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Shining a Light on Payments to Governments: SEC Adopts ‘Publish What You Pay’ Rule for Resource Extraction Issuers

On June 27, 2016, the US Securities and Exchange Commission (“SEC”) adopted a final rule¹ implementing Section 1504 of the Dodd-Frank Wall Street Reform and Consumer Protection Act (the “Dodd-Frank Act”). Section 1504 of the Dodd-Frank Act calls on the SEC to make rules requiring resource extraction issuers to disclose payments they make to governments for the commercial development of oil, natural gas or minerals. The new rule will take effect for an issuer’s first fiscal year ending on or after September 30, 2018, and will require disclosure of government payment information annually in a specialized disclosure report on Form SD no later than 150 days after an issuer’s fiscal year end.

The SEC originally adopted “publish what you pay” rules implementing Section 1504 of the Dodd-Frank Act in August 2012, but in July 2013 the SEC rule was vacated by US federal courts. In September 2015, a US federal court ordered the SEC to expedite its rulemaking process for adopting a final government payments disclosure rule, and in December 2015, the SEC issued a new proposed rule for comment.

In the new rule, the SEC has sought to address the findings of the court that vacated its prior rule. In addition, the SEC has considered similar recent extractive industry transparency initiatives in the European Union and Canada, as well as by the Extractive Industries Transparency Initiative (“EITI”), with a view to enhancing the consistency and comparability of the SEC rules with the disclosure requirements of these other key jurisdictions.

Summary of New Rule

The SEC’s rulemaking adds new Rule 13q-1 under the Securities Exchange Act of 1934 (the “Exchange Act”).

Which Companies Are Subject to the Rules?

This rule applies to SEC reporting issuers that are required to file annual reports on Form 10-K, 20-F or 40-F and that engage in the commercial development of oil, natural gas or minerals. “Commercial development” includes:

- exploration;
- extraction;
- processing;
- export; and

¹ <https://www.sec.gov/rules/final/2016/34-78167.pdf>

- the acquisition of a license for any such activity.

Such issuers are required to file annually a specialized disclosure report on Form SD (the same form currently used to report conflict minerals disclosures) within 150 days after their fiscal year end.

The rule clarifies that “processing” activities include, among other things, midstream activities such as the processing of gas to remove liquid hydrocarbons, the removal of 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. It also includes the crushing and processing of raw ore prior to the smelting phase. “Processing” does not include downstream activities, such as refining or smelting.

“Export” is defined as the transportation of a resource from its country of origin to another country by an issuer with an ownership interest in the resource. It would not include transportation on a fee-for-service basis by a service provider with no ownership interest. The movement of a resource across an international border by a company not otherwise engaged in exploration, extraction or processing activities and that acquired its ownership interest in the resource directly from a government is not considered to be “exporting” for purposes of the rule.

The rule does not apply to ancillary or preparatory activities for the commercial development of oil, natural gas or minerals (e.g., the manufacturing of drill bits), nor does it apply to transportation (unless such transportation activities fall within the definition of “export”). While the provision of hydraulic fracturing or drilling services to enable an operator to extract resources would be considered “ancillary” activities, the resource extraction issuer must disclose payments made by a service provider to a government on its behalf that fall within the definition of “payment.”

Which Types of Payments Must be Reported?

A payment is required to be included in an issuer’s government payments disclosure on Form SD only if it falls within one of the following categories:

- taxes—including taxes levied on corporate profits, corporate income and production, but excludes taxes levied on consumption (such as VAT, personal income taxes or sales taxes);
- royalties—including unit-based, value-based and profit-based royalties;
- fees (including license fees)—includes rental fees, entry fees and concession fees;
- production entitlements;
- bonuses—including signature, discovery and production bonuses;
- dividends—excludes dividends paid to a government as a common or ordinary shareholder under the same terms as other shareholders;
- infrastructure payments—e.g., building a road or railway to further the development of oil, natural gas or minerals; and
- community and social responsibility (“CSR”) payments that are required by law or contract.

While the proposed rule would not have required disclosure of CSR payments, consistent with the EITI, the rule as adopted includes such payments to the extent they are required by law or contract, as the SEC believes

these are part of the commonly recognized revenue stream for the commercial development of oil, natural gas or minerals.

