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ALERT MEMORANDUM

SEC Resource Extraction Payments Final Rule – Are We Having Fun Yet?

December 21, 2020

On December 16, 2020, a divided SEC adopted a final rule on the disclosure of resource extraction payments. The final rule comes four years after a 2016 iteration of the rule was disapproved by a joint resolution of Congress, seven years after a federal court vacated the 2012 iteration of the rule and a decade after the Dodd-Frank Act first required the SEC to adopt the rule.

The SEC was faced with the daunting task of crafting a rule that (a) meets the detailed directive in the underlying statute, (b) complies with the Congressional Review Act prohibition on reissuing the 2016 rule in substantially the same form and (c) addresses the issues that had caused the court to vacate the 2012 rule. As a result, the new 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.

The tortured history of the resource extraction payments rule began over 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, including the type and total amount of such payments for each project. The statute also requires the SEC, to the extent practicable, to make a compilation of this information available to the public. Along with the controversial 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.

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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 four years later, the SEC has made a third attempt to comply with the statutory mandate. But the CRA prohibition on adopting "substantially the same" rule as the 2016 rule presented a challenge, absent any statutory definition or historical practice on the meaning of the prohibition. How should the SEC interpret that prohibition?

— In the December 2019 proposing release, the SEC relied on the legislative history of the CRA, which urges Congress to provide direction about reissuance when debating disapproval, to craft a proposal that addressed the issues raised by members of Congress in 2017.

— Many commenters on the proposal objected to this approach. They argued that it gave too much emphasis to these concerns (including because many had been ameliorated by intervening international developments) and incorrectly limited the SEC's discretion in crafting the new rule.

— The SEC rejected suggestions that it could comply with the CRA by altering the economic rationale for the new rule or by changing a significant number of the ancillary or secondary components of the new rule.

— The SEC ultimately focused on ensuring that the final rule is not "substantially the same" as the one that was disapproved. In doing so, the SEC determined that to comply with both the CRA and the requirements of Section 13(q), it must change one of the two central discretionary determinations in implementing the Section 13(q) disclosure system, which it concluded are (a) the relative granularity of the definition of "project" (which is undefined in the statute) and (b) whether payments must be publicly disclosed by each applicable issuer, or could instead be submitted privately to the SEC, which would then publicly release an aggregated, anonymized compilation.

The SEC chose to modify the definition of "project," which in the 2016 rule was defined narrowly as activities governed by a single legal agreement that forms the basis of the payment obligations (a definition generally used by similar reporting regimes). The SEC decided that requiring issuers to file payment information publicly (as it did in 2016) would more effectively achieve the transparency objective of Section 13(q) than sticking with the narrow 2016 definition of "project." It consequently adopted a broader definition, consistent with what it

proposed in December 2019. Under the new rule, a project is defined using three general factors: the type of resource, the method of extraction and the major subnational political jurisdiction where the commercial development of the resource occurred. Unsurprisingly, the SEC received many comments objecting to this change, but it emphasized in the adopting release that this change is necessary to comply with the CRA (in the absence of making the more drastic change of allowing private submission in lieu of public filings).

Some of the additional significant changes from the prior versions of the rule (and the 2019 proposal) are summarized below.

— Compromises on Payment Aggregation and Disclosure Thresholds: To mitigate concerns about loss of information and transparency that may result from the revised project definition, the SEC walked back some of its proposed changes relating to payment information. The 2016 rule permitted only very limited aggregation of payments (activities had to be operationally and geographically related), whereas the final new rule permits aggregation by payment type at the major subnational and lower government levels. However, while the proposed new rule would have permitted aggregation across all lower government levels and a generic description of the payee, the final new rule requires that the aggregated amount for each government payee (subnational or below) be disclosed and the payee identified. In response to concerns that a large percentage of projects may go unreported under the proposed higher threshold for when a payment is "not de minimis" (and therefore required to be disclosed),[1] the SEC ultimately adopted the same $100,000 threshold as in the 2016 rule.

