC had not yet re-proposed resource extraction payment disclosure rules, in September 2014, Oxfam America filed suit to compel the SEC to adopt new rules. In September 2015, the U.S. District Court for the District of Massachusetts concluded the SEC's delay in re-promulgating resource extraction payment disclosure rules amounted to final agency action "unlawfully withheld" under the Administrative Procedure Act and ordered the SEC to file an expedited schedule with its plans to finalize the rules. A second, revised Rule 13q-1, and corresponding amendments to Form SD, were adopted in June 2016.

The 2016 Rules were subsequently disapproved in February 2017, pursuant to the Congressional Review Act, by a joint Congressional resolution, which was then signed by President Trump. Under the CRA, Congress may disapprove a broad range of Federal regulatory rules (within a certain specified period after a rule has been submitted to Congress) by adopting a joint resolution of disapproval, which, once enacted into law, prevents the rule from taking or continuing in effect. Concerns of members of Congress who supported the joint resolution included the potential adverse economic effects of the 2016 Rules due to the compliance costs subject companies would incur and competitive harm relative to foreign companies not subject to similar requirements.

Under the CRA, a Federal agency is barred from reissuing a new rule in substantially the same form as the disapproved rule, unless the new rule is specifically authorized by a law enacted after the date of the joint resolution disapproving the original rule. The Rules differ from the 2016 Rules in several significant respects, in particular by moving away from contract-level project disclosure, which will in at least some cases result in less granular payments disclosures.

Our Alert discussing the proposed Rules is available here. That Alert contains a detailed comparison to the 2016 Rules. As additional context, for further information on the 2016 Rules, see our earlier Alerts here and here. In addition, our comment letter on the 2016 Rules is available here. We were one of the few law firms that submitted comments on the 2016 Rules and were pleased that some of our comments made their way into the final 2016 Rules (and in turn the current Rules).

Adoption of the Rules by a Divided Commission

The Rules were adopted with a divided vote. Chairman Clayton and the other two Republican Commissioners – Hester Peirce and Elad Roisman – voted in favor. Commissioners Caroline Crenshaw and Allison Herren Lee voted against.

In their public statements, the Commissioners addressed both the Rules and their views more generally on environmental, social and governance (ESG)-themed disclosures, including whether they are within the SEC's mandate and whether the SEC's existing principles-based disclosure framework is sufficient for providing investors with material ESG-related information. ESG-themed rulemaking is likely to be an increasing area of focus for the SEC in 2021 and beyond, especially in the environmental sphere. See our earlier Alert here describing some of the potential drivers in this area.

Although publicly on record on numerous occasions as being opposed to prescriptive ESG disclosure requirements and rules not perceived to be in furtherance of the SEC's mandate, the Republican Commissioners presumably viewed adoption of the Rules now as the lesser of two evils, since rules adopted post-January 20 would likely have involved different policy choices resulting in additional requirements for issuers.

In his remarks, Chairman Clayton showed little enthusiasm for the Rules. Although supportive of the purpose of Section 13(q), he was unequivocal in his view that the SEC is not well-positioned to pursue rulemaking in this subject area, noting both that it is outside of the SEC's area of expertise and that in many cases using the information generated by the Rules is outside its jurisdictional authority. He was critical of the SEC being asked to promulgate a disclosure rule that others who were not part of the rulemaking process and who had demonstrated little effectiveness in pursuing anti-corruption efforts would be counted on to use as an information tool. He also was critical of the SEC's disclosure regime being used to address the interests of non-investors or parties for whom investing is not their primary interest.

Similarly, in his remarks, Commissioner Roisman (now Acting Chairman) was critical of the Rules, which he felt do not advance the SEC's mission of protecting investors, maintaining fair, orderly and efficient markets and facilitating capital formation. Commissioner Roisman noted that, while some investors may choose to invest based on "certain idiosyncratic interests and values," the SEC's mandate has never been understood to include requiring disclosure of all information that any investor might want to know, particularly for making an investment decision. In voting for the Rules, Commissioner Roisman indicated his vote did not reflect any enthusiasm for the policy mandate received from Congress, but rather that he was supporting the Rules because he believes the SEC has a duty to implement Congress' mandates and the Rules are a reasonable implementation of that mandate.

Looking to the future, Commissioner Roisman expressed the hope that Congress will cease using the SEC's disclosure regime to effect social policy goals outside the SEC's mission. He specifically called out foreign policy, energy policy, environmental policy and extraterritorial social policies not material to investment decisions.

In the most colorful remarks of the day, Commissioner Peirce compared the rulemaking process to Tim Burton's *The Nightmare Before Christmas*, "a movie that [she] would prefer not to watch, let alone play a part in." She indicated she supported the Rules solely because the law required the SEC to act and it was taking a reasonable approach to fulfilling its Congressional mandate. She also expressed the view that the Rules are unrelated to the SEC's mission and do not provide material information to investors, and that an issue that is of societal importance is not necessarily material from a securities law perspective.