In-kind payments (such as production entitlements) are required to be disclosed if they meet one of the covered payment types listed above. In-kind payments must be reported at cost, unless historical costs are not reasonably available or determinable, in which case such payments may be reported using fair market value, and issuers must briefly describe how the monetary value was calculated. Where an issuer makes an in-kind production entitlement payment and then repurchases the resources associated with the production entitlement within the same fiscal year, the issuer must use the purchase price when reporting the in-kind value of the production entitlement (or the difference in value, if the purchase is made in a subsequent fiscal year and the purchase price is greater than the initially reported in-kind payment).

Payment information required to be disclosed on Form SD need not be audited and must be made on a cash (rather than accrual) basis.

Payments made for obligations levied at the entity level, such as corporate taxes, may be disclosed at the entity level, and are not required to be allocated at the project level.

The rule includes an exception for *de minimis* payments, which are payments under \$100,000, or the equivalent in the issuer's reporting currency, whether made as a single payment or series of related payments. Periodic payments, such as rental fees, are required to be disclosed if the aggregate amount of such payments exceeds the \$100,000 threshold.

Payments from Whom and to Whom?

The new rule covers payments made by the issuer, as well as by any subsidiary or entity under the control of the issuer. "Subsidiary" and "control" for this purpose are aligned with the issuer's accounting principles.

Therefore, an issuer will be required to disclose payments made by any entity that is consolidated (including proportional consolidation of an interest in an entity or operation) under the accounting principles applicable to the issuer's financial statements filed as part of its Exchange Act reports. For entities that are proportionally consolidated, only the issuer's proportionate interest in the payment need be disclosed.

Disclosure is required for payments made to any "foreign government," which includes a department, agency or instrumentality of a foreign government or a company at least majority owned by a foreign government. The rule covers payments to foreign subnational governments, such as the government of a state, province, county, district, municipality or territory under a foreign national government. In the United States, only payments to the US federal government are within the scope of the rules, and payments to states or other subnational governments in the United States are excluded.

Project-Level Disclosure

Section 1504 of the Dodd-Frank Act requires the reporting of payments made by resource extraction issuers to governments by type and total amount per project. In the new rule, the SEC has sought to align the definition of "project" to EU and Canadian standards. The rule defines "project" as operational activities that are governed by a single contract, license, lease, concession or similar legal agreement, which form the basis for payment liabilities with a government. Issuers may treat multiple agreements that are both operationally and geographically interconnected as a single project.

An instruction to the rule provides a non-exhaustive list of factors to consider when determining whether agreements are “operationally and geographically interconnected,” no single one of which is necessarily determinative:

- whether the agreements relate to the same resource and the same or contiguous part of a field, mineral district or other geographic area;
- whether they will be performed by shared key personnel or with shared equipment; and
- whether they are part of the same operating budget.

The SEC specifically addresses the definition of “project” proposed by the American Petroleum Institute, which would aggregate payments by resource within a single subnational political jurisdiction. The SEC believes that a contract-based definition of “project” provides greater transparency and consistency with the EU and Canadian rules.

Form and Timing of Disclosure

Issuers are required to disclose government payments information annually in a specialized disclosure report on Form SD, no later than 150 days after the issuer’s fiscal year end. The required disclosure will need to be filed on EDGAR in an electronically tagged XBRL exhibit to Form SD. The final rules will take effect for an issuer’s first fiscal year ending on or after September 30, 2018. For companies with a calendar year-end, the first year of compliance will be the year ended December 31, 2018, and the filing deadline will be May 30, 2019.

For any payment required to be disclosed, the issuer will need to disclose and electronically tag (in XBRL format) the following information:

- the total amounts of the payments, by category;
- the currency used to make the payments;
- the financial period in which the payments were made;
- the business segment of the resource extraction issuer that made the payments (consistent with the reportable segments used for purposes of the issuer’s financial reporting);
- the government that received the payments, and the country in which the government is located (including the ISO 3166 code, if available);
- the project of the resource extraction issuer to which the payments relate;
- the particular resource that is the subject of commercial development; and
- the subnational geographic location of the project (including the ISO 3166 code, if available).

In addition, an issuer will need to provide and tag the type and total amount of payments made for each project and the type and total amount of payments for all projects made to each government.

In the July 2013 US federal court ruling vacating the SEC’s prior attempt at adopting a final “publish what you pay” rule, the court determined that the statutory text of Section 1504 of the Dodd-Frank Act did not compel the SEC to require issuers to publicly file their annual government payments reports or to otherwise make such reports publicly available, in addition to the statutory requirement of the SEC to make publicly available a compilation of the information from such reports. While the court found fault with the SEC’s rulemaking process,

it clarified that the statute gives the SEC discretion whether to require public filing of the reports. In the new rulemaking, the SEC exercised its discretion to require issuers to publicly file their government payments report on EDGAR, reasoning that this approach best accomplishes the purposes of the statute, including reducing corruption in the extractive industries, promoting governmental accountability and consistency with international transparency promotion efforts, such as the EITI and the EU rules.

