

# Client Update

## SEC Adopts New Disclosure Requirements for Resource Extraction Issuers

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On June 27, 2016, the SEC adopted Rule 13q-1, requiring resource extraction issuers to disclose annual payments in excess of \$100,000 made to foreign governments or the U.S. federal government for the commercial development of oil, natural gas or minerals. This rule, adopted pursuant to Section 1504 of the Dodd-Frank Act, follows years of public debate regarding the need for balancing transparency, preventing corruption and promoting accountability. A prior version of this rule was vacated by a federal court in 2013. New Rule 13q-1 contains the following significant elements:

### RESOURCE EXTRACTION ISSUERS

Rule 13q-1 applies to any “resource extraction issuer,” which is defined as any issuer (i) required to file an annual report on Form 10-K, 20-F or 40-F and (ii) that engages in commercial development of oil, natural gas or minerals. The rule does not exclude smaller reporting companies, emerging growth companies or foreign private issuers, nor does it exempt a company whose resource extraction operations represent an insignificant proportion of its revenue.

### PAYMENTS

The rule requires disclosure of any payment or series of payments that exceeds \$100,000 during the same fiscal year in connection with commercial development of oil, natural gas or minerals. Payments that must be disclosed include certain taxes, royalties, fees (including licensing fees), production entitlements, bonuses, dividends, payments for infrastructure improvements and, if required by law or contract, community and social responsibility (“CSR”) payments. Moreover, an entity providing only services to a resource extraction issuer to assist with exploration, extraction, processing or export would generally not be considered a resource extraction issuer; however, where such a service provider makes a payment that falls within Rule 13q-1’s definition of “payment” to a government on behalf of a resource extraction issuer, the resource extraction issuer must disclose such payment. Although Rule 13q-1 does not specifically require disclosure of payments that fall outside these categories or are otherwise not recognized as part of the commonly recognized revenue stream, it does

require disclosure of any activity or payment that is part of a scheme or plan to evade the rule's disclosure requirements. Payment information must be provided on a cash (*i.e.*, not accrual) basis and such information is not required to be audited.

### COMMERCIAL DEVELOPMENT OF OIL, NATURAL GAS OR MINERALS

Payments must be disclosed if made to promote the commercial development of oil, natural gas or minerals. Rule 13q-1 defines "commercial development" to include exploration, extraction, processing, export or acquisition of a license for any such activity. "Extraction" means the production of oil and natural gas as well as the extraction of minerals. "Processing" includes, without limitation, midstream activities such as the processing of gas to remove liquid hydrocarbons, the removal of impurities from natural gas prior to its transportation through a pipeline, the upgrading of bitumen and heavy oil, and the crushing and processing of raw ore prior to the smelting phase; it does not, however, include downstream activities, such as refining or smelting. "Export" is defined, subject to certain exceptions, as the transportation of a resource from its country of origin to another country by an issuer with an ownership interest in the resource. The definition of "commercial development" does not include ancillary or preparatory activities to commercial development.

### MADE TO THE U.S. GOVERNMENT OR FOREIGN GOVERNMENTS

Rule 13q-1 covers payments made to the U.S. government as well as foreign governments or subnational governments, which includes any department, agency or instrumentality thereof. Notably, the rule also applies to payments made to companies that are majority-owned by a foreign government.

### PROJECT

Rule 13q-1 requires resource extraction issuers to disaggregate and separately report payments attributable to each project, rather than as a single lump-sum report of the total amount paid by the entity. "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.

### SUBSIDIARY OR CONTROL

Even if a resource extraction issuer does not itself make a payment, it is required to disclose covered payments that are made by a subsidiary or an entity under its "control." An entity would have "control" over another if it consolidated that entity or proportionately consolidated an interest in that entity under the accounting method it uses in its periodic reports filed with the SEC.

## EXEMPTIONS

Rule 13q-1 provides for transitional relief or delayed reporting in two circumstances:

- Issuers that have acquired or obtained control over another entity whose resource extraction payments now bring that issuer within the ambit of Rule 13q-1 when it otherwise was not subject to resource extraction disclosure obligations in the United States or substantially similar obligations elsewhere are permitted to delay disclosure to the fiscal year immediately following the effective date of acquisition.
- In order to protect commercially sensitive information, disclosure of payments in connection with exploratory activities may be delayed until the fiscal year following the fiscal year in which the payments were made.

Equally noteworthy, however, is an exemption that was not included in the final rule: the SEC rejected calls for providing a blanket exemption for companies doing business in countries whose laws prohibit disclosure, instead insisting that it will consider doing so on a case-by-case basis under its general exemptive authority.

Compliance with Rule 13q-1 is required for fiscal years ending on or after September 30, 2018, at which point annual disclosures must be filed publicly (*i.e.*, not furnished) as an XBRL-tagged exhibit to Form SD no later than 150 days after the end of a company's fiscal year. Moreover, resource extraction issuers that properly file disclosures in adherence with the European Union's Transparency and Accounting Directives, Canada's Extractive Sector Transparency Measures Act, and the United States, Extractive Industries Transparency Initiative will generally satisfy their reporting obligations under Rule 13q-1.

It remains to be seen how this rule will affect resource extraction activity in countries where disclosure of payment information is prohibited, such as Angola, Cameroon, China and Qatar. In addition, there is a strong possibility that this rule will once again be challenged in court.

The final rule may be found at <http://www.sec.gov/rules/final/2016/34-78167.pdf>.

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Please do not hesitate to contact us with any questions.