

Securities Regulation Daily Wrap Up, STRATEGIC PERSPECTIVES— Mayer Brown's Bob Gray explains key facets of SEC's resource disclosure rule, (Jun. 28, 2016)

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By Mark S. Nelson, J.D.

The final version of the Commission's court-ordered re-write of its resource extraction issuer rule leaves some big questions unanswered for firms that may need to comply with the new disclosure requirements contained in Exchange Act Rule 13q-1 and Form SD, even if the agency's rule revamp seems to have prompted at least cautious optimism from organizations seeking greater transparency for the payments energy firms make to governments in order to access vital natural resources.

The Commission's final rule is effective 60 days after it appears in the *Federal Register*, and firms must comply with the rule and Form SD for fiscal years ending on or after September 30, 2018. A separate Commission order found that some disclosure regimes around the world have requirements substantially similar to those in the U.S. for purposes of U.S. compliance.

Related activities. According to Robert F. "Bob" Gray, Jr., partner and co-leader of Mayer Brown's Corporate & Securities practice, one of the thornier questions is how entities that may be subject to the new rule will handle reports on activities related to the commercial development of oil, natural gas, and minerals. Gray said this concern is especially significant for the many smaller companies that may be unaware of their potential reporting obligations.

"SEC-reporting companies involved in the oil, natural gas or mining industries—even if such activities are not the primary focus of their business—will need to carefully assess whether they are subject to the Rule's reporting obligations," said Gray. According to Gray, companies will need to pay close attention to how the rule treats activities such as processing or exporting.

The Commission's final rule release collects key terms in the text of Form SD, which defines "resource extraction issuer" as a company that files annual Exchange Act reports and engages in the commercial development of oil, natural gas, and minerals. The rule clarifies that these terms refer to activities such as processing and exporting.

As for processing activities, Gray said companies will need to understand how their midstream operations may fit into the SEC's disclosure regime. The rule defines "processing" to include the midstream activities of removing liquid hydrocarbons or other impurities from natural gas prior to transport via pipeline, and the upgrading of bitumen or heavy oil. Moreover, the term includes the crushing and processing of raw ore before smelting, but not downstream refining or smelting.

The term "export" means the movement of a resource across an international border from the host country to another country by a company with an ownership interest in the resource. But some activities would not fall within the meaning of the term, including solely acting as a service provider with no ownership of the resource.

Compliance costs, liability, exemptions. Another area of uncertainty will be the initial and ongoing costs of complying with the Commission's resource extraction issuer disclosure regime, even though the final rule substantially tracks the re-proposing release issued late last year. Companies also will face logistical issues in documenting compliance with the SEC's requirements for project-level disclosures.

Gray noted that information technology, consulting, training, and travel costs are just some of the expenditures companies may incur. "Companies will need IT and accounting control methods to track payments by project," said Gray. He added that many companies have multiple projects in a single country, further compounding the difficulty of tracking these payments.

Moreover, Gray observed that the Commission's final rule and the potential for Exchange Act Section 18 liability make compliance potentially tricky. Gray said the Commission's decision to grant case-by-case exemptions

instead of a blanket compliance exemption also may add complexity to the rule. According to Gray, there are no exemptions based on the size, ownership, foreign private-issuer status or extent of business operations constituting commercial development, only a "de minimis" payment threshold of \$100,000 that will not likely capture many payments. Still, Gray said it remains unclear if the final rule will competitively damage resource extraction issuers.

One bright spot, Gray noted, is the availability of alternative reporting for some resource extraction issuers. Under the Commission's separate order, these issuers could use a report from a country with a substantially similar disclosure regime to meet their U.S. reporting obligations.

The back story—prolonged court battle. The Commission's release of its resource extraction issuer rule, which was mandated by the so-called Cardin-Lugar amendment that became Dodd-Frank Act Section 1504, is the product of a two-pronged litigation attack on the agency's first attempt to issue a final rule to make companies' resource payments more transparent to investors and the general public. The first attack on the initial rule resulted in a decision by a federal district judge to vacate and remand the rule to the Commission due to alleged missteps by the agency in handling requirements for published reports, limiting the agency's discretion over publication of a data compilation, and the lack of an exemption for firms doing business in countries that bar public disclosure of royalties payments.

The human rights group Oxfam America, Inc. opened the second litigation front when it sued to press the Commission to speed the rule re-write. Ultimately, the Commission would adopt its second resource extraction issuer rule on the exact date it predicted in a reply to the federal judge in the Oxfam case. A press release issued by Oxfam said it "welcomed" the SEC's "sunshine rule" even if all of the details were not yet clear, while Sen. Ben Cardin (D-Md) hailed the rule as a "watershed moment" that will enable ordinary citizens around the world to hold their governments accountable for the management of natural resources.

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Companies: Oxfam America, Inc.

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