Unlike her Republican colleagues, Commissioner Lee felt that rulemaking in this area is consistent with the SEC's role in anti-corruption efforts. In addition, she felt that rules in this area could further good governance by issuers and yield material information to investors. However, she voted against the Rules because, in her view, they do not promote good governance or yield material information to investors. In particular, she took exception with the manner in which the Rules allow payment information to be aggregated (including the underlying reasoning and deviation from the original statutory mandate), arguing this will obscure information crucial to anti-corruption efforts and material to investment analysis. She also was concerned that other changes from the proposed Rules will reduce transparency.

More broadly, Commissioner Lee expressed the view that general principles-based obligations do not invariably yield the specific information material to investors, providing a window into how she is likely to think about future ESG-themed legislation.

Commissioner Crenshaw also voted against the Rules because they do not meet the transparency objectives of the statute and depart from the SEC's previous findings in connection with the 2016 Rules concerning the level of disclosure necessary to fulfill these objectives without an adequate and reasoned basis. Commissioner Crenshaw also was of the view the SEC should be moving toward a more uniform global disclosure approach to resource extraction payments disclosure that will allow for comparability across issuers operating in the same country, noting that other countries have imposed detailed disclosure requirements that largely mirror those in the 2016 Rules and that many issuers subject to the Rules already are complying with.

Commissioner Crenshaw also addressed the argument that resource extraction payment disclosure requirements are not within the SEC's mandate or material to investors. In her view, Congress resolved that debate when it directed the SEC to promulgate a resource extraction payment disclosure rule.

Principal Changes from the Proposed Rules

The Rules adopted by the SEC are substantially similar to the proposed Rules, with some modifications in response to comments received during the rulemaking process. The principal changes made are as follows:

- Limited the exemption for emerging growth companies and smaller reporting companies to those that are not required to make disclosures under an alternative reporting regime recognized by the SEC.
- Changed the due date for Form SD submissions, to 270 days after fiscal year end. Under the proposed Rules, an issuer with a fiscal year ending on or before June 30 would have been required to submit its Form SD by March 31 of the following calendar year and the Form SD of an issuer with a fiscal year ending after June 30 would have been due on March 31 of the second calendar year following its most recent fiscal year.
- Reduced the de minimis threshold to $100,000. Payments that meet the threshold are required to be disclosed. The proposed Rules had a project level threshold of $750,000 and an additional payment threshold of $150,000.
- Removed an accommodation that would have allowed issuers to aggregate payments of the same payment type to foreign governments below the major subnational government level and not identify the payees by name.
- Excluded reporting of payments by entities in which an issuer only has a proportionate interest.
- Modified the requirements for describing the location of an offshore project, to enhance clarity.

The Proposing Release had left the door open for confidential, non-public submissions of payment information and solicited comments on this approach. In the Proposing Release, the SEC indicated that, while it preliminarily believed the proposed Rules struck an appropriate balance, it also was considering the alternative approach of permitting resource extraction issuers to submit their annual reports on Form SD to the SEC non-publicly. The SEC would then have used the non-public submissions to produce an aggregated, anonymized public compilation. The SEC ultimately decided to move forward with a public disclosure regime, concluding that approach more effectively achieves Section 13(q)'s goal of increasing the transparency of extractive payments by resource extraction issuers.

Issuers Coming Under the Rules

"Resource extraction issuers" will have disclosure obligations under the Rules. This term includes all issuers that:

- file annual reports on Form 10-K, Form 20-F or Form 40-F; and
- are engaged in the commercial development of oil, natural gas or minerals.

Emerging growth companies and smaller reporting companies generally are not subject to the Rules. However, the final Rules scaled back the blanket exemption for these issuers, excluding from the exemption EGCs and SRCs that are subject to the resource extraction payment disclosure requirements of an alternative reporting regime that has been deemed by the SEC to require disclosures that satisfy the transparency objectives of Section 13(q). The designation of alternative reporting regimes is discussed later in this Alert.

Registered investment companies, Rule 12g3-2(b) issuers and issuers subject to Tier 2 reporting obligations under Regulation A are outside the scope of the Rules.

The SEC estimates that approximately 426 issuers will be subject to the Rules. According to the Adopting Release, 177 of these issuers are likely to be able to avail themselves of alternative reporting provisions recognized by the SEC.

Applicability to Controlled Entities and Subsidiaries; Treatment of Proportionately Consolidated Entities. Under the Rules, a resource extraction issuer also will be required to disclose payments made by its subsidiaries and other entities under its control. Whether an entity is a "subsidiary" or there is "control" is based on accounting principles, rather than having the meaning contained in Rule 12b-2 of the Exchange Act.

Under the Rules, a "subsidiary" is defined as an entity controlled directly or indirectly through one or more intermediaries.

A resource extraction issuer will have "control" of another entity if the issuer consolidates that entity under the accounting principles applicable to the U.S. GAAP or IFRS financial statements included in its Exchange Act reports. The Rules indicate that a foreign private issuer that prepares financial statements according to a comprehensive set of accounting principles other than U.S. GAAP and that files a U.S. GAAP reconciliation should consider determining control using U.S. GAAP.

