Third Time a Charm: SEC Enacts Resource Extraction Disclosure Rules

December 22, 2020

Rules are the third attempt by the SEC to implement the Dodd-Frank mandate

After almost a decade of attempting to issue rules on resource extraction disclosure, on December 16 the SEC adopted **amendments** that would require resource extraction companies to disclose payments made to foreign governments or to the U.S. federal government for the commercial development of oil, natural gas, or minerals. The new rules are the third attempt by the SEC to implement the resource extraction disclosure rules mandated by the Dodd-Frank Act. By requiring disclosure at the national and major subnational political jurisdiction level, rather than the contract level, this version of the final rules mandates less disclosure than the SEC's previous resource extraction disclosure rules.

Background of the new rules

The SEC is mandated by Section 13(q) of the Securities Exchange Act of 1934, which was adopted as part of the Dodd-Frank Act (the "Exchange Act") in 2010 to issue resource extraction disclosure rules. The two previous attempts by the SEC to enact similar rules were unsuccessful. The first resource extraction disclosure rules were adopted in August 2012 but, following an industry challenge, were overturned in federal court which found that the SEC had "misread" the statute by requiring public disclosure of the information and that the SEC's denial of an express exemption for disclosures prohibited under foreign law was arbitrary and capricious. A revised set of resource extraction disclosure rules that sought to address issues raised in the prior litigation was adopted by the SEC in June 2016 (the "2016 Rules"), but was disapproved by a joint resolution of Congress pursuant to the Congressional Review Act in 2017. Among the reasons cited by those who supported the disapproval of the 2016 Rules were the cost of compliance, disclosure of project-level sensitive business information and putting U.S.-registered companies at a competitive disadvantage.

In December 2019, the SEC proposed its third iteration of the rules (as discussed in our memo **here**), and has now adopted the new rules substantially as proposed. As stated by SEC Commissioner Jay Clayton, the new final rules falls within the "Venn diagram intersection" of the Dodd-Frank mandate and the requirement, pursuant to the Congressional Review Act, that the new final rules not be "substantially the same" as the ones that were disapproved by Congress. A number of provisions in the new rules differ from the 2016 Rules, and among the most significant is the requirement to disclose at the national and major subnational political jurisdiction level, as opposed to the contract level. This change should be a welcome relief to resource extraction companies.

Highlights of the new rules

The new rules will require a domestic or foreign company that files a Form 10-K, 20-F or 40-F to disclose payments made to a foreign government or to the U.S. federal government if the company engages in the commercial development of oil, natural gas, or minerals.

The new rules include several changes compared to the 2016 Rules vacated pursuant to the Congressional Review Act. For example, the new rules:

- expand the definition of the term "project" to no longer reference a specific project, but to reference a matter defined by three factors: the type of resource, the method of extraction and at the national and major subnational political jurisdiction where the commercial development of the resource is taking place, leading to disclosure that is less specific;
- add conditional exemptions for when a foreign law or a preexisting contract prohibits the required disclosure;
- add an exemption, in certain instances, for smaller reporting companies and emerging growth companies, or "EGCs" and add relief for companies that have recently completed their IPOs;

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- revise the definition of "control" to mean when a company consolidates an entity under the applicable accounting principles and *exclude* entities or operations in which a company has only a proportionate interest;
- limit the liability for the required disclosure by deeming the payment information to be furnished to, but not filed with, the SEC;
- permit a company to aggregate payments by payment type made at a level below the major subnational government level; and
- extend the deadline for furnishing the payment disclosures.

In a change from the SEC's recent proposal, the new rules retain the "not *de minimis*" threshold from the 2016 Rules.

Covered Entities

Under the new rules, the term "resource extraction issuer" applies to U.S. and foreign companies that (1) file a Form 10-K, 20-F or 40-F with the SEC pursuant to Section 13 or 15(d) of the Exchange Act and (2) engage in the commercial development of oil, natural gas or minerals. Covered companies will also be required to disclose payments made by a subsidiary or other entity they control.

Registered investment companies will not be subject to the new rules. Emerging growth companies and smaller reporting companies will also not be subject to the rules, unless they are subject to the resource extraction payment disclosure requirements of an alternative reporting regime that the SEC has deemed to satisfy the transparency objectives of Section 13(q). Voluntary filers are also not explicitly covered by the rules.