— Expanded Exemptions: Consistent with the goal of reducing overall compliance costs, the SEC held firm on providing several exemptions not found in the first two iterations of the rule. Smaller reporting companies and emerging growth companies are generally exempted from compliance,[2] and newly public companies are granted a grace period until after their first full fiscal year as a public company. There are also two new exemptions, consistent with the proposal, from reporting payments where disclosure is prohibited either by foreign law[3] or by a pre-existing contract. While there are conditions to these two exemptions, and an issuer must disclose when it relies on them, the SEC hopes their inclusion will help address 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.

— Compliance by Alternative Reporting: Consistent with the 2016 rule, the new rule allows companies to meet their obligations by providing disclosure that complies with the requirements of certain approved alternative reporting regimes. However, instead of requiring that the SEC determine that a regime is "substantially similar" (the 2016 test), the new rule allows 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)." This change was

[1] The proposed new rule would have applied a two-part test, first at the project level (at least $750,000 in payments before reporting would have been required) and, if that prong were met, then at the individual payment level (only payments of at least $150,000 would have been required to be reported).

[2] However, in a change from the proposed new rule, smaller reporting companies and emerging growth companies that are subject to the requirements of the approved alternative reporting regimes discussed below are no longer exempted, given the limited incremental cost of filing their existing disclosures with the SEC.

[3] 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 of 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 rule, the SEC is still willing to consider case-by-case relief in addition to the new exemptions provided.

perhaps due to the more significant divergence between the new rule and the requirements of international regimes as compared to the 2016 rule. In a concurrent order, the SEC recognized the EU, UK, Norwegian and Canadian regimes as satisfying the transparency objectives of Section 13(q).

— Form, Timing and Treatment of Disclosure: The new 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 had initially sought to ease the burden on companies by proposing a substantially extended deadline for filing.[4] In response to comments that the proposed deadline would result in information being provided so long after the relevant payments were made that it would significantly limit its usefulness, the SEC compromised here too, imposing a filing deadline of 270 days after fiscal year end.[5] In a change from both prior final versions of the rule, and consistent with the proposal, the final new rule provides that disclosure will 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 arising from incorporation by reference into an issuer's registration statements filed under the Securities Act of 1933 (and any possible liability resulting from such incorporation).

The SEC adopted the proposed two-year transition period, meaning that issuers will be required to comply with the new rule for fiscal years ending no earlier than two years after the effective date. The new rule will become effective 60 days after publication in the federal register, meaning that calendar year-end companies will need to file their first report by September 30, 2024 covering the fiscal year ended December 31, 2023.

The SEC acknowledged that the new rule is unlikely to satisfy everyone and, anticipating further challenges and perhaps mindful that the conflict minerals rule is still operating under SEC guidance issued after a 2014 court decision finding part of the rule unconstitutional, it took the unusual step of pre-emptively laying out how the new rule is intended to operate if the two most controversial aspects (the definition of project and the scope of exemptions) are rejected by courts. If the definition of project is invalidated, issuers must continue to make all disclosures required by Section 13(q) but may use their own reasonable definition of project while the SEC reconsiders the matter. If any exemptions are invalidated, issuers must continue to make all required disclosures, but while the SEC reconsiders, it may issue exemptive orders as appropriate under its existing authority.

Predictably, the SEC vote to adopt the proposal split down party lines, with both Democratic Commissioners dissenting and arguing that the new rule (and, in particular, the new definition of project) does too little to support the goal of increasing transparency, failing to advance the original goals of Section 13(q), and does not adequately take into account international developments since 2016. Even the Commissioners who voted in favor of the new rule hardly provided ringing endorsements, assenting only because the SEC is legally obligated to try again and expressing varying degrees of exasperation at the continued use of SEC resources to adopt for a third time a rule that falls outside of the scope of its mandate and will almost certainly still fail to satisfy many interested parties.

[4] The filing deadline under the 2016 rule was 150 days after fiscal year end. Under the proposed new rule, an issuer with a fiscal year ending on or before June 30 would have been required to submit its Form SD no later than March 31 the following year, and an issuer with a fiscal year ending after June 30 would have had until March 31 the second following year.

[5] An issuer that complies with the new rule by submitting an alternative report may follow the alternative jurisdiction's deadline, if it submits notice of its intent to do so before the 270-day deadline and files within 7 days of the alternative jurisdiction's deadline.

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, on the 2017 disapproval of the 2016 rule, available here, and on the 2019 rule proposal, available here.

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