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Dodd-Frank Act: Proposed Rules to Implement Sections 1502-1504 relating to Conflict Minerals, Mine Safety and Payments by Resource Extraction Issuers

On July 21, 2010, President Obama signed into law the Dodd-Frank Wall Street Reform and Consumer Protection Act of 2010 (the "**Dodd-Frank Act**"). Among the other notable changes to the U.S. financial regulatory system, the Dodd-Frank Act included three sections of particular importance to petroleum and mining companies registered under the Securities Exchange Act of 1934 (the "**Exchange Act**"):

A. Section 1502 governing "conflict minerals" from the Democratic Republic of the Congo ("**DRC**") and adjoining countries (collectively, the "**DRC Countries**");

B. Section 1503 governing the reporting of mine safety matters; and

C. Section 1504 requiring disclosure of payments to domestic and foreign governments by resource extraction issuers.

On December 15, 2010, the Securities and Exchange Commission (the "**SEC**") proposed new disclosure rules to implement and interpret Sections 1502, 1503 and 1504 with a comment period originally scheduled to end on January 31, 2011. The SEC extended the comment period for each section's respective rules to March 2, 2011 in order to accommodate multiple inquiries from industry. As of this writing, final rules have not been issued.

Section 1502: Conflict Minerals

Section 1502, also known as the "Conflict Minerals Provision," adds Section 13(p) to the Exchange Act, requiring the SEC to promulgate disclosure rules for the use of conflict minerals originating in DRC Countries. Conflict minerals include: columbite-tantalite, also known as coltran (the metal or from which tantalum is extracted); cassiterite (the metal ore from which tin is extracted); gold; wolframite (the metal ore from which tungsten is extracted); the foregoing minerals' derivatives; or any other mineral or derivative thereof determined by the Secretary of State to be financing conflict in DRC Countries.

The SEC's proposed rules would apply to issuers who file Form 10-K, Form 20-F or Form 40-F with the SEC under Exchange Act Sections 13(a) or 15(d). The SEC requested comment on whether wholly-owned subsidiaries and asset-backed issuers should continue to be able to omit information under General Instruction I and J to Form 10-K, respectively.

To determine the level of disclosure required for an issuer, the SEC proposed a three-step process:

Firstly, the issuer must determine whether it is an entity for which "conflict minerals are necessary to the functionality or production of a product manufactured by such [entity]." Issuers that do not meet this test are not subject to the Conflict Minerals Provision. Although Section 1502 is intended to apply only to issuers that manufacture products, the SEC proposes

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to include issuers that contract for the manufacture of products as well. To clarify the statute's new scope, the SEC proposes excluding retail issuers that only sell third parties' products as long as those retailers have no influence over the products' manufacture. The SEC's proposed rules would also consider issuers that mine conflict minerals to be "manufacturing" these minerals.

If the criterion above is met, the issuer would then be required to determine if its conflict minerals originated in DRC Countries by undertaking a "reasonable country of origin inquiry." If an issuer determines that its conflict minerals did not originate in DRC Countries, the issuer would disclose this determination and the reasonable country of origin inquiry it used in the body of its annual report. The SEC would assess the reliability of any such inquiry solely by determining whether the information used provided a reasonable basis for an issuer to trace the origin of any particular conflict mineral it uses. An issuer could not conclude it to be unreasonable to determine the origin of conflict minerals solely on the basis of the large quantity of such minerals used in the manufacture of a product or the high percentage of its product portfolio that required such minerals. After a reasonable country of origin inquiry, if an issuer determines that its conflict minerals originated in DRC Countries or if it is unable to establish that its conflict minerals did not have such origins, the issuer would be required to disclose this conclusion in its annual report.

Finally, issuers with conflict minerals originating in DRC Countries and issuers that are unable to determine that their conflict minerals did not originate in DRC countries would be required to furnish a Conflict Minerals Report. In the report, an issuer would provide a description of any of its products that contain conflict minerals that it was unable to establish did not "directly or indirectly finance or benefit armed groups" in DRC Countries. Such products would be required to be designated as not "DRC conflict free." If any of an issuer's products contained conflict minerals that did not "directly or indirectly finance or benefit" these armed groups, the issuer could describe such products as "DRC conflict free," regardless of the minerals' origins.

