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Shining a Light on Payments to Governments: SEC Proposes New "Publish What You Pay" Rule

On December 11, 2015, the US Securities and Exchange Commission ("SEC") issued a proposed rule[1] to implement Section 1504 of the Dodd-Frank Wall Street Reform and Consumer Protection Act (the "Dodd-Frank Act"). Section 1504 of the Dodd-Frank Act calls on the SEC to make rules requiring resource extraction issuers to disclose payments they make to governments for the commercial development of oil, natural gas or minerals.

The SEC originally adopted "publish what you pay" rules implementing Section 1504 of the Dodd-Frank Act in August 2012, but in July 2013 the SEC rule was vacated by US federal courts. In September 2015, a US federal court ordered the SEC to expedite its rulemaking process for adopting a final government payments disclosure rule.

In the newly proposed rule, the SEC addresses the findings of the court that vacated its prior rule. In addition, the SEC indicates that it is endeavoring to more closely align its reporting regime with developments in extractive industry transparency in the European Union and Canada since its original rulemaking,[2] with a view to enhancing the consistency and comparability of the SEC rules with the disclosure requirements of these key jurisdictions.

Summary of Proposed Rule

The SEC's proposed rulemaking would add Rule 13q-1 under the Securities Exchange Act of 1934 (the "Exchange Act").

Which Companies Are Subject to the Rules?

This rule would apply to SEC reporting issuers that are required to file annual reports on Form 10-K, 20-F or 40-F and that engage in the commercial development of oil, natural gas or minerals. "Commercial development" includes:

- exploration;
- extraction;
- processing;
- export; and
- the acquisition of a license for any such activity.

[1] http://www.sec.gov/rules/proposed/2015/34-76620.pdf

[2] Directive 2013/34/EU, commonly referred to as the EU Accounting Directive, was adopted in June 2013 by the European Parliament and the Council of the European Union and required Member States to enact implementing legislation by July 20, 2015. In Canada, the Extractive Sector Transparency Measures Act entered into force on June 1, 2015.

Such issuers would be required to file annually a specialized disclosure report on Form SD (the same form currently used to report conflict minerals disclosures) within 150 days after their fiscal year-end.

The proposed rule would clarify that "processing" activities include, among other things, midstream activities such as the processing of gas to remove liquid hydrocarbons, the removal of impurities from natural gas prior to its transport through a pipeline and the upgrading of bitumen and heavy oil, through the earlier of the point at which oil, gas or gas liquids (natural or synthetic) are either sold to an unrelated third party or delivered to a main pipeline, a common carrier or a marine terminal. It would also include the crushing and processing of raw ore prior to the smelting phase. "Processing" would not include the downstream activities of refining or smelting.

"Export" would be defined as the transportation of a resource from its country of origin to another country by an issuer with an ownership interest in the resource. It would not include transportation on a fee-for-service basis by a service provider with no ownership interest.

The rule would not apply to ancillary or preparatory activities for the commercial development of oil, natural gas or minerals (e.g., the manufacturing of drill bits), nor would it apply to transportation (unless such transportation activities fall within the definition of "export").

Which Types of Payments Must Be Reported?

A payment would be required to be included in an issuer's government payments disclosure on Form SD only if it falls within one of the following categories:

- taxes – includes taxes levied on corporate profits, corporate income and production, but excludes taxes levied on consumption (such as VAT, personal income taxes or sales taxes);
- royalties;
- fees (including license fees) – includes rental fees, entry fees and concession fees;
- production entitlements;
- bonuses – includes signature, discovery and production bonuses;
- dividends – excludes dividends paid to a government as a common or ordinary shareholder under the same terms as other shareholders; and
- infrastructure payments – e.g., building a road or railway to further the development of oil, natural gas or minerals.

Consistent with the approach taken by the EU, social or community payments (such as payments to build a hospital or school) would be expressly excluded from the scope of the rule.