The Rules exclude from the definition of "control" an interest in an entity or operation that is proportionately consolidated by the issuer. Proportionately consolidated entities or operations include those entities or operations that are proportionately consolidated in accordance with ASC 810-10-45-14 and "joint operations" as defined in IFRS 11, Joint Arrangements. The SEC decided to exclude these entities because the resource extraction issuer may not have the same level of ability to direct the entity or operations making payments or ready access to detailed payment information.

Covered Activities

The activities that come within the scope of the Rules are the commercial development of oil, natural gas or minerals.

The Rules do not define the terms "oil," "natural gas" or "minerals." In the case of minerals, the SEC indicates in the Adopting Release that it believes that term is commonly understood. The Rules, however, include an Instruction indicating that "minerals" includes any material for which an issuer with mining operations would provide disclosure under the SEC's then-current disclosure requirements and policies.

"Commercial Development of Oil, Natural Gas or Minerals" Defined. The Rules define this term to include the exploration, extraction, processing and export of oil, natural gas or minerals, or the acquisition of a license for any of the foregoing activities.

The Adopting Release notes that commercial development captures only activities that are directly related to the commercial development of oil, natural gas or minerals. The Release indicates the SEC does not consider ancillary or preparatory services to be within the scope of the Rules. This excludes, for example, an issuer that manufactures drill bits or provides hardware to help companies to explore or extract. Similarly, an issuer engaged by an operator to provide hydraulic fracturing or drilling services is not considered a resource extraction issuer. Marketing activities and security support also are excluded.

Meanings of "Extraction," "Export" and "Processing." To help clarify which activities come within "commercial development," the Rules define and/or provide guidance on the meanings of the terms "extraction," "export" and "processing."

- ***Extraction***. The production of oil or natural gas as well as the extraction of minerals.
- ***Export***. 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 functioning solely as a service provider on a fee-for-service basis, with no ownership interest in the resource being transported, are not considered to be exports.

  "Export" also is not intended to capture an activity with little relationship to upstream or midstream activities, such as a commodity trading-related activity.

  However, the Adopting Release indicates that "export" covers the purchase of government-owned resources by an issuer otherwise engaged in resource extraction, due to the stronger nexus between the movement of the resource across an international border and the upstream development activities. The Adopting Release indicates this link would be particularly strong in instances where the issuer is repurchasing government production entitlements that it originally extracted.
- ***Processing***. The Instructions to the Rules provide examples of activities that constitute processing.

  Instruction (8) indicates that processing includes, but is not limited to, midstream activities such as removing liquid hydrocarbons from gas, 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, 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 also includes the crushing or preparing of raw ore prior to the smelting phase, but not the downstream activities of refining or smelting (since issuers do not typically make payments to host governments in connection with refining or smelting).

Anti-Evasion Provision. The Rules include an anti-evasion provision that requires disclosure concerning an activity, payment or series of payments that, although not within one of the categories of activities or payments specified in the Rules, is part of a plan or scheme to evade the Rules. The Adopting Release notes this provision covers, for example, payments that are substituted for otherwise reportable payments in an attempt to evade the disclosure requirements of the

Rules, as well as activities and payments that are structured, split or aggregated in an attempt to avoid application of the Rules. The Adopting Release notes that, similarly, a resource extraction issuer cannot avoid disclosure by re-characterizing an activity as transportation that is otherwise covered under the Rules, or by making a payment to the government via a third party in order to avoid disclosure under the Rules.

Definitions of "Foreign Government" and "Federal Government"

The Rules only require disclosure of payments to a foreign government or the U.S. Federal government.

The Rules define "foreign government" broadly. In addition to a national foreign government, the Rules include within the definition:

- a department, agency or instrumentality of a foreign national government;
- a company at least majority-owned by a foreign national government; and
- a foreign subnational government, such as the government of a state, province, department, county, district, municipality or territory under a foreign national government.

"Federal government" is defined as the U.S. Federal government. Payments made to U.S. state, local or other subnational governments are not required to be disclosed, since disclosure of these payments is not contemplated by Section 13(q).

Payments Within (and Outside) the Scope of the Rules

Under the Rules, a resource extraction issuer is required to disclose specified types of payments that are made to further the commercial development of oil, natural gas or minerals.

"Payment" Defined. The definition of "payment" includes the following:

- Taxes.

  Taxes on corporate profits, corporate income and production are required to be disclosed when the taxes are made to further the commercial development of oil, natural gas or minerals. Taxes levied on consumption, such as value-added taxes, personal income taxes or sales taxes are not required to be disclosed. (Instruction (9)) As discussed later in this Alert, payments for obligations levied at the enterprise level, such as corporate taxes, can be disclosed at the entity level, rather than the project level.

- Royalties.

  Royalties include, but are not limited to, unit-based, value-based and profit-based royalties. (Instruction (10))

- Fees.

  Fees include, but are not limited to, license fees, rental fees, entry fees and other consideration for licenses or concessions. (Instruction (10))

- Production entitlements.

- Bonuses.