Issuers would be required to exercise extensive due diligence on the source and chain of custody of their conflict minerals and to describe this process in their Conflict Minerals Report. This description must include a certification that the issuer obtained an independent public sector audit of its Conflict Minerals Report conducted in accordance with standards established by the Comptroller General of the United States. An issuer's Conflict Minerals Report would also have to include descriptions of its products that are not "DRC conflict free," the facilities used to process those conflict minerals, their country of origin and the efforts made to determine the mine or location of origin with the greatest possible specificity.

The SEC has also proposed that issuers obtaining conflict minerals from a recycled or scrap source may consider those minerals to be "DRC conflict free." Issuers, however, would be required to provide a Conflict Minerals Report describing the due diligence measures used to conclude the conflict minerals were from recycled or scrap sources.

The Conflict Minerals Report, including the audit report, would not be deemed incorporated by reference into any Securities Act or Exchange Act filing, except to the extent that an issuer specifically does so. The Report would hence be deemed "furnished" and would be treated as "not filed" for the purposes of Section 18 of the Exchange Act. The independent private sector auditor therefore would not assume expert liability and the issuer would only have to file a consent from that auditor if the issuer specifically incorporated the Conflict Minerals Report into a Securities Act registration statement.

The date an issuer takes possession of conflict minerals would determine the year in which the SEC would require a Conflict Minerals Report. Under the proposed rules, an issuer would provide its initial Conflict Minerals Report after its first full fiscal year following the promulgation of the SEC's rules. As the SEC anticipates publishing final rules by April 15, 2011, issuers with a fiscal year-end of May 31 would have to provide conflict minerals disclosure or a Conflict Minerals Report in its annual filing for the June 1, 2011 - May 31, 2012 fiscal year while issuers with a fiscal year-end of December 31 would not have to do so until the end of the December 31, 2012 fiscal year.

Section 1503: Mine Safety Disclosure

Section 1503 of the Dodd-Frank Act, which took effect on August 21, 2010, requires issuers that file reports under Sections 13(a) or 15(d) of the Exchange Act and are operators, or have a subsidiary that is an operator, of a "coal or other mine" to make the following disclosures to the SEC:

I. *Mine Safety Information*

A. The total number of violations of mandatory health or safety standards that could significantly and substantially contribute to the cause and effect of mine safety or health hazard under Section 104 of the Federal Mine Safety and Health Act of 1977 (the "**Mine Act**") and for which the operator received a citation from the Mine Safety and Health Administration (the "**MSHA**");

B. The total number of orders issued under Section 104 (b) of the Mine Act;

C. The total number of citations and orders for unwarrantable failure of the mine operator to comply with mandatory health or safety standards under Section 104(d) of the Mine Act;

D. The total number of flagrant violations under Section 110(b)(2) of the Mine Act;

E. The total number of imminent danger orders issued under Section 107(a) of the Mine Act;

F. The total dollar value of proposed assessments from the MSHA under the Mine Act; and

G. The total number of mining-related fatalities.

In addition to the above, the issuer must set forth in its periodic reports:

1. A list of coal or other mines, of which the issuer or a subsidiary of the issuer is the operator, that received written notice from the MSHA of:

   a. A pattern of violations of mandatory health or safety standards that are of such nature as could have significantly and substantially contributed to the cause and effect of coal or other mine health or safety hazards under Section 104(e) of the Mine Act; or

   b. The potential to have such a pattern; and

   c. Any pending legal action before the Federal Mine Safety and Health Review SEC involving such coal or other mines.

II. *Shutdowns and Patterns of Violations*

A. Issuers that operate or have a subsidiary that operates a coal or other mine must file a current report on Form 8-K disclosing the following information on each of its mines:

   1. The receipt of imminent danger orders issued under Section 107 (a) of the Mine Act; and

   2. The receipt of written notice from the MSHA that the mine has:

      a. a pattern of violations of mandatory health or safety standards that are of such nature as could have significantly and substantially contributed to the cause and effect of coal or other mine health or safety hazards under Section 104(e) of the Mine Act; or

      b. the potential to have such a pattern.