In-kind payments would be required to be disclosed if they meet one of the covered payment types listed above. Issuers may report in-kind payments either at cost, or if cost is not determinable, at fair market value, and provide a brief description of how the monetary value was calculated.

Payments made for obligations levied at the entity level, such as corporate taxes, may be disclosed at the entity level, and are not required to be allocated at the project level.

The rule would include an exception for *de minimis* payments, which are payments under $100,000, or the equivalent in the issuer's reporting currency, whether made as a single payment or series of related payments.

Periodic payments, such as rental fees, would be required to be disclosed if the aggregate amount of such payments exceeds the $100,000 threshold.

Payments from Whom and to Whom?

The proposed rule would cover payments made by the issuer, as well as by any subsidiary or entity under the control of the issuer. "Subsidiary" and "control" for this purpose are aligned with the issuer's accounting principles. Therefore, an issuer would have to disclose payments made by any entity that is consolidated (including proportional consolidation of an interest in an entity or operation) under the accounting principles applicable to the issuer's financial statements filed as part of its Exchange Act reports. For entities that are proportionally consolidated, only the issuer's proportional interest in the payment need be disclosed.

As proposed, disclosure would be required for payments made to any "foreign government," which includes a department, agency or instrumentality of a foreign government or a company owned by a foreign government. The proposed rule would cover payments to foreign subnational governments, such as the government of a state, province, county, district, municipality or territory under a foreign national government. It would also cover payments made to state-owned enterprises that are at least majority-owned by a foreign government. In the United States, only payments to the US federal government would be in the scope of the rules, and payments to states or other subnational governments in the United States would be excluded.

Project-Level Disclosure

Section 1504 of the Dodd-Frank Act requires the reporting of payments made by resource extraction issuers to governments by type and total amount per project. The SEC's previous rulemaking attempt did not define "project" in the aim of providing greater flexibility. In the new proposed rules, the SEC has sought to align the definition of "project" to EU and Canadian standards. Under the proposed rule, "project" would be 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. Issuers would be able to treat multiple agreements that are both operationally and geographically interconnected as a single project.

The SEC is proposing to provide a non-exhaustive list of factors to consider when determining whether agreements are "operationally and geographically interconnected," no single one of which would necessarily be determinative:

- whether the agreements relate to the same resource and the same or contiguous part of a field, mineral district, or other geographic area;
- whether they will be performed by shared key personnel or with shared equipment; and
- whether they are part of the same operating budget.

The SEC specifically addresses the definition of "project" proposed by the American Petroleum Institute, which would aggregate payments by resource within a single subnational political jurisdiction. The SEC believes that a contract-based definition of "project" would provide greater transparency and consistency with the EU and Canadian rules.

Form and Timing of Disclosure

Issuers would be required to disclose government payments information annually in a specialized disclosure report on Form SD, no later than 150 days after the issuer's fiscal year end. The required disclosure would need to be filed on EDGAR in an electronically-tagged XBRL exhibit to Form SD. The final rules will take effect

for a fiscal year ending not earlier than one year after the SEC issues the final rule. Assuming the final rule is adopted in June 2016, an issuer's first resource extraction payment report will be required for its first fiscal year ended on or after June 30, 2017. For issuers with a December 31 fiscal year end, calendar year 2017 would be the first year for which compliance is required.

For any payment required to be disclosed, the issuer will need to disclose and electronically tag (in XBRL format) the following information:

- the total amounts of the payments, by category;
- the currency used to make the payments;
- the financial period in which the payments were made;
- the business segment of the resource extraction issuer that made the payments (consistent with the reportable segments used for purposes of the issuer's financial reporting);
- the government that received the payments, and the country in which the government is located;
- the project of the resource extraction issuer to which the payments relate;
- the particular resource that is the subject of commercial development; and
- the subnational geographic location of the project.

In addition, an issuer would need to provide and tag the type and total amount of payments made for each project and the type and total amount of payments for all projects made to each government.

