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Securities Law ADVISORY ■

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Resource Extraction Issuers Must Report Payments to Governments

On December 16, 2020, the Securities and Exchange Commission (SEC) adopted a final rule to implement Section 13(q) of the Securities Exchange Act of 1934, as amended. Pursuant to the rule, oil, natural gas, and mining companies that are required to file reports under Section 13 or 15(d) of the Exchange Act will be required to provide information about the type and total amount of payments made to a foreign government or the federal government for each of their projects related to the commercial development of resources.

The adopting release can be found here.

Background

In 2010, Congress enacted Section 1504 of the Dodd–Frank Act to increase the transparency of payments that resource extraction issuers make to governments for the purpose of the commercial development of resources. Section 1504 added Section 13(q) to the Exchange Act, which directed the SEC to issue final rules to require resource extraction issuers to include in annual reports information about payments the issuers, their subsidiaries, or companies under their control make to foreign governments or the federal government for commercial development. The information must be submitted in an interactive data format and include:

- The type and total amount of such payments made for each project of the resource extraction issuer relating to the commercial development of resources.
- The type and total amount of such payments made to each government.

In August 2012, the SEC adopted Rule 13q-1 and other amendments to Form SD, which were vacated by the U.S. District Court for the District of Columbia in July 2013. Then, in June 2016, the SEC adopted a revised version of Rule 13q-1 and other amendments to Form SD that addressed the concerns raised in litigation of the 2012 rules. The 2016 rules were disapproved by a joint resolution of Congress pursuant to the Congressional Review Act (CRA). Part of the CRA instructed the SEC that it may not reissue the disapproved rule in "substantially the same form" or issue a new rule that is "substantially the same" as the disapproved rule. In response, the SEC proposed new rules in December 2019, which have been adopted substantially as proposed.

Final Rule 13q-1 and Amendments to Form SD

Although certain key elements of the final Rule 13q-1 and the amendments to Form SD are the same as the 2016 rules, the SEC has made changes to areas that it believes are sufficient to address Congress's requirements for the new rules.

Definition of "project"

The final rules require resource extraction issuers to disclose payments made to governments relating to the commercial development of resources by type of resource and total amount per project. The SEC adopted the definition of "project" as proposed. The new definition takes a broader approach than the definition in the 2016 rules, which was more granular and would have deemed the activities resulting from each individual contract, lease, etc. as a separate project. The revised definition of "project" is based on the following three criteria:

(i.) The type of resource being commercially developed;

(ii.) The method of extraction; and

(iii.) The major subnational political jurisdiction where the commercial development of the resource is taking place.

Pursuant to the first prong, resource extraction issuers are required to disclose if the project relates to the commercial development of a resource. However, they will not be required to disclose the specific type or quantity or distinguish between subcategories of the same resource. For example, disclosures related to an oil project will not need to distinguish between light or heavy crude oil, but disclosures related to a mining project will need to disclose if the mineral is gold, silver, coal, or some other mineral.

The second prong requires resource extraction issuers to identify whether the resource is extracted by use of a well, an open pit, or underground mining. Other detailed information, such as whether it is a vertical drill, hydraulic fracturing, block cave mining, or other such methods do not need to be disclosed.

The third prong addresses the geographical location of the project and requires issuers to disclose only the level of the major subnational jurisdiction in which the project is taking place (e.g., state, province, region, or territory). As proposed, issuers must also provide electronic tagging information for the country and subnational jurisdiction that is consistent with the International Organization for Standardization code. For offshore projects, the identification should include the body of water where the project is located, using the smallest applicable body of water (e.g., gulf, bay, or sea), as well as the nearest major subnational jurisdiction. If the project is equidistant between two major subnational jurisdictions, the issuer may disclose both.

Lastly, projects that are in the same major subnational jurisdiction can be treated as a single project even if the activities involve multiple resource types or extraction methods. The issuer, however, is required to describe each type of resource being developed and each method of extraction used in the project. Also, as proposed, the final rules require the activities in each major subnational jurisdiction to be treated as an individual project if extraction of a resource occurs across borders.

"Not de minimis" payment

Although Section 13(q) defines "payment" as a payment that is not de minimis, it does not define "not de minimis." To that end, the SEC proposed to define "not de minimis" as any payment of $150,000 (or its equivalent in the issuer's reporting currency) or more made to a foreign government in a host country or the federal government, whether a single payment or a series of related payments, so long as that disclosure for a project is only required if the total

payments for a project equal or exceed $750,000. This represents a significantly higher threshold than was proposed in the 2016 rules, which defined a "not de minimis" payment as any payment (or series of related payments) that equals or exceeds $100,000 or its equivalent in the issuer's reporting currency.

