

Third SPEE European 2012 Chapter Meeting

Recent Developments in the Disclosure Requirements for Oil and Gas Companies

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Transparency Imperative

- Oil and gas and mining companies are the custodians of strategically important natural resources and their operations and activities can have a significant impact on the environment, the economy and people
- In the last few years SEC rulemaking and comment letters have been focussed on the integrity of the reserves estimates and the impact on financial reporting – this continues
- There is a growing emphasis on social, political and ethical issues alongside the traditional focus on financial performance

Recent Events

- Major oil spills, gas leaks and problems with aging infrastructure have highlighted significant environmental and safety risks facing the industry
- Emerging importance of unconventional resources has opened the debate about the environmental risks associated with shale and oil sands extraction methods
- Political tensions and instability in certain oil producing countries have heightened the concerns about doing business in those areas
- US Congressional mandates using SEC disclosure for public policy purposes

Environmental Issues

SEC reserves definitions do not explicitly take into account environmental and social impact issues

- The SEC has for many years required oil and gas companies to make disclosures about the potential **costs of environmental regulation and litigation**
- SEC comment letters during the last two years have required oil and gas companies to provide more disclosure regarding their **oil spill preparedness** and the potential changes to business as a result of regulatory response to the *Deepwater Horizon* incident
- Companies that employ **hydraulic fracturing** have been asked to disclose details regarding the chemicals and processes used, water management, the risks of environmental contamination and steps taken to minimise potential environmental impact
- Companies involved in production from **oil sands** have provided more disclosure about the methods employed and the environmental concerns

Environmental Issues

Continued

- Recently the SEC has directed companies to discuss the potential impact on their business of **climate change**:
 - the impact of new regulation, particularly greenhouse gas regulation
 - the physical impact of climate change
 - the consequences of technical and scientific developments and demand for goods that result in lower GHGs
 - the impact of new international standards

Environmental Issues

Continued

- Oil and gas companies are disclosing that they are providing more investment in:
 - Biofuels
 - Wind and solar
 - Carbon capture storage
- Alternative energy sources have their own environmental and social issues

Dodd-Frank Disclosure Requirements

- New Dodd-Frank Act disclosure requirements (statute's main purpose was to address problems in the financial services industry)
 - Resource payments to governments
 - Conflict minerals
 - Mine safety

Resource Payments

Purpose – to increase the accountability of governments to their citizens in resource-rich countries for the wealth generated by those resources

- **The SEC adopted final rules in August 2012: first report (Form SD) due May 2014 to cover 4Q 2013**
- **No audit required**
- **Draws on the guidelines of the Extractive Industries Transparency Initiative**
- **Applies to all resource extraction issuers who file reports with the SEC**
- **Companies who are not SEC reporting companies are not subject to these rules raising concerns that it puts SEC filers at a competitive disadvantage**
- **API, US Chamber of Commerce, Independent Petroleum Association of America and National Foreign Trade Council and API are joining together to file a legal challenge**

Resource Payments

Continued

- Captures payments made to governments to further the commercial development of oil, natural gas or minerals
 - Taxes
 - Royalties
 - Fees
 - Production entitlements
 - Bonuses
 - Dividends
 - Infrastructure improvements (e.g. roads and railways)
- Excludes *de minimis* payments, i.e., less than \$100,000
- Excludes social and community payments (e.g. schools and hospitals)

Resource Payments

Continued

- “Project” is not defined – SEC guidance states that underlying principle is that contracts between company and governments define the relationships and payment flows
- No exception in the case of foreign law or contractual prohibitions on disclosure

Resource Payments

Continued

Information regarding:

- the type and total amount of payments for each project
- the type and total amount of payments made to each government
- the total amount of payments by category (taxes, royalties, fees, etc)
- the government that received the payments and the country in which the government is located
- the currency used
- the financial period in which the payments relate
- the business segment that made the payments
- the government that received the payments and the country in which the government is located
- the project to which they payments relate

Resource Payments

Continued

- Although the rules are being challenged, companies need to plan for the collection and reporting of this data
- Many questions to clarify including what entities are to be included
- Other regulators may follow suit
 - Existing Norwegian requirement
 - Currently pending EU directive

Conflict Minerals

- Each SEC reporting company must determine whether conflict minerals are
 - **necessary to the functionality or production of a product**
 - **that it manufactured or contracted to manufacture**
- “Conflict minerals” include gold, tin, tungsten, tantalum, columbite-tantalite, wolframite and cassiterite . It could also include any other mineral so determined by the US Secretary of State

Conflict Minerals

Continued

- “Manufacturing” is not defined – generally understood term – should assume it includes processing, refining, and possibly production
- “Contract to manufacture” – where company has influence on the selection of materials, parts, ingredients or components to be included in the ultimate product
- “Necessary to the functionality or production of a product” - not defined
 - Does not cover products for which a conflict mineral is not found in the final product, even if the conflict mineral is intentionally included in the production process – e.g. a catalyst (except where a trace remains)
 - Does not include tools used in making the product

Conflict Minerals

Continued

- No *de minimis* threshold
- Mining is excluded
- If any such products are identified, the company will be required to conduct a reasonable **country of origin inquiry** and report to the SEC on new Form SD (due May 2014) whether their conflict minerals originated in the Democratic Republic of Congo or an adjoining country or are from recycled or scrap sources