The SEC proposes incorporating Section 1503's disclosure rules by adding new exhibits to Form 10-K and Form 10-Q and by adding Items 106 and 601(b)(95) to Regulation S-K. Mine safety disclosures would be made in Part II of Form 10-Q, Part I of Form 10-K and Forms 20-F and 40-F, as applicable, referencing more detailed information in the exhibits of each respective form. The SEC did not require a specific method of presentation in the exhibits of each form as it did in the case of Section 1504, but encouraged tabular presentation to facilitate investor understanding. Form 10-K, as proposed, would include

disclosures for the fourth quarter as well as aggregate data for the full fiscal year. Issuers would be required to include information about orders, violations and citations that were received during the covered time period but were subsequently dismissed.

Noting that the Mine Act only applies to mines located in the United States, the SEC emphasized that issuers, or subsidiaries thereof, operating mines outside of the United States do not have to disclose information about such mines under the proposal. The SEC, however, noted that disclosure from foreign operators could be required to the extent that mine safety issues constitute material information pursuant to Items 303, 503(c), 101 or 103 of Regulation S-K.

Among the Section 1503 disclosures clarified by proposed Item 106, the SEC provided guidance for the following:

- 1503(a)(1)(A) requires disclosure of violations that the MSHA deems significant and substantial ("**S&S**") under Section 104 of the Mine Act. An S&S violation would be one "that is reasonably likely to result in a reasonably serious injury or illness under the unique circumstance contributed to [sic] by the violation …" The SEC proposes to require the disclosure of all citations received under Section 104 of the Mine Act noting a S&S violation.
- 1503(a)(1)(E) requires the disclosure of the total dollar amount of proposed assessments for the time period covered by the periodic report. The SEC proposes requiring issuers to disclose the total dollar amount of penalties assessed by MSHA during the time period covered by the report.
- 1503(a)(1)(G) requires the disclosure of the total number of mining-related fatalities for each coal or other mine operated by an issuer or a subsidiary thereof. As the application of Section 1503 is limited to mines covered by the Mine Act and although this subsection does not reference the Mine Act, the SEC proposes to use the MSHA's "comprehensive scheme of regulation, reporting and assessment for mine-related fatalities." Use of the MSHA's standards would exclude "non-chargeable" deaths which include homicides, suicides, death due to natural causes and fatalities involving trespassers. Use of the MSHA standard would also create consistency among reporting obligations.

In addition to the above, the SEC proposes requiring issuers to provide a brief description of each category of violations, orders and citations reported under Regulation S-K. Although not required by Section 1503, this disclosure would serve the purpose of informing investors of the bases of these violations, orders and citations.

The SEC also proposes adding Item 1.04 to Form 8-K to implement Section 1503(b)'s requirement of "reporting shutdowns and patterns of violations." An issuer would be required to file a Form 8-K within four business days of the receipt of notice by that issuer of any Section 1503(b) "triggering events," regardless of the duplicative nature of the disclosure given the filing of the other forms mentioned above. However, the SEC would amend General Instruction I.A.3(b) of Form S-3 in order to ensure that the untimely filing of the new Form 8-K would not result in the loss of Form S-3 eligibility.

The SEC would include smaller reporting companies and foreign private issuers within the scope of its proposed rules implementing Section 1503. As foreign private issuers are not subject to Regulation S-K, they would be required to make disclosures about mines subject to the Mine Act in proposed amendments to Forms 20-F (Item 16-J) and 40-F (Paragraph 18 of General Instruction B) in addition to their disclosures under Form 6-K. The SEC also interpreted the Act's reference to "each coal or other mine" as the intent to elicit disclosure for distinct mines covered by the Mine Act; the SEC would not permit disclosures for groupings of mines, whether by project or geographic region.

The SEC, while admitting that some of its proposals appear burdensome, stated in the Release that the required disclosures are based upon information readily available.

Section 1504: Payments by Resource Extraction Issuers

Section 1504, by adding Section 13(q) to the Exchange Act, mandates the SEC to issue rules requiring resource extraction issuers to disclose publicly in their annual reports "information related to any payment made by [it], a subsidiary, or any entity under its control to a foreign government or the U.S. Federal Government … for the purpose of the commercial development of oil, natural gas or minerals." An issuer would also be required to include in its annual report the type and total amounts of payments made for each project relating to the commercial development of oil, gas, or minerals as well as to each government.

The SEC has proposed amendments to Form 10-K, Form 20-F and Form 40-F to require that these annual reports include the disclosures mandated by Section 13(q). The disclosure requirements for Form 10-K would be set forth in new Item 105 to

Regulation S-K. Item 601 of Regulation S-K would also be amended by adding two new exhibits, 97 and 98, setting forth required disclosure of payments made to foreign governments or the United States Federal Government in Form 10-K. Although mandatory, the disclosure would be deemed "furnished" rather than "filed" in order to avoid burdensome liability under Section 18 of the Exchange Act.