Exemptions and Recognition of Equivalency

In vacating the prior rule, the US federal court further held that the SEC had acted arbitrarily and capriciously in concluding that Section 1504 does not allow an exemption to the reporting requirements for payments to governments in countries where disclosure is prohibited by law (specifically, and currently, Angola, Cameroon, China and Qatar). Rather than writing a blanket exemption into the rule, the new rule permits issuers to apply to the SEC for exemptions on a case-by-case basis. In such a request for exemptive relief, the SEC would expect an opinion of counsel in support of any claim that a foreign law prohibits the disclosure of the information in question.

In response to comments received in the rulemaking process, the new rule includes a targeted exemption for payments made in connection with exploratory activities. Specifically, issuers are permitted to delay reporting such payments until the fiscal year following the year in which the payments were made. The SEC believes that this approach should reduce the likelihood of competitive harm in regards to a new discovery. Payments are considered to be related to exploratory activities if they are made as part of the process of identifying areas that may warrant examination or examining specific areas that are considered to have prospects of containing oil and gas reserves, or as part of a mineral exploration program. This exemption is not available once development or extraction activities have commenced.

The new rule also provides for a transition period for recently acquired companies that were not previously subject to government payments reporting under Rule 13q-1 or another jurisdiction's "publish what you pay" requirements that have been deemed substantially similar. Issuers are permitted not to comply with government payments reporting in respect of such recently acquired companies until the issuer's Form SD filing for the fiscal year immediately following the effective date of the acquisition. There is no similar transitional relief for initial public offerings.

In line with the EU and Canadian "publish what you pay" reporting regimes, which provide for recognition of foreign reporting regimes deemed equivalent, the SEC is allowing issuers to comply with the SEC rule by using reports prepared in compliance with a foreign jurisdiction's rules if the SEC has determined that those rules or requirements are substantially similar to the final rule adopted by the SEC. Currently, the SEC recognises the EU and Canadian reporting regimes, as well as the US Extractive Industries Transparency Initiative ("USEITI"),² as substantially similar and therefore will accept reports prepared in compliance with those alternative rules. If an issuer elects to provide an alternative report to satisfy SEC government payments reporting requirements, the alternative report must be tagged using XBRL, and the issuer must provide a fair and accurate English translation if the report is in a foreign language.

² USEITI reports will only satisfy Rule 13q-1 for payments made to the U.S. Federal Government, and not to foreign governments, and payment information must be on a fiscal year basis.

Anti-evasion

Like the EU and Canadian regimes, the new rule includes an anti-evasion provision, which requires disclosure with respect to an activity (or payment) that, although not strictly within the covered activity or payment categories enumerated in the rule, is part of a plan or scheme to evade the disclosure requirements.

Comparison of Reporting Regimes

The chart on the following pages gives a detailed comparison of the US, EU, Canadian and EITI reporting frameworks. A few caveats should be noted:

- The information presented regarding the EU rules is based on the EU Accounting Directive and, where noted, the UK Reports on Payments to Governments Regulations 2014. The implementation of the EU Accounting Directive in each Member State may differ in some aspects that are not reflected in the chart.
- The information presented regarding the Canadian rules is based on the statutory text of the Extractive Sector Transparency Measures Act (Canada), together with the implementation tools (the Guidance and the Technical Reporting Specifications), which have been developed by Natural Resources Canada.