In the July 2013 US federal court ruling vacating the SEC's prior attempt at adopting a final "publish what you pay" rule, the court determined that the statutory text of Section 1504 of the Dodd-Frank Act did not compel the SEC to require issuers to publicly file their annual government payments reports or to otherwise make such reports publicly available, in addition to the statutory requirement of the SEC to make publicly available a compilation of the information from such reports. While the court found fault with the SEC's rulemaking process, it clarified that the statute gives the SEC discretion whether to require public filing of the reports. In the new rulemaking, the SEC is proposing to exercise its discretion to require issuers to publicly file their government payments report on EDGAR, reasoning that this approach best accomplishes the purpose of the statute, including consistency with international transparency promotion efforts, such as the EU rules.

Exemptions and Recognition of Equivalency

In vacating the prior rule, the US federal court further held that the SEC had acted arbitrarily and capriciously in concluding that Section 1504 does not allow an exemption to the reporting requirements for payments to governments in countries where disclosure is prohibited by law (specifically, and currently, Angola, Cameroon, China and Qatar). In the new proposed rule, the SEC would permit issuers to apply to the SEC for exemptions on a case-by-case basis, rather than writing a blanket exemption into the rule. In such a request for exemptive relief, the SEC would expect an opinion of counsel in support of any claim that a foreign law prohibits the disclosure of the information in question.

In line with the EU and Canadian "publish what you pay" reporting regimes, which provide for recognition of foreign reporting regimes deemed equivalent, the SEC is proposing to allow issuers to comply with the SEC rule by using reports prepared in compliance with a foreign jurisdiction's rules or that meet the reporting

requirements being implemented in connection with the United States acceding to the EITI, if the SEC has determined that those rules or requirements are substantially similar to the final rule adopted by the SEC.

Anti-evasion

The proposed rules, like the EU and Canadian regimes, would include an anti-evasion provision, which would require disclosure with respect to an activity (or payment) that, although not strictly within the covered activity or payment categories enumerated in the rule, is part of a plan or scheme to evade the disclosure requirements.

Request for Comments

Initial comments on the proposed rule are due on January 25, 2016. A second round of comments, responding to issues raised in the initial comment period, will be due on February 16, 2016. Comments may be submitted through the SEC's website.

Comparison of Reporting Regimes

The chart on the following pages gives a detailed comparison of the US, EU, Canadian and EITI reporting frameworks. A few caveats should be noted:

- The information presented regarding the US rules is based on the proposed rule issued by the SEC on December 11, 2015.
- The information presented regarding the EU rules is based on the EU Accounting Directive and, where noted, the UK Reports on Payments to Governments Regulations 2014. The implementation of the EU Accounting Directive in each Member State may differ in some aspects that are not reflected in the chart.
- The information presented regarding the Canadian rules is based on the statutory text of the Extractive Sector Transparency Measures Act (Canada), together with the proposed implementation tools (the Guidance and the Technical Reporting Specifications), which have been subject to a public consultation process.

Comparison of "Publish What You Pay" Reporting Regimes

	US[3]	EU	Canada	EITI
In force?	No. Proposed rule issued on 11 December 2015. Final rule expected to be adopted by June 2016.	Yes. Member States to enact implementing legislation by 20 July 2015.	Yes. Law came into force on 1 June 2015. Compliance required beginning with first full financial year after the date the law came into force.	Yes, in countries that have adopted the EITI Standard.
Which companies are subject to the reporting requirements?	Any company that is: ▪ engaged in the commercial development of oil, natural gas or minerals; and ▪ required to file annual reports (10-K, 20-F or 40-F) with the SEC. Does not include foreign private issuers that are exempt from Exchange Act registration pursuant to Rule 12g3-2(b).	Large undertakings[4] (whether or not listed) and public-interest entities (including companies with securities admitted to trading on a regulated market in the EU) that are active in the extractive industry (minerals, oil, natural gas deposits or other materials) or the logging of primary forests.	Any entity that is engaged in the commercial development of oil, gas or minerals and: ▪ is listed on a stock exchange in Canada; or ▪ has a place of business in Canada, does business in Canada or has assets in Canada and, based on its consolidated financial statements, meets at least two of the following for at least one of two most recent financial years: ▪ at least C$20 million in assets; ▪ at least C$40 million in revenue; and ▪ employs an average of at least 250 employees.	Oil, gas and mining companies that make payments to government within a particular country. Implementing countries may elect to expand to include other sectors/ industries.
Equivalency of other reporting regimes recognized?	Yes.	Yes.	Yes.	Not addressed in EITI Standard.

