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ALERT MEMORANDUM

SEC Resource Extraction Payments Rule – Third Time's the Charm?

December 20, 2019

On December 18, 2019, a divided SEC issued a new proposed rule on the disclosure of resource extraction payments. The proposal comes almost three years after a 2016 iteration of the rule was disapproved by a joint resolution of Congress, six years after a federal court vacated the 2012 iteration of the rule and nine years after the Dodd-Frank Act first required the SEC to adopt the rule.

The SEC was faced with the daunting task of crafting a new proposal that manages to meet the detailed directive in the underlying statute, comply with the Congressional Review Act prohibition on reissuing the 2016 rule in substantially the same form and address the issues that had caused the court to vacate the 2012 rule. As a result, the new proposed rule is similar in many ways to both prior iterations, but there are some important differences, most of which are favorable to affected companies as they expand available exemptions and attempt to both reduce the risk of competitive harm and ease compliance burdens.

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The tortured history of the resource extraction payments rule began almost a decade ago, in 2010, with the passage of Section 1504 of the Dodd-Frank Act. Section 1504 added Section 13(q) to the Securities Exchange Act of 1934 requiring the SEC to adopt a rule that any reporting company engaged in the commercial development of oil, natural gas or minerals provide annual disclosures of amounts paid to governments for that purpose. Along with the conflict minerals rule, Section 1504 is one of the "specialized disclosure" requirements included in the Dodd-Frank Act, which use the SEC disclosure system to promote public policy objectives not directly related to the usual purposes of corporate disclosures. Instead, this provision was intended to combat corruption and the "resource curse" by increasing the transparency of payments made by oil, natural gas and mining companies to governments for the purpose of the commercial development of their oil, natural gas and minerals.

An initial rule was adopted in August 2012, long after the deadline set by the statute. After a challenge by industry groups, the U.S. federal district court for the District of Columbia vacated the rule in 2013. The court (a) disagreed with the SEC's conclusion that public filing of the disclosures was required by the statute, holding that the SEC instead had discretion on this point, and (b) found that the SEC's failure to provide an exemption for the disclosure of payments in countries that prohibit disclosure was arbitrary and capricious.

The SEC was slow to take further action after the 2012 rule was vacated, but Oxfam sued the agency in Massachusetts federal court in 2015 to compel implementation of the statutory mandate. The court held that the SEC had acted unlawfully by failing to adopt a final rule, and the SEC then tried again and adopted a new version of the rule in June 2016. However, the timing of final adoption left the 2016 rule available for disapproval under the CRA when the 115th Congress sat following the 2016 election – the CRA requires federal agencies to submit adopted final rules to Congress and allows Congress to disapprove a rule within 60 legislative days following submission. That period for the 2016 rule had not yet run when the 114th Congress adjourned. The 115th Congress moved quickly and disapproved the 2016 rule in February 2017, with those voting in favor of disapproval citing concerns that the 2016 rule would impose outsized compliance costs, restrict job growth and put U.S. companies at a competitive disadvantage. The disapproval meant that the 2016 rule was treated as if it had never taken effect, and the SEC was prohibited under the CRA from reissuing a rule in substantially the same form - but the Exchange Act still required the SEC to adopt a rule pursuant to the original Dodd-Frank mandate.

Now, almost three years later, the SEC is making a third attempt to comply with its mandate. In the absence of a definition of "substantially the same" in the CRA, the SEC relied on the legislative history of the CRA, which urges Congress to provide direction about reissuance when debating disapproval, to use the issues raised by members of Congress in 2017 to tailor a proposed rule that the SEC believes complies with the CRA. Some of the more significant changes to the prior versions of the rule, most of which are likely to be welcomed by impacted companies, are summarized below.

— Exemptions for Certain Companies, Payments and Filings: Consistent with the SEC's goal of reducing overall compliance costs, the new proposed rule would provide several exemptions not found in the first two iterations of the rule. Smaller reporting companies and emerging growth companies would be exempted from compliance, and newly public companies would be granted a grace period until after their first full fiscal year as a public company. There are also two new exemptions from reporting payments where disclosure is prohibited either by foreign law[1] or by a pre-existing contract. While there are certain conditions to these two exemptions, and companies must disclose when they rely upon them, the SEC stated that it hopes their inclusion will help mollify concerns regarding competitive damage and administrative difficulties. The transitional relief for newly acquired companies contained in the 2016 rule is retained, as is the exemption for exploratory payments and the allowance for companies to meet their obligations by providing disclosure that complies with the requirements of certain alternative reporting regimes.[2]

— Broader Definition of "Project," Increased Payment Aggregation and Higher Disclosure Threshold: Section 13(q) requires the disclosure of the type and total amount of payments made for each project to a government. While the 2016 rule

[1] The 2016 rule did not provide an exemption for disclosures prohibited by foreign governments, even though the court found that failing to provide one was one of the flaws in the 2012 rule. In response to the court's finding, the 2016 rule instead provided that the SEC would be willing to consider exemptive relief on a case-by-case basis. Under the new proposed rule, the SEC would still be willing to consider case-by-case relief in addition to the new exemptions provided.

