AN ALERT FROM THE BDO NATIONAL ASSURANCE PRACTICE

# BDO FLASH REPORT
# SEC MATTERS

## SUBJECT
## SEC ADOPTS RULE REQUIRING PAY RATIO DISCLOSURES

## DETAILS

On December 11th, the SEC re-proposed Exchange Act Rule 13q-1, which was mandated by Section 1504 of the Dodd-Frank Wall Street Reform and Consumer Protection Act (the Act). Congress enacted Section 1504 to combat global corruption by promoting international transparency of payments made to governments for the commercial development of oil, natural gas, and minerals. Rule 13q-1 would require resource extraction issuers to disclose information about certain payments made to the United States and foreign governments. The SEC's press release announcing this rulemaking can be accessed here, and the proposing release can be accessed here. Comments on the proposed rule are due by January 25, 2016.

The Commission initially adopted Rule 13q-1 to satisfy the Act's statutory mandate in August 2012. However, following a lawsuit to overturn the rule filed by the American Petroleum Institute, the U.S. Chamber of Commerce and two other business groups, a federal court vacated the rule in July 2013. The court ruled that the SEC misread Section 1504 of the Act to require public disclosure of such information. The court also noted that the SEC's decision to deny any exemptions from the rule was "arbitrary and capricious." In response, the SEC has rewritten and re-proposed the rule. The Commission has also filed with a court a rulemaking schedule indicating that it will vote on a final rule in June 2016.

## BDO USA CORPORATE GOVERNANCE PRACTICE

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The proposal is substantially consistent with the rule adopted in 2012. The most significant changes are:

- The term "project" was defined.
- The Commission will consider using its authority to grant requests for exemptive relief.
- As an alternative to the required report, issuers would be able to use a report prepared for foreign regulatory purposes if the SEC deems the requirements of the foreign regime to be substantially similar to the Commission's requirements.

The proposed rule would apply to "resource extraction issuers," defined as domestic and foreign issuers engaged in the commercial development of oil, natural gas, or minerals and are required to file an annual report under the Exchange Act. The activities that constitute "commercial development of oil, natural gas, or minerals" would include exploration, extraction, processing, export, or the acquisition of a license for any such activity.

Issuers would be required to disclose any payment (or series of related payments) to the U.S. government or foreign governments that is not de minimis (which the rule defines as equaling or exceeding $100,000 during a fiscal year) and has been made to further the commercial development of oil, natural gas, or minerals.

The disclosures would include, among other things, the type and total amount of payments made for each project and to each government.[1] As proposed, a project is contract-based and would be defined as the "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." The proposal contains a non-exclusive list of factors to consider when considering whether two or more agreements may be treated as a single project for purposes of the disclosure.

Since Rule 13q-1 was first adopted in 2012, several international bodies and countries have adopted similar disclosure requirements. The European Union has adopted and Canada has proposed rules requiring similar disclosures. In light of these developments, the Commission proposed allowing issuers to use a report prepared for foreign regulatory purposes as discussed above.

The proposed location and timing of the disclosures are similar to the initial rule adopted in 2012. The disclosures would be filed annually in an XBRL-formatted exhibit to Form SD, which was created for the purpose of reporting the information required by this rule and the rule requiring disclosure of the use of conflict minerals. The report would be due 150 days after the end of an issuer's fiscal year. The proposed disclosures may be reported on a cash basis and would not need to be audited [2] or be subject to officer certifications.

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[1] The disclosure must include payments made by the issuer's subsidiaries or other entities it controls, by reference to the financial consolidation principles applied in the issuer's audited financial statements (e.g., a consolidated variable interest entity). Consequently, payments made by an issuer's equity method investee would generally not need to be reported.

[2] Moreover, since Form SD does not include audited financial statements, auditors would not need to read the disclosures and consider whether they are materially inconsistent with the audited financial statements.