  Bonuses include, but are not limited to, signature, discovery and production bonuses. (Instruction (10))

- Dividends.

  Dividends paid to a government as a common or ordinary shareholder of the resource extraction issuer paid under the same terms as to other shareholders are not required to be disclosed. However, any dividends paid in lieu of production entitlements or royalties are required to be disclosed. (Instruction (11))

- Payments for infrastructure improvements.

  Examples cited in the Adopting Release include payments for building a road or railway to further the development of oil, natural gas or minerals.

- Community and social responsibility payments required by law or contract.

  Examples cited in the Adopting Release include funds to build or operate a training facility for oil and gas workers, funds to build housing, payments for tuition or other educational purposes and, in general, payments to support the social or economic well-being of communities within the country where the expenditures are made.

In-Kind Payments. Pursuant to Instruction (12), if an in-kind payment of a type of payment required to be disclosed is made, the in-kind payment is required to be disclosed. The Adopting Release cites as examples production entitlement payments and infrastructure payments.

De Minimis Threshold. Only payments that are "not de minimis" are required to be disclosed.

Under the Rules, a payment is not de minimis if it is at least $100,000 or the equivalent in the issuer's reporting currency, whether made as a single payment or series of related payments. This is a change from the proposed Rules, and instead is consistent with the 2016 Rules. Under the proposed Rules, an issuer would not have been required to provide disclosure if the aggregate project payments for all types of payments for an individual project were below $750,000. If the aggregate payments for an individual project equaled or exceeded $750,000, only payments made to each foreign government or the Federal government that equaled or exceeded $150,000, or its equivalent in the issuer's reporting currency, whether made as a single payment or a series of related payments, would have been required to be reported.

If an arrangement provides for periodic payments or installments, the resource extraction issuer is required to use the aggregate amount of the related periodic payments or installments of the related payments in determining whether the payment threshold has been met for that series of payments and disclosure is required.

Instruction (2) to the Rules indicates 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 Instruction indicates that, for example, this may occur when the resource extraction issuer is using a non-U.S. dollar reporting currency. There are three methods that can be used for calculating currency conversions, as described later in this Alert.

Joint Ventures and Arrangements Where No One Party Has Control. The final Rules add a new Instruction (6) that addresses joint ventures and other arrangements where no one party has control. Where this is the case, a resource extraction issuer that is the operator of the venture or arrangement and makes payments to governments for the entire venture or arrangement on behalf of its non-operator members must report all of the payments. The non-operator members are not required to report payments made to reimburse the operator for their share of the payments to governments. The non-operator members are required to report only payments that, as resource extraction issuers, they make directly to governments.

Payments Made Through Service Providers. Instruction (7) provides that, if a service provider acting as a third-party agent or broker makes a payment that falls within the definition of "payment" to a government on behalf of a resource extraction issuer, the resource extraction issuer is required to disclose the payment. In an addition from the proposed Rules, the final Rules indicate this disclosure obligation does not apply to a non-operator partner of a joint venture or arrangement that reimburses the operator for its share of the payments to governments made by the operator.

Entities Proportionately Owned. As earlier noted, in a change from the proposed Rules, if a resource extraction issuer holds only a proportionate interest in an entity, it is not required to disclose the proportionate amount of payments made by that entity.

Determining What Constitutes a "Project"

Section 13(q) requires resource extraction issuers to provide information about the type and total amount of payments made for each of their projects relating to the commercial development of oil, natural gas or minerals. That Section does not define or provide a methodology for determining what constitutes a "project." Instead, the SEC has come up with an approach as part of its discretionary authority.

Under the Rules, "project" is defined using the following criteria:

- The type of resource being commercially developed.

  Under Instruction (5)(i), a resource extraction issuer is required to disclose whether the project relates to the commercial development of oil, natural gas or a specified type of mineral. The Instruction indicates that a resource extraction issuer should identify synthetic oil obtained through processing tar sands, bitumen or oil shales as "oil" and should identify gas obtained from methane hydrates as "natural gas." Synthetic oil or gas obtained through processing of coal should be identified as "coal." Minerals are required to be identified by type, such as gold, copper, coal, sand or gravel, but additional detail is not required.

  The Adopting Release notes that a resource extraction issuer is not required to describe the specific type or quality of oil or natural gas or distinguish between subcategories of the same mineral type. For example, an issuer disclosing payments relating to an oil project is not required to describe whether it is extracting light or heavy crude oil. Similarly, an issuer disclosing payments relating to a mining project is required to disclose whether the mineral is gold, copper, coal, sand, gravel or some other generic mineral class, but not whether it is, for example, bituminous coal or anthracite coal.

- The method of extraction.

  As indicated in Instruction (5)(ii), a resource extraction issuer is required to identify whether the resource is being extracted through the use of a well, an open pit or underground mining. According to the Adopting Release, additional detail about the method of extraction is not required. For example, a resource extraction issuer is not required to disclose whether it is using horizontal or vertical drilling, hydraulic fracturing or strip, sublevel stope or block cave mining.

- The major subnational political jurisdiction where the commercial development of the resource is taking place.