[3] Based on proposed rules issued by the SEC on 11 December 2015.

[4] A "large undertaking" is defined as a company that, as of the balance sheet date, exceeds at least two of the three following criteria: (a) balance sheet total: EUR 20 million; (b) net turnover: EUR 40 million; (c) average number of employees during the financial year: 250.

	US[3]	EU	Canada	EITI
Reporting period	Fiscal year	Financial year	Financial year	Subject to agreement by the country's multi-stakeholder group.
Extractive activities subject to the reporting requirements	▪ exploration ▪ extraction ▪ processing ▪ export ▪ the acquisition of a license for any such activity	▪ exploration, prospection and discovery ▪ extraction ▪ development	▪ exploration ▪ extraction ▪ the acquisition or holding of a permit, licence, lease or any other authorization to carry out any such activity	▪ exploration ▪ production Each enacting jurisdiction may elect to include revenue streams from other activities.
Excluded activities	▪ ancillary or preparatory activities (e.g., manufacturing drill bits or other machinery used in the extraction of oil) ▪ transportation ▪ downstream activities (e.g., refining, smelting) ▪ marketing	▪ processing (e.g., refining and smelting)[5] ▪ export ▪ ancillary or preparatory activities ▪ transportation ▪ service companies	Proposed implementing guidance would exclude: ▪ ancillary or preparatory activities (e.g., manufacturing equipment or construction of extraction sites) ▪ post-extraction activities (e.g., refining, smelting, marketing, transportation, export)	Typically does not include downstream activities, such as processing or export.
Types of payments included	Any of the following if made to further the commercial development of oil, natural gas or minerals: ▪ taxes ▪ royalties ▪ fees ▪ production entitlements ▪ bonuses ▪ dividends (other than when paid to a government as a common or ordinary shareholder on the same terms as other	▪ taxes levied on the income, production or profits of companies (excluding taxes levied on consumption such as value added taxes, personal income taxes or sales taxes) ▪ royalties ▪ licence fees, rental fees, entry fees and other considerations for licences and/or concessions ▪ production entitlements ▪ signature, discovery	Any of the following if made in relation to the commercial development of oil, gas or minerals: ▪ taxes (other than consumption taxes and personal income taxes) ▪ royalties ▪ fees (including rental fees, entry fees and regulatory charges as well as fees or other consideration for licences, permits or concessions) ▪ production entitlements	▪ the host government's production entitlement (such as profit oil) ▪ national state-owned production entitlement ▪ profits taxes ▪ royalties ▪ dividends ▪ bonuses, such as signature, discovery and production bonuses ▪ licence fees, rental fees, entry fees and other considerations

[5] List of excluded activities under the EU rules based on *The Reports on Payments to Government Regulations 2014*: *Industry Guidance* (*Draft*) (Nov. 5, 2014), relating to the implementation in the UK.