In addition to the proposed rule above, the SEC has provided some statutory interpretation for Section 1504:

A "resource extraction issuer" would include all U.S. and foreign companies engaged in the commercial development of oil, natural gas, or minerals and that are required to file annual reports with the SEC. The size or extent of the business operations of an issuer engaged in commercial development of oil, natural gas or minerals would be irrelevant in determining whether an issuer would be required to file reports. No exemption was proposed for smaller companies, foreign private issuers, wholly-owned subsidiaries or asset-backed issuers that would normally benefit from certain exemptions under General Instructions I and J to Form 10-K. The SEC solicited comments, however, on possibly exempting these issuers.

The SEC proposed to define "commercial development of oil, natural gas or minerals" to include exploration, extraction, processing, export and "other significant actions relating to oil, natural gas or minerals" as well as the acquisition of licenses for any of the foregoing. This definition would necessarily encompass more than the "upstream" activities of exploration and extraction. The SEC's definition is intended only to encompass activities that are *directly* related to the "commercial development of oil, natural gas, or minerals," not ancillary or preparatory activities such as the manufacture of machinery used in extraction. Transportation activities, for example, would be excluded from this definition. The removal of impurities from natural gas after extraction but before its transport through a pipeline, however, would be included as such removal is a necessary part of processing natural gas in order to prevent corrosion of the pipeline.

Section 1504 defines "payments" as a payment that "is made to further the commercial development of oil, natural gas, or minerals; is not de minimis; and includes taxes, royalties, fees (including license fees), production entitlements, bonuses, and other material benefits that the [SEC], consistent with [Extractive Industries Transparency Initiative ("**EITI**")]'s guidelines, determines are part of the commonly recognized revenue stream for the commercial development of oil, natural gas or minerals." The SEC did not propose to determine what "other material benefits" should be classified as "payments" and requested comments on possible rules that would be consistent with EITI guidelines. The SEC also did not propose any clarification on "de minimis" as the SEC considers this term to clearly equate with a materiality standard.

With respect to subsidiaries and the term "control" (as in an entity under the control of the resource extraction issuer), the definition of this term would be consistent with the securities laws (*e.g.*, Rule 12b-2). An issuer would need to make a factual determination as to whether it had control of an entity based on a consideration of all relevant facts and circumstances. "Control" would include consolidated entities in the definition provided by US GAAP and IFRS; an issuer would be required to disclose payments by an entity under its control even if this entity is not consolidated.

"Foreign government" under Section 13(q) means a foreign government, a department, agency, or instrumentality of a foreign government, or a company owned by a foreign government. The SEC proposed including foreign sub-national governments in this definition and proposed defining a "company owned by a foreign government" as being at least majority-owned by that foreign government. "Federal Government" would only mean the Federal Government of the United States.

Section 13(q) requires disclosure of payments made to a foreign government or the Federal Government for each project relating to the commercial development of oil, natural gas, or minerals. "Project" is undefined in the statute, and EITI does not provide for the disclosure of payments on a per project basis. The SEC offered no guidance on this term, but requested comment on whether a definition was necessary and, if so, what would be appropriate. The definition of this term is especially salient with respect to reporting of tax payments. It is not clear if the SEC will define the term "project" in the context of tax payments so that an issuer may disclose its aggregate taxes for a jurisdiction or whether the issuer will be required to allocate tax payments to each extraction site, refinery or other "project."

The SEC's disclosure rules for oil and gas reserves adopted in 2008 required disclosure of reserves in the aggregate and by geographic area as well as of the reserves in each country containing 15% or more of a registrant's proved reserves. These rules provided an exemption for the latter if a country's government prohibited disclosure of its reserves. Section 13(q) does not contain such an exemption and while none was proposed, the SEC requested comment on whether the proposed disclosure requirement would force issuers to violate host countries' laws and the possible necessity of providing such an exemption.

Issuers will have to make Section 1504 disclosures not later than one year after the date on which the SEC issues final rules. As Section 13(q) requires the SEC to enact final rules by April 15, 2011, issuers will be required to make the new disclosures in their annual reports for the fiscal year ending on or after April 15, 2012.