  Under Instruction (5)(iv), a resource extraction issuer may treat all the activities within a major subnational political jurisdiction as a single project, although it is required to describe each type of resource being commercially developed and each method of extraction used in the description of the project. A resource extraction issuer may not combine as one project activities that cross the borders of a major subnational political jurisdiction.

  Instruction (5)(iii) indicates that onshore and offshore development of resources may not be treated as a single project. A resource extraction issuer must identify when a project is offshore and identify the body of water in which the project is located, using the smallest body of water applicable (e.g., gulf, bay or sea), in addition to identifying the nearest major subnational political jurisdiction. The requirement to identify the body of water is an incremental enhancement from the proposed Rules. If an offshore project is equidistant from two major subnational political jurisdictions, the issuer may identify both jurisdictions. The final Rules modified the requirements for identifying offshore projects to mitigate the risk of confusion.

Alternative Approaches. In the Adopting Release, the SEC recognizes that some resource extraction issuers have expressed a commitment to provide more granular project disclosure in accordance with the requirements adopted by Canada, the European Union and Norway. Issuers may elect to furnish reports prepared under alternative reporting regimes recognized by the SEC. Alternatively, issuers can provide this information outside of their Form SD, such as on their website, in a corporate social responsibility report or on a Form 8-K or Form 6-K.

Have We Heard the Last Word on the Definition of Project? The Adopting Release contemplates the possibility of further litigation involving the Rules, seeking to invalidate the definition of "project." The Adopting Release indicates the SEC's preference for how the Rules should be applied if the definition of "project" is held invalid by a court or otherwise deemed ineffective. If this occurs, the SEC's preference is that the Rules be enforced and resource extraction issuers disclose resource extraction payments to the fullest extent practicable, including the per-project payment disclosures required by Section 13(q).

If the current definition of "project" is invalidated, the Adopting Release instructs issuers to determine based on their own business structure and other relevant considerations how to identify and describe their various projects until the SEC completes any further rulemaking to define "project." The SEC believes this is a reasonable approach since Section 13(q) does not define "project" and issuers would be able to take this approach if the SEC had not exercised its discretion to adopt a definition of "project." However, the Adopting Release notes the anti-evasion provisions of the Rules would apply to these disclosures.

Information to Be Reported

Under the Rules, the information indicated below will be required to be provided. Selected project-specific disclosures are described in the discussion of the definition of "project" earlier in this Alert, rather than in this portion of the Alert. The payment categories for which disclosure is required also are discussed earlier in this Alert.

- The type and total amount of the payments, by payment type, 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 the payments, by payment type, for all projects made to each government.
- The total amounts of the payments, by payment type.
- The currency used to make the payments.
- The fiscal year in which the payments were made.
- The business segment of the resource extraction issuer that made the payments.

  For purposes of the Rules, a business segment is consistent with the reportable segments used by the resource extraction issuer for purposes of financial reporting.
- The governments that received the payments, and the country in which each such 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 method of extraction used in the project.
- The major subnational political jurisdiction of the project.

The proposed Rules included an additional Instruction that would have permitted an issuer to aggregate all of its payments of a particular payment type made to foreign governments below the major subnational government level without having to identify the particular subnational government payees. The issuer instead could have generically

identified the type of administrative or political level of subnational government that received the payments. For example, an issuer would have been able to aggregate payments made to multiple counties and municipalities without identifying the payees by name or disclosing the amount of the payment each received. After considering the comments received on the proposed Rules, the SEC excluded this accommodation from the final Rules.

Entity Level Payments. The Rules include a clarifying instruction (Instruction (4)) indicating that resource extraction issuers do not need to disaggregate payments that are made for obligations levied on the issuer at the entity level rather than the project level.

Calculating Payments; Audits

Cash Basis. Payment information is required to be provided on a cash basis.

Reporting Currency; Currency Conversions. Payments are required to be reported in either U.S. dollars or the resource extraction issuer's reporting currency if not U.S. dollars. If payments are made in a currency other than its reporting currency or U.S. dollars, the issuer is permitted to choose to calculate the currency conversion in one of three ways:

- translating the expenses at the exchange rate at the time the payment is made;
- using a weighted average of the exchange rates during the period; or
- based on the exchange rate as of the issuer's fiscal year end.

The method used to calculate the currency conversion must be disclosed. In addition, a consistent method must be used for all currency conversions within the same submission.

Valuing In-Kind Payments. Instruction (12) to the Rules indicates that, when reporting an in-kind payment, the resource extraction issuer is required to determine the monetary value of the payment and tag the information as "in-kind" for purposes of the currency.

The issuer generally is required to report the payment at cost, or, if cost is not determinable, at fair market value, and must provide a brief description of how the monetary value was calculated. If a resource extraction issuer makes an in-kind production entitlement payment and then repurchases the resources associated with the production entitlement within the same fiscal year, the resource extraction issuer is required to report the payment using the purchase price (rather than at cost or 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 is required to report the difference in values in the latter fiscal year (assuming the amount of that difference exceeds the de minimis threshold). 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.