Comparison of “Publish What You Pay” Reporting Regimes

	US	EU	Canada	EITI
In force?	Yes. Compliance required beginning with first fiscal year ending on or after September 30, 2018.	Yes. Member States were to enact implementing legislation by July 20, 2015.	Yes. Law came into force on June 1, 2015. Compliance required beginning with first full financial year after the date the law came into force.	Yes, in countries that have adopted the EITI Standard.
Which companies are subject to the reporting requirements?	Any company that is: <ul style="list-style-type: none"> engaged in the commercial development of oil, natural gas or minerals; <u>and</u> required to file annual reports (10-K, 20-F or 40-F) with the SEC. Does <u>not</u> include foreign private issuers that are exempt from Exchange Act registration pursuant to Rule 12g3-2(b).	Large undertakings ³ (whether or not listed) and public-interest entities (including companies with securities admitted to trading on a regulated market in the EU) that are active in the extractive industry (minerals, oil, natural gas deposits or other materials) or the logging of primary forests.	Any entity that is engaged in the commercial development of oil, gas or minerals and: <ul style="list-style-type: none"> is listed on a stock exchange in Canada; <u>or</u> has a place of business in Canada, does business in Canada or has assets in Canada and, based on its consolidated financial statements, meets at least two of the following for at least one of two most recent financial years: <ul style="list-style-type: none"> at least C\$20 million in assets; at least C\$40 million in revenue; and employs an average of at least 250 employees. 	Oil, gas and mining companies that make payments to government within a particular country. Implementing countries may elect to expand to include other sectors/ industries.
Equivalency of other reporting regimes recognized?	Yes.	Yes.	Yes.	Not addressed in EITI Standard.
Reporting period	Fiscal year.	Financial year.	Financial year.	Subject to agreement by the country's multi-stakeholder group.

³ A “large undertaking” is defined as a company that, as of the balance sheet date, exceeds at least two of the three following criteria: (a) balance sheet total: EUR 20 million; (b) net turnover: EUR 40 million; (c) average number of employees during the financial year: 250.

	US	EU	Canada	EITI
Extractive activities subject to the reporting requirements	<ul style="list-style-type: none"> ▪ exploration ▪ extraction ▪ processing ▪ export ▪ the acquisition of a license for any such activity 	<ul style="list-style-type: none"> ▪ exploration, prospection and discovery ▪ extraction ▪ development 	<ul style="list-style-type: none"> ▪ exploration ▪ extraction ▪ the acquisition or holding of a permit, licence, lease or any other authorization to carry out any such activity 	<ul style="list-style-type: none"> ▪ exploration ▪ production <p>Each enacting jurisdiction may elect to include revenue streams from other activities.</p>
Excluded activities	<ul style="list-style-type: none"> ▪ ancillary or preparatory activities (e.g., manufacturing drill bits or other machinery used in the extraction of oil) ▪ transportation ▪ commodity trading ▪ downstream activities (e.g., refining, smelting) ▪ marketing 	<ul style="list-style-type: none"> ▪ processing (e.g., refining and smelting)⁴ ▪ export ▪ ancillary or preparatory activities ▪ transportation ▪ service companies 	<ul style="list-style-type: none"> ▪ ancillary or preparatory activities (e.g., manufacturing equipment or construction of extraction sites) ▪ post-extraction activities (e.g., refining, smelting, marketing, transportation, export) 	Typically does not include downstream activities, such as processing or export.
Types of payments included	<p>Any of the following if made to further the commercial development of oil, natural gas or minerals:</p> <ul style="list-style-type: none"> ▪ taxes ▪ royalties ▪ fees ▪ production entitlements ▪ bonuses ▪ dividends (other than when paid to a government as a common or ordinary shareholder on the same terms as other shareholders) ▪ payments for infrastructure improvements ▪ community and social responsibility 	<ul style="list-style-type: none"> ▪ taxes levied on the income, production or profits of companies (excluding taxes levied on consumption such as value added taxes, personal income taxes or sales taxes) ▪ royalties ▪ licence fees, rental fees, entry fees and other considerations for licences and/or concessions ▪ production entitlements ▪ signature, discovery and production bonuses ▪ dividends (other than when paid to a government as a common or ordinary 	<p>Any of the following if made in relation to the commercial development of oil, gas or minerals:</p> <ul style="list-style-type: none"> ▪ taxes (other than consumption taxes and personal income taxes) ▪ royalties ▪ fees (including rental fees, entry fees and regulatory charges as well as fees or other consideration for licences, permits or concessions) ▪ production entitlements ▪ bonuses ▪ dividends (other than dividends paid as ordinary shareholders) 	<ul style="list-style-type: none"> ▪ the host government's production entitlement (such as profit oil) ▪ national state-owned production entitlement ▪ profits taxes ▪ royalties ▪ dividends ▪ bonuses, such as signature, discovery and production bonuses ▪ licence fees, rental fees, entry fees and other considerations for licences and/or concessions ▪ any other significant payments and material benefit to government

⁴ List of excluded activities under the EU rules based on *The Reports on Payments to Government Regulations 2014: Industry Guidance (Draft)* (Nov. 5, 2014, withdrawn Dec. 10, 2015), relating to the implementation in the UK.

