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Resource Extraction Proposal

In December 2015, the U.S. Securities and Exchange Commission (SEC) proposed Rule 13q-1 and an amendment to Form SD. The proposed rules would require all reporting issuers under the *Securities Exchange Act of 1934*, as amended (Exchange Act), including Canadian and other foreign companies, that are engaged in the commercial development of oil, natural gas or minerals to report information about payments made to the U.S. federal government or foreign governments that are related to the commercial development of these resources.[1] The stated purpose of the rule (which implemented a provision of the *Dodd–Frank Wall Street Reform and Consumer Protection Act*) is to increase the transparency of payments made by these companies to governments in order to help combat global corruption and empower citizens of resource-rich countries to hold their governments accountable for the wealth generated by those resources. In many respects, the proposed rules are consistent with corresponding regulations in the European Union (EU) and in Canada, and the SEC has framed its proposal as a further step in supporting international transparency efforts.

Under Rule 13q-1 as re-proposed, a "resource extraction issuer" (meaning an issuer that is required to file with the SEC annual reports on Forms 10-K, 20-F or 40-F under the Exchange Act and engages in the commercial development of oil, natural gas or minerals) would be required to disclose in a Form SD no later than 150 days after the end of such issuer's fiscal year certain payments made to the U.S. federal government or a foreign government for each project. The SEC did not extend this requirement to issuers that are exempt from Exchange Act registration and reporting under Rule 12g3-2(b), which provides relief to foreign private issuers that are not currently Exchange Act reporting companies (*i.e.,* they are not listed nor have made a registered offering in the United States) and whose primary trading market is located outside the United States.[2]

The proposed rules would require resource extraction issuers to disclose, among other things, the type and total amount of non-*de minimis* payments to the U.S. federal government or any foreign government related to the commercial development of oil, natural gas or minerals for each project.[3] Such payments include taxes, royalties, fees (including license fees), production entitlements, bonuses and other material benefits. The SEC added two categories of payments that were not required to be disclosed under the prior rules: dividends (except for dividends paid to a government as a common or ordinary shareholder of the issuer and therefore paid to the government under the same terms as other shareholders) and payments for infrastructure

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[1] Rules implementing section 13(q) were originally adopted by the SEC in 2012; however, the U.S. District Court for the District of Columbia vacated these rules on the basis of two findings: first, that the SEC misread section 13(q) to compel the public disclosure of issuers' reports; and second, the SEC's explanation for not granting an exemption when disclosure is prohibited by foreign governments was arbitrary and capricious.

[2] Imposing a resource extraction reporting requirement on such issuers would go beyond what is contemplated by section 13(q), which defines a "resource extraction issuer" as an issuer that is "required to file an annual report with the SEC".

[3] The proposed rules define "not *de minimis*" as any payment, whether a single payment or a series of related payments, that equals or exceeds US$100,000 during the same fiscal year.

improvements, such as building a road or railway to further the development of oil, natural gas or minerals.

Under the proposed rules, and consistent with the transparency regulations adopted in the EU and Canada, resource extraction issuers are not required to disclose social or community payments, such as payments to build a hospital or school. As the SEC noted, it is unclear whether these types of payments are part of the commonly recognized revenue stream for the commercial development of oil, natural gas or minerals.

In a change from the 2012 rules, the proposed rules define "project" as operational activities governed by a single contract license, lease, concession or similar legal agreement that forms the basis for payment liabilities to a government. Although similar to the EU directives and the Canadian draft definitions, the SEC's proposed definition would allow issuers additional flexibility to treat multiple agreements that are both operationally and geographically interconnected as a single project without the additional requirement that the agreements also have "substantially similar terms" – as required by the EU and Canadian draft definitions. The SEC opted to define "project" using the same core elements used in the EU directives and the Canadian draft definitions to help reduce compliance costs for issuers that are listed in both the United States and the EU or Canada by not requiring different disaggregation standards for project-related costs. In addition, such an approach might enable issuers to take advantage of equivalency provisions available in other jurisdictions.

The proposed rules do not provide for exemptions for countries that prohibit the mandated resource extraction disclosures; however, the SEC noted that it will consider using its existing authority under the Exchange Act to provide exemptive relief at the request of a resource extraction issuer. This case-by-case approach to exemptive relief, according to the SEC, is preferable to either adopting a blanket exemption for a foreign law prohibition (or for any other reason) or providing no exemptions and no avenue for exemptive relief.

In light of similar disclosure laws adopted by other countries and with a view to reducing compliance costs, the SEC proposed a provision that is consistent with the Canadian and EU frameworks. The provision allows issuers to meet the requirements of the proposed rule by providing disclosures that comply with a foreign jurisdiction's rules or that meet the U.S. Extractive Industries Transparency Initiative reporting requirements if the SEC determines that those rules or requirements are substantially similar to the proposed rules.

The SEC has proposed an extensive comment process and expects to vote on the proposed rules in June 2016, although the SEC noted that a number of factors may cause it to depart from this expedited schedule.

If you have any questions regarding the foregoing, please contact Jeffrey Nadler (212.588.5505) in our New York office.

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