Audit Not Required. The Rules indicate that a resource extraction issuer is not required to have the payment information presented in its Form SD audited.

Transition and Other Exemptions

The Rules contain targeted exemptions addressing conflicts with laws and pre-existing contracts. The Rules also include transition exemptions for IPO issuers and acquired companies and allow for delayed reporting of exploratory activities. Issuers also can apply for exemptions on a case-by-case basis. All of these exemptions are further discussed below.

The Rules do not include blanket exemptions where disclosure would jeopardize competitively sensitive information or potentially jeopardize the safety and security of employees and operations. However, the SEC notes in the Adopting Release that it believes the changes made to the 2016 Rules should help alleviate these concerns.

As noted earlier in this Alert, there also is an exemption for emerging growth companies and smaller reporting companies.

Legal Conflicts. If a resource extraction issuer is prohibited by the law of the jurisdiction where the project is located from providing the payment information required by Form SD, it is permitted to exclude that disclosure, subject to the following conditions:

- The issuer took all reasonable steps to seek and use any exemptions or other relief under the applicable law of the foreign jurisdiction, and was unable to obtain or use such an exemption or other relief;
- The issuer discloses on Form SD the foreign jurisdiction for which it is omitting the disclosure, the particular law of that jurisdiction that prevents the issuer from providing the disclosure and the efforts the issuer undertook to seek and use exemptions or other relief under the applicable law of that jurisdiction, and the results of those efforts; and
- The issuer furnishes as an exhibit to its Form SD a legal opinion from counsel that opines on the issuer's inability to provide such disclosure without violating the foreign jurisdiction's law.

The exemption is not limited to pre-existing foreign laws.

Contractual Conflicts. A resource extraction issuer that is unable to provide the payment information required by Form SD without violating one or more contract terms that were in effect prior to the effective date of the Rules is permitted to exclude that disclosure, subject to the following conditions:

- The issuer took all reasonable steps to obtain the consent of the relevant contractual parties, or to seek and use another contractual exception or relief, to disclose the payment information, and was unable to obtain such consent or other contractual exception or relief;
- The issuer discloses on Form SD the jurisdiction for which it is omitting the disclosure, the particular contract terms that prohibit the issuer from providing the disclosure and the efforts the issuer undertook to obtain the consent of the contracting parties, or to seek and use another contractual exception or relief, to disclose the payment information, and the results of those efforts; and
- The issuer furnishes as an exhibit to its Form SD a legal opinion from counsel that opines on the issuer's inability to provide such disclosure without violating the contractual terms.

The Adopting Release notes that the obligation to take reasonable steps to obtain consent does not include an obligation to renegotiate an existing contract or to compensate the other contractual parties for their consent to disclose resource extraction payments.

Payments Relating to Exploratory Activities. The Rules allow for a temporary delay in reporting payments relating to exploratory activities. Resource extraction issuers are permitted to delay reporting these payments until the fiscal year following the fiscal year in which the payments are made.

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

Acquired Entities. A resource extraction issuer that acquires or otherwise obtains control over another entity that was not obligated in its last full fiscal year to provide disclosure pursuant to Rule 13q-1 or another alternative reporting regime

recognized by the SEC is not required to commence reporting payment information for the acquired entity until its Form SD submission for the fiscal year immediately following the effective date of the acquisition. The resource extraction issuer is required to disclose that it is relying on this accommodation in the body of its Form SD submission.

IPO Issuers. A resource extraction issuer that completed its initial public offering in its last full fiscal year is not required to commence reporting payment information pursuant to Rule 13q-1 until the Form SD submitted for the fiscal year immediately following the fiscal year in which the registration statement for its U.S. initial public offering became effective.

Case-by-Case Exemptions. Issuers may apply for exemptions on a case-by-case basis using the procedures set forth in Rule 0-12 of the Exchange Act. For example, an issuer could apply for an exemption where disclosure would have a substantial likelihood of jeopardizing the safety of its personnel.

An issuer seeking an exemption is required to submit a written request for exemptive relief to the SEC describing the particular payment disclosures it seeks to omit and the specific facts and circumstances it believes warrant an exemption, including the particular costs and burdens it faces if the information is disclosed.

The Adopting Release notes that, in situations where exigent circumstances exist, the SEC staff, acting pursuant to delegated authority, could rely on Exchange Act Section 12(h) for the limited purpose of providing interim relief while the SEC considers the exemptive application.

Form, Format and Other Submission Requirements

Submissions on Form SD. Disclosures are required to be submitted on Form SD through the SEC's EDGAR system. This aspect of the Rules is further discussed below.

All of the substantive disclosure required to be submitted is to be contained on an exhibit – Exhibit 2.01 – to the Form SD.

The information provided by resource extraction issuers on Form SD will be "furnished" instead of "filed." The distinction is that furnished information is not subject to liability under Section 18 of the Exchange Act.

Submission Due Dates; Initial Compliance Date. A resource extraction issuer must submit its Form SD within 270 days after the end of its most recently completed fiscal year.