	US	EU	Canada	EITI
	<ul style="list-style-type: none"> payments that are required by law or contract 	<ul style="list-style-type: none"> shareholder on the same terms as other shareholders) payments for infrastructure improvements 	<ul style="list-style-type: none"> payments for infrastructure improvements 	
Corporate group covered	<ul style="list-style-type: none"> subsidiaries and other entities consolidated in the issuer's financial statements (including proportional consolidation) 	<ul style="list-style-type: none"> consolidated report required if a parent undertaking is obligated to prepare consolidated financial statements under the EU Accounting Directive includes all subsidiary undertakings of the parent undertaking, as defined in the EU Accounting Directive 	<ul style="list-style-type: none"> entities controlled by the reporting entity 	All companies making material payments to the government.
Exemptions	<ul style="list-style-type: none"> exploratory activities—payments reporting may be delayed until following fiscal year recently acquired companies (not previously subject to payments reporting)—not required until fiscal year immediately following acquisition effective date 	<p>An undertaking need not be included in a consolidated report if:</p> <ul style="list-style-type: none"> severe long-term restrictions substantially hinder the parent undertaking in the exercise of its rights over the assets or management of that undertaking extremely rare cases where the information cannot be obtained without disproportionate expense or undue delay the shares of that undertaking are held exclusively with a view to their subsequent resale 	<p>During two-year transition period, payments to Aboriginal governments in Canada need not be disclosed.</p>	None (other than materiality standard).
Definition of "government"	<ul style="list-style-type: none"> foreign national and subnational governments companies at least majority-owned by a foreign government US Federal Government (but not subnational level in the United States) 	<ul style="list-style-type: none"> any national, regional or local authority of a Member State or of a third country includes a department, agency or undertaking controlled by any such authority 	<ul style="list-style-type: none"> any government in Canada or in a foreign state a body established by two or more governments bodies and authorities that exercise or perform a power, duty or function of government for any 	<p>All government entities, including:</p> <ul style="list-style-type: none"> state-owned enterprises subnational governments transfers/revenue sharing between national and subnational

	US	EU	Canada of the foregoing	EITI government entities
De minimis exemption threshold	\$100,000 whether made as a single payment or a series of related payments.	EUR 100,000 (£86,000 in UK) whether made as a single payment or as a series of related payments within a financial year.	C\$100,000 total amount of all payments within a category of payment that are made to the same payee within the financial year.	Only “material” payments are required to be reported. Each country’s multi-stakeholder group agrees on appropriate materiality definitions and thresholds.
Exemption for disclosure prohibited by foreign law or subject to confidentiality?	No. However, the SEC will consider requests for exemptive relief on a case-by-case basis. The SEC may request an opinion of counsel or other evidence in support of any claim that a foreign law prohibits disclosure.	No.	No.	No. In order to achieve EITI Compliant status, countries must remove legal and regulatory obstacles to EITI reporting (for example, by governments waiving contractual confidentiality provisions).
Anti-evasion provision?	Yes.	Yes.	Yes.	No.
Report required to be audited?	No.	No.	Yes (report must include an attestation either by a director or officer or by an independent auditor or accountant).	Yes (EITI report must either be reconciled or audited by an independent third-party firm).
Level of disclosure	By project. “Project” is defined as: operational activities that are governed by a single contract, license, lease, concession or similar legal agreement, which form the basis for payment liabilities with a government. Multiple agreements that are both operationally and geographically interconnected may be treated as a single project (even if different terms). Payments may be disclosed at the entity level if the payment is made for obligations levied on the issuer at the entity level rather than the project level	By project, where payments have been attributed to a specific project. “Project” is defined as: the operational activities that are governed by a single contract, license, lease, concession or similar legal agreements and form the basis for payment liabilities with a government. Nonetheless, if multiple such agreements are substantially interconnected, this shall be considered a project. Payments made in respect of obligations imposed at entity level may be disclosed at	By project, where payments can be attributed to a specific project. A “project” means the operational activities that are governed by a single contract, license, lease, concession or similar legal agreements and form the basis for payment liabilities with a government. Nonetheless, if multiple such agreements are substantially interconnected, this shall be considered a project. Payee-level disclosure for payments is sufficient where a payment is not attributable to a	Each implementing country’s multi-stakeholder group decides on the level of disaggregation in the public EITI report, which may be by individual company, government entity, revenue stream and/or project.

US	EU	Canada	EIT
(e.g., corporate income taxes).	the entity level rather than at project level.	specific project.	

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This memorandum is intended only as a general discussion of these issues. It should not be regarded as legal advice. We would be pleased to provide additional details or advice about specific situations if desired.

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