	US[3]	EU	Canada	EITI
	shareholders) ▪ payments for infrastructure improvements	and production bonuses ▪ dividends (other than when paid to a government as a common or ordinary shareholder on the same terms as other shareholders) ▪ payments for infrastructure improvements	▪ bonuses ▪ dividends (other than dividends paid as ordinary shareholders) ▪ payments for infrastructure improvements	for licences and/or concessions ▪ any other significant payments and material benefit to government
Corporate group covered	▪ subsidiaries and other entities consolidated in the issuer's financial statements (including proportional consolidation)	▪ consolidated report required if a parent undertaking is obligated to prepare consolidated financial statements under the EU Accounting Directive ▪ includes all subsidiary undertakings of the parent undertaking, as defined in the EU Accounting Directive	▪ entities controlled by the reporting entity	All companies making material payments to the government.
Exemptions	N/A	An undertaking need not be included in a consolidated report if: ▪ severe long-term restrictions substantially hinder the parent undertaking in the exercise of its rights over the assets or management of that undertaking ▪ extremely rare cases where the information cannot be obtained without disproportionate expense or undue delay ▪ the shares of that undertaking are held exclusively with a view to their subsequent resale	During two-year transition period, payments to Aboriginal governments in Canada need not be disclosed.	None (other than materiality standard).
Definition of "government"	▪ foreign national and subnational governments ▪ companies at least majority-owned by a	▪ any national, regional or local authority of a Member State or of a third country ▪ includes a	▪ any government in Canada or in a foreign state ▪ a body established by two or more	All government entities, including: ▪ state-owned enterprises ▪ subnational

	US[3]	EU	Canada	EITI
	foreign government ▪ US Federal Government (but not subnational level in the United States)	department, agency or undertaking controlled by any such authority	governments ▪ bodies and authorities that exercise or perform a power, duty or function of government for any of the foregoing	governments ▪ transfers/revenue sharing between national and subnational government entities
***De minimis* exemption threshold**	$100,000 whether made as a single payment or a series of related payments.	EUR 100,000 (£86,000 in UK) whether made as a single payment or as a series of related payments within a financial year.	C$100,000 total amount of all payments within a category of payment that are made to the same payee within the financial year.	Only "material" payments are required to be reported. Each country's multi-stakeholder group agrees on appropriate materiality definitions and thresholds.
Exemption for disclosure prohibited by foreign law or subject to confidentiality?	No. However, SEC will consider requests for exemptive relief on a case-by-case basis. An opinion of counsel would need to be given in support of any claim that a foreign law prohibits disclosure.	No.[6]	No.	No. In order to achieve EITI Compliant status, countries must remove legal and regulatory obstacles to EITI reporting (for example, by governments waiving contractual confidentiality provisions).
Anti-evasion provision?	Yes.	Yes.	Yes.	No.
Report required to be audited?	No.	No.	Yes (report must include an attestation either by a director or officer or by an independent auditor or accountant).	Yes (EITI report must either be reconciled or audited by an independent third-party firm).
Level of disclosure	By project. "Project" is defined as: operational activities that are governed by a single contract, license, lease, concession or similar legal agreement, which form the basis	By project, where payments have been attributed to a specific project. "Project" is defined as: the operational activities that are governed by a single contract, license,	By project, where payments can be attributed to a specific project. A "project" means the operational activities that are governed by a single contract, license, lease,	Each implementing country's multi-stakeholder group decides on the level of disaggregation in the public EITI report, which may be by individual company, government entity, revenue stream

[6] However, in such cases, *The Reports on Payments to Government Regulations 2014: Industry Guidance (Draft)* (Nov. 5, 2014) recommends that companies subject to the UK rules should report any inability to obtain permission from a host government or state-owned enterprise to the UK Department of Business, Innovation and Skills and provide all of the relevant evidence, including copies of relevant legal opinions.

	US[3]	EU	Canada	EITI
	for payment liabilities with a government. Multiple agreements that are both operationally and geographically interconnected may be treated as a single project (even if different terms). Payments may be disclosed at the entity level if the payment is made for obligations levied on the issuer at the entity level rather than the project level (e.g., corporate income taxes).	lease, concession or similar legal agreements and form the basis for payment liabilities with a government. Nonetheless, if multiple such agreements are substantially interconnected, this shall be considered a project. Payments made in respect of obligations imposed at entity level may be disclosed at the entity level rather than at project level.	concession or similar legal agreements and form the basis for payment liabilities with a government. Nonetheless, if multiple such agreements are substantially interconnected, this shall be considered a project. Payee-level disclosure for payments is sufficient where a payment is not attributable to a specific project.	and/or project.

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