The due date was modified from the proposed Rules. Under the proposed Rules, an issuer with a fiscal year ending on or before June 30 would have been required to submit its Form SD no later than March 31 in the calendar year following its most recent fiscal year. For an issuer with a fiscal year ending after June 30, the Form SD submission would have been due no later than March 31 in the second calendar year following the issuer's most recent fiscal year.

The Rules require a resource extraction issuer to comply with them for fiscal years ending no earlier than two years after their effective date. The effective date of the Rules is 60 days after they are published in the Federal Register. Using the example cited in the Adopting Release, if the Rules become effective on March 1, 2021, the initial compliance date for an issuer with a December 31 fiscal year-end will be September 30, 2024, which is 270 days after its fiscal year ending December 31, 2023.

XBRL Requirements. Payment disclosure is required to be presented in the eXtensible Business Reporting Language (XBRL) electronic format and contain XBRL tags. The tags consist of both tags with fixed definitions and customizable tags.

A resource extraction issuer is permitted to omit data tags that are inapplicable because the payments relate to obligations levied at the entity level. Examples of tags that might be omitted are the project tag and business segment tag. The resource extraction issuer is required to provide all other electronic tags, including the tag identifying the recipient government.

Location Tagging. Instruction (3) indicates that, when identifying the country and major subnational political jurisdiction where the commercial development of the resource is taking place, a resource extraction issuer is required to use the combined country and subdivision code provided in ISO 3166, if available. When identifying the country in which a government is located, a resource extraction issuer is required to use the two-letter country code provided in ISO 3166, if available.

In a change from the proposed Rules, issuers are required to provide an electronic tag identifying each subnational government payee, rather than referring to payees below the major subnational political jurisdiction generically. This change was made in response to commenters' concerns that the proposed treatment of payments to subnational governments was not sufficiently transparent.

Inline XBRL Not Required. 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 Rules, which is primarily an exhibit with tabular data, the SEC has indicated it does not believe that Inline XBRL would improve the usefulness or presentation of the required disclosure.

Subsidiary and Other Controlled Entity Registrants. If a resource extraction issuer is controlled by another resource extraction issuer that has submitted a Form SD disclosing the information otherwise required to be disclosed by the controlled entity, then the controlled entity is not required to separately provide the same disclosure. The controlled entity is required only to submit a notice on Form SD indicating that the disclosure was submitted by the controlling entity, identifying the controlling entity and the date the information was submitted. The reporting controlling entity also is required to note that it is submitting the disclosure for the controlled entity and to identify the controlled entity in its submission.

Alternative Reporting

The Rules contemplate allowing issuers to submit disclosures made pursuant to foreign resource extraction payment disclosure regulations. As discussed below, in connection with the adoption of the Rules, the SEC issued an Order recognizing several foreign disclosure requirements as alternative reporting regimes that satisfy the transparency objectives of Section 13(q).

Substantive Reporting Requirements. Under the Rules, a resource extraction issuer that is subject to the payment disclosure requirements of an alternative reporting regime that has been deemed by the SEC to require disclosure that satisfies the transparency objectives of Section 13(q) may meet its Form SD disclosure obligations by including as an exhibit to its Form SD a report complying with the reporting requirements of the alternative jurisdiction.

The alternative report is required to be the same as that which is prepared and made publicly available pursuant to the requirements of the approved alternative reporting regime.

Additional Form SD Disclosures. The resource extraction issuer is required to (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 submitted report in the alternative jurisdiction; and (4) specify that the payment disclosure required by Form SD is included in an exhibit to the Form.

XBRL. The alternative report is required to be provided in XBRL format.

Translations. A fair and accurate English translation of the entire report is required to be submitted if the report is in a foreign language.

Timing. The resource extraction issuer can follow the submission deadline of the approved alternative jurisdiction if it submits a notice on Form SD on or before what would otherwise be the due date of its Form SD indicating its intent to submit the alternative report using the alternative jurisdiction's deadline. If a resource extraction issuer fails to submit the notice in a timely manner, or submits a notice but fails to submit the alternative report within seven business days of the alternative jurisdiction's deadline, it will not be able to rely on the alternative reporting accommodation for the following fiscal year. The final Rules modified the four-business-day period contemplated in the proposed Rules.

Additional Requirements. Resource extraction issuers also are required to comply with any additional requirements that are provided by the SEC in connection with permitting alternative reporting.

Designation of Alternative Reporting Regimes. The SEC issued an Order recognizing the following resource extraction payment disclosure regimes as alternative reporting regimes that satisfy Section 13(q)'s transparency objectives:

- the EU Accounting Directive;
- the EU Transparency Directive;
- the UK's Report on Payments to Governments Regulations;
- Norway's Regulations on Country-by-Country Reporting; and
- Canada's Extractive Sector Transparency Measures Act.

In connection with the adoption of the 2016 Rules, the SEC recognized the EU Directives and the Canadian ESTMA as alternative reporting regimes.

In its Adopting Release, the SEC estimates that 177 issuers are subject to the requirements of one of the recognized alternative reporting regimes.