Covered Activities

The new rules define "commercial development of oil, natural gas, or minerals" as exploration, extraction, processing, and export of oil, natural gas, or minerals, or the acquisition of a license for any such activity. The new rules define the relevant terms as follows:

- "Commercial development of oil, natural gas, or minerals" is defined as "exploration, extraction, processing, and export of oil, natural gas, or minerals, or the acquisition of a license for any such activity." The rules state that the definition is intended to capture only those activities that are *directly* related to the commercial development of oil, natural gas, or minerals, and not activities ancillary or preparatory to such commercial development. Accordingly, a company that is only providing products or services that support the exploration, extraction, processing, or export of such resources (e.g., hydraulic fracturing or drilling services) would not be a "resource extraction issuer" under the rules. In addition, it does not cover transportation made for a purpose other than export.
- "Extraction": The new rules define "extraction" as the production of oil or natural gas, or the extraction of minerals.
- "Processing": The definition of "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 the upgrading of 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 or refining phase. It does not include downstream activities such as refining or smelting.

Covered Payments

The new rules require companies to disclose payments made to governments during any fiscal year relating to the commercial development of oil, natural gas, or minerals by type and total amount per project.

A company will be required to disclose payments it makes directly, as well as payments made by its subsidiaries and other entities under its control, if those entities' financial information must be consolidated under the accounting principles applicable to the company's financial statements included in

its Exchange Act reports. Disclosure will not be required for the proportionate amount of the payments made by a company's proportionately consolidated, or non-consolidated, entities or operations. Where no single party has control in a joint venture or arrangement, the company that is the operator of the venture or arrangement and makes payments to governments on behalf of its non-operator members must report all of the payments. In addition, if an entity providing services to a resource extraction company makes a payment to a government on its behalf that falls within the definition of "payment," the resource extraction company must disclose the payments. This disclosure obligation, however, 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.

The types of payments related to commercial development activities that will need to be disclosed on Form SD are:

- taxes;
- royalties, fees, and bonuses;
- dividends (excluding those paid to a government as an ordinary shareholder);
- payments for infrastructure improvements;
- community and social responsibility payments that are required by law or contract; and
- in-kind payments.

Disclosure will not be required for payment types such as commodity trading-related payments, payments for government expenses, providing jobs or tuition to persons related to government officials, investing in companies created by officials or related persons, payments of fines and penalties or other similar payments. The new rules include an anti-evasion provision that requires disclosure with respect to an activity or payment that, although not within one of the categories of activities or payments specified under the new rules, is part of a plan or a scheme to evade the disclosure requirements.

Under the new rules, the payment disclosure must be made on a cash basis instead of an accrual basis and need not be audited.

Not *De Minimis* Threshold

Section 13(q) requires the disclosure of payments that are "not *de minimis*." Pursuant to the new rules, disclosure will be required if the total payments made to each foreign government equal or exceed $100,000, whether made as a single payment or a series of related payments.

Modified Version of Project Reporting

In the most significant change from the 2016 Rules, the new rules define the term "project" to require disclosure at the national and major subnational political jurisdiction, as opposed to the contractual, level. By expanding the definition of "project," the new rules will reduce the competitive harm of disclosing granular, contractual information. The new rules define "project" using the following three criteria:

- the type of resource being commercially developed (e.g., oil, gas or specific mineral--subcategories are not required);
- the method of extraction (e.g., a well, an open pit, or underground mining); and
- the major subnational political jurisdiction (e.g., state, province, district, region, territory) where the commercial development of the resource is taking place.

Commercial development activities using multiple resource types or extraction methods may be treated as a single project if such activities are located in the same major subnational political jurisdiction. Where a resource being commercially developed could cross the borders between, and generate payment obligations in, multiple major subnational political jurisdictions, the new rules require the company to treat the activities in each major subnational political jurisdiction as separate projects.

If the project is offshore, the identification of the major subnational political jurisdiction where the commercial development of the resource is taking place should include the body of water in which the project is located, using the smallest body of water applicable (e.g., gulf, bay, sea) as well as the nearest

major subnational jurisdiction. In addition, if the project is equidistant from two major subnational jurisdictions, the company may disclose both such jurisdictions.