[2] Instead of requiring that the SEC determine that a regime is "substantially similar" (the 2016 test), the new proposed rule would allow companies to rely on the alternative reporting relief if the SEC has determined that the foreign regime requires disclosure that "satisfies the transparency objectives of Section 13(q)." Possibly this change was included in part to make sure the European Union and Canadian reporting regimes qualify, even though both differ from the new proposed rule, for example in using a narrower definition of "project."

defined “project” narrowly as activities governed by a single legal agreement that forms the basis of the payment obligations, the new proposed rule would define this term using three broad factors: the type of resource, the method of extraction and the major subnational political jurisdiction where the commercial development of the resource occurred. The 2016 rule also only permitted very limited aggregation of payments (activities had to be operationally and geographically related), whereas the new proposed rule would permit aggregation by payment type at the major subnational or lower government levels. The new proposed rule would also increase the threshold for when a payment is “not de minimis” (and therefore required to be disclosed). A two-part test would apply, first at the project level (at least $750,000 in payments before reporting is required) and, if that prong is met, then at the individual payment level (only payments of at least $150,000 are required to be reported). These revisions are all designed to reduce the competitive harms of disclosing more granular payment information and the compliance burdens of tracking it.

— <u>Form, Timing and Treatment of Disclosure</u>: The new proposed rule is consistent with the 2012 rule and the 2016 rule in requiring that the disclosures be made publicly on Form SD (which is already used for conflict minerals disclosures). The SEC has sought to ease the burden on companies by substantially extending the deadline for filing, which in the 2016 rule was 150 days after fiscal year end. A company with a fiscal year ending on or before June 30 will be required to submit its Form SD no later than March 31 the following year, and a company with a fiscal year ending after June 30 will have until March 31 the second following year. Finally, in a change from both prior final versions of the rule, the new proposed rule provides that disclosure would be treated as furnished to, not filed with, the SEC, eliminating both the risk of liability for the disclosures under Section 18 of the Exchange Act, as well as the risk of incorporation by reference into a company’s registration statements filed under the Securities Act of 1933 (and any possible liability resulting from such incorporation).

Some commenters on the prior iterations of the rule urged the SEC not to require that companies’ disclosures be made publicly available. As noted above, the SEC originally concluded that the statute left it no discretion on this point, and that conclusion was one basis for the judicial decision striking down the 2012 rule. In adopting the 2016 rule, the SEC determined that public filing would better serve the purposes of Section 13(q). In the new proposed rule, the SEC has reached the same view but says its view is preliminary, and it invites comment on an alternative under which companies would be allowed to submit their Form SDs non-publicly, and the SEC would subsequently publish an aggregated and anonymized public compilation of extraction payment information.

The SEC vote to adopt the proposal split down party lines, with both Democratic Commissioners dissenting and arguing that the new proposed rule would provide too little information (especially if the SEC were to change the proposal to allow companies to file non-publicly) and undermine the original objective of increasing transparency. However, even Commissioners who voted in favor of the proposal acknowledged the bizarre circumstances and questioned whether this statutory mandate is consistent with the SEC’s mission.

Comments are due within sixty days of the publication of the new proposed rule in the *Federal Register*. We would encourage impacted companies (some of which are also still working towards compliance with the SEC’s new mining disclosure rules passed in 2018) to study the proposal carefully and consider submitting comments on the questions raised by the SEC. In crafting the new proposed rule, the SEC cited many comment letters submitted on the previous proposals, and in light of the focus on addressing Congress’ concerns relating to compliance burdens and competitive harm, the SEC is requesting feedback on a number of points on whether they have struck the right balance between these concerns and the transparency objectives of the Dodd-Frank mandate.

We are continuing to analyze the proposal and expect to publish a more detailed discussion soon. For additional information about the resource extraction rule, see our Alert Memos on the adoption of the 2012 rule, available here, on the judicial decision vacating the 2012 rule, available here, on the 2016 rule proposal, available here, and on the 2017 disapproval of the 2016 rule, available here.

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