To the extent resource extraction payment disclosure legislation is adopted in other jurisdictions, the SEC can consider whether those disclosure regimes also should qualify as alternative reporting regimes. The SEC can do so either on its own initiative or pursuant to an application submitted by an issuer or a jurisdiction. The SEC indicated in the Adopting Release that it would anticipate considering the following criteria, among others:

- the types of activities that trigger disclosure;
- the types of payments that are required to be disclosed; and
- whether project-level disclosure is required and, if so, the definition of "project."

Next Steps for Issuers

There are several action items relevant issuers should consider in anticipation of reporting under the Rules.

Determine the Applicability of the Rules. Larger companies generally have a good handle on the Rules and how the Rules impact them. These companies have been following the Rules closely, in many cases for the past ten years, and also have been involved in industry advocacy efforts.

In contrast, we have found that many smaller and mid-sized public companies are significantly less up to speed on the Rules. Now that final Rules have been adopted, these issuers should assess the applicability of the Rules to their business. As a threshold matter, they will need to determine whether they are a resource extraction issuer. If so, they will

need to determine whether they will have a reporting obligation under the Rules and what disclosures they will be required to make. In some cases, this will require an analysis and determination of what the issuer's projects are for purposes of the Rules, since that may not be clear on its face.

Take the Rules into Account in Contracting. As discussed in this Alert, a confidentiality provision in a new contract will not excuse a resource extraction issuer from making the disclosures required by the Rules. When negotiating new contracts, resource extraction issuers should be mindful of the disclosure requirements of the Rules, so that non-disclosure provisions align with their obligations under the Rules.

Evaluate the Impact of the Rules on Existing Contracts. Issuers should assess whether disclosures under the Rules would breach any existing contracts. As discussed earlier in this Alert, a resource extraction issuer that is unable to provide required payment information without violating contract terms in effect prior to the effective date of the Rules is permitted to exclude that information if the issuer satisfies certain requirements. To the extent an existing contract prohibits payment disclosure, the issuer should determine the steps to be taken to seek the consent of the relevant contract parties, or to seek another contractual exception or relief that is applicable, to be able disclose the information contemplated by the Rules.

Determine Whether Disclosures May Violate Foreign Laws. As noted earlier in this Alert, if a resource extraction issuer is prohibited by the law of the jurisdiction where a project is located from providing the payment information contemplated by the Rules, it may exclude that information if it meets certain conditions. As an initial step, potentially impacted issuers should determine whether any laws might prohibit disclosure. For example, during the rulemaking process, one commenter indicated that Qatar and China prohibit payment disclosures required by the Rules. If applicable, the issuer should formulate an approach for seeking and using any exemptions or other relief under the applicable law of the foreign jurisdiction.

Assess the Adequacy of Existing Data Collection and Internal Reporting Processes. Many resource extraction issuers are expected to need to modify aspects of their enterprise resource planning and financial reporting systems to be able to efficiently track, record and report the information contemplated by the Rules. For example, issuers may need to establish additional granularity in existing coding structures, develop a mechanism to appropriately capture data by project, build new collection tools within financial reporting systems, establish a trading partner structure to identify and provide granularity around government entities, establish transaction types to accommodate different types of payments and develop a systematic approach to handling in-kind payments. Issuers should assess where modifications to existing processes and/or systems are necessary and develop a plan for implementing the modifications.

Assess Communications Risk and Develop a Communications Strategy. Payment disclosures by resource extraction issuers are likely to be scrutinized by NGOs, at least some institutional investors, community activists and other external stakeholders. As is the case with other ESG and corporate social responsibility disclosures, disclosures by resource extraction issuers will be used by external constituencies to help determine which companies to target and the engagement strategy for doing so. Issuers should assess how their particular disclosures may be perceived and used by external stakeholder constituencies, as well as what additional messaging they may want to put out beyond the required disclosures under the Rules and the form of that messaging.

Assess Other Business Risks. Issuers and trade associations have identified other potential risks that might result from disclosures under the Rules, including competitive harm and risks to personnel and property. These risks – and the responses – will differ greatly by issuer. And, many of these risks may require substantial lead times to mitigate. Accordingly, issuers should assess the likelihood and potential severity of business risks that may result from disclosures under the Rules.

Determine Whether to Seek Case-by-Case Exemptive Relief. The Rules provide that issuers can apply for exemptions on a case-by-case basis. For example, an issuer could apply for an exemption if disclosure would have a substantial likelihood of jeopardizing the safety of its personnel. An issuer seeking an exemption is required to submit a written request for exemptive relief to the SEC describing the particular payment disclosures that it seeks to omit and the specific facts and circumstances that it believes warrant an exemption, including the particular costs and burdens it faces if the information is disclosed.

About Our Practice

Ropes & Gray has a leading ESG, CSR and business and human rights compliance practice. We offer clients a comprehensive approach in these subject areas through a global team with members in the United States, Europe and Asia. In addition, senior members of the practice have advised on these matters for more than 30 years, enabling us to provide a long-term perspective that few firms can match.

For further information on the practice, click here.

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