Exemptions from compliance

The SEC also adopted exemptions to the reporting requirements of Section 13(q). First, issuers will be granted a conditional exemption when an issuer is unable to comply with Section 13(q) disclosure requirements without violating the law of the jurisdiction where the project is located. In order to be eligible for exemption, issuers must attempt compliance and seek to use exemptions in the laws of the foreign jurisdiction before furnishing, as an exhibit to Form SD, an opinion of local counsel that opines on the issuer's inability to comply due to a conflict of law.

In addition, issuers will be exempt if the disclosure requirements violate preexisting contract terms, though the terms must have been expressly included in a contract before the effective date of the final rules.

Issuers will also be able to apply for exemptions on a case-by-case basis by submitting a written request for exemptive relief to the SEC describing the particular payment disclosures it seeks to omit and the specific facts and circumstances that warrant the exemption, including costs and burdens it faces if it were to make the disclosure.

Smaller reporting companies and emerging growth companies will also be exempt from the reporting requirements of Section 13(q) unless they are subject to the reporting requirements of an alternative reporting regime, such as the European Union. In that case, the issuer may submit a report that complies with the requirements of the alternative reporting regime.

Lastly, issuers that have completed their initial public offering will not have to comply until the first fiscal year following the fiscal year it completed its initial public offering.

Alternative reporting

The SEC is adopting the alternative reporting provision, which means that if the SEC determines that a foreign jurisdiction's reporting regime satisfies the transparency objectives of Section 13(q), it will allow issuers to provide the disclosures made to the foreign jurisdiction to satisfy the issuer's Section 13(q) reporting obligations. As part of the adopted rules, the disclosure requirements of the European Union, United Kingdom, Norway, and Canada would satisfy Section 13(a)'s reporting obligations.

Conclusion

The adopted amendments will go into effect 60 days after publication in the *Federal Register*. There will be a two-year transition period, so issuers must begin to comply with Rule 13q-1 and Form SD for fiscal years ending no earlier than two years after the effective date of the rules. Following the transition period, disclosures made on Form SD pursuant to the requirements of Section 13(q) must be filed no later than 270 days following the end of the issuer's most recently completed fiscal year.

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ATLANTA: One Atlantic Center ■ 1201 West Peachtree Street ■ Atlanta, Georgia, USA, 30309-3424 ■ 404.881.7000 ■ Fax: 404.881.7777
BEIJING: Hanwei Plaza West Wing ■ Suite 21B2 ■ No. 7 Guanghua Road ■ Chaoyang District ■ Beijing, 100004 CN ■ +86 10 8592 7500
BRUSSELS: Level 20 Bastion Tower ■ Place du Champ de Mars ■ B-1050 Brussels, BE ■ +32 2 550 3700 ■ Fax: +32 2 550 3719
CHARLOTTE: Bank of America Plaza ■ 101 South Tryon Street ■ Suite 4000 ■ Charlotte, North Carolina, USA, 28280-4000 ■ 704.444.1000 ■ Fax: 704.444.1111
DALLAS: Chase Tower ■ 2200 Ross Avenue ■ Suite 2300 ■ Dallas, Texas, USA, 75201 ■ 214.922.3400 ■ Fax: 214.922.3899
FORT WORTH: 3700 Hulen Street ■ Building 3 ■ Suite 150 ■ Fort Worth, Texas, USA, 76107 ■ 214.922.3400 ■ Fax: 214.922.3899
LONDON: 5th Floor, Octagon Point, St. Paul's ■ 5 Cheapside ■ London, EC2V 6AA, UK ■ +44.0.20.3823.2225
LOS ANGELES: 333 South Hope Street ■ 16th Floor ■ Los Angeles, California, USA, 90071-3004 ■ 213.576.1000 ■ Fax: 213.576.1100
NEW YORK: 90 Park Avenue ■ 15th Floor ■ New York, New York, USA, 10016-1387 ■ 212.210.9400 ■ Fax: 212.210.9444
RALEIGH: 555 Fayetteville Street ■ Suite 600 ■ Raleigh, North Carolina, USA, 27601-3034 ■ 919.862.2200 ■ Fax: 919.862.2260
SAN FRANCISCO: 560 Mission Street ■ Suite 2100 ■ San Francisco, California, USA, 94105-0912 ■ 415.243.1000 ■ Fax: 415.243.1001
SILICON VALLEY: 1950 University Avenue ■ Suite 430 ■ East Palo Alto, California, USA 94303 ■ 650.838.2000 ■ Fax: 650.838.2001
WASHINGTON, DC: The Atlantic Building ■ 950 F Street, NW ■ Washington, DC, USA, 20004-1404 ■ 202.239.3300 ■ Fax: 202.239.3333