The new rules allow aggregated disclosure of payments made to subnational political jurisdictions, but require disclosure of the aggregated amount paid to, and identity of, each subnational political jurisdiction. For example, a company with extractive operations in the three oil sands regions of Alberta, Canada (the Regional Municipality of Wood Buffalo, Northern Sunrise County, and the Municipality of Cold Lake), would be required to identify each such subnational government entity as well as aggregate and report all of its fees paid for environmental and other permits to each such entity.

Exemptions from Compliance

The new rules include two new exemptions for the reporting requirements where disclosure is (i) prohibited by foreign law or (ii) conflicts with preexisting contracts.

The conflict of law exemption will not require companies to apply to the SEC for exemptive relief, as the 2016 Rules required. A company seeking to rely on the exemption will first be required to take all reasonable steps to seek and use exemptions or other relief under the applicable laws. Having failed to obtain such relief, the company will be required to make certain disclosures about its eligibility for relief and furnish a legal opinion regarding the conflict of law.

The exemption for a conflict with a preexisting contract will only apply when such terms are expressly included in writing in the contract prior to the effective date of the new rules. A company will have to first take reasonable steps to obtain the consent of the relevant parties or to seek and use any contractual exceptions or other relief to disclose the payment information. Having failed to obtain such relief, the company will be required to make certain disclosures about its eligibility for relief and furnish a legal opinion regarding its inability to provide such disclosure without violating the contract. The company's disclosure and its reliance on the exemption will be subject to staff review. This could pose a problem for recent public companies with contracts that went into effect after the effective date of the rules and will therefore not be eligible for the exemption. Davis Polk and others had noted this in comment letters to the SEC, but the provision remains unchanged from the proposal.

The new rules also allow a company to file an application for exemptive relief on a case-by-case basis.

Delayed Reporting Exemptions

The new rules include targeted exemption for payments related to exploratory activities. Under the new rules, a company may delay disclosing payments related to exploratory activities until it submits a Form SD for the fiscal year following the fiscal year in which the payments were made.

Transitional relief will also be available for recently acquired companies that were not previously subject to reporting requirements under the Exchange Act or an alternative reporting regime. A company will not be required to commence reporting payment information for the acquired entity until it files its Form SD for the first full fiscal year immediately following the effective date of the acquisition.

A company that has completed its initial public offering will not be required to commence reporting payment information until the first fiscal year immediately following the fiscal year in which it completed its IPO.

Alternative Reporting

A company that is subject to the resource extraction payment disclosure requirements of an alternative reporting regime, which has been deemed by the SEC to require disclosure that satisfies the transparency objectives of Section 13(q), may satisfy its disclosure obligations by including, as an exhibit to Form SD, a report complying with the reporting requirements of the alternative jurisdiction. The company must make certain disclosures about the alternative report in its Form SD and 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.

Form SD Requirements

For any payment required to be disclosed, the new rules require a company to provide public disclosure of the following information in an XBRL exhibit to Form SD using electronic tags:

- the total amounts of payments made (i) for each category of payment type (e.g., taxes, royalties, etc.), (ii) for each category of payment type for each project and (iii) for each category of payment type for all projects paid to each government;
- the currency used to make the payments;
- the financial period in which the payments were made;
- the company's business segment that made the payments;
- the government that received the payments and the country in which the government is located;
- the project to which the payments relate;
- the particular resource that is the subject of commercial development;
- the method of extraction used in the project; and
- the major subnational political jurisdiction of the project.

The rules provide that the SEC's staff will periodically make a separate public compilation of the payment information submitted on Forms SD available online, to the extent practicable.

Reduced Liability

In contrast to the 2016 Rules, the new rules provide that the resource extraction payment disclosure provided on Form SD would be considered "furnished" with the SEC rather than "filed." Accordingly, the disclosure will not be subject to liability under Section 18 but would remain subject to liability under Section 10 of the Exchange Act and Rule 10b-5 thereunder.

Timing and Effective Date

Under the new rules, a resource extraction company must furnish the required disclosure no later than 270 days following the end of the company's most recently completed fiscal year. A company may delay disclosing payment information related to exploratory activities until the Form SD submitted for the fiscal year immediately following the fiscal year in which the payment was made.

The new rules becomes effective 60 days after publication in the Federal Register; however, the rules provide a transition period whereby a company will be required to comply for fiscal years ending no earlier than two years after the effective date. For example, if the rules were to become effective on March 1, 2021, the compliance date for a company with a December 31 fiscal year end would be Monday, September 30, 2024 (i.e., 270 days after its fiscal year end of December 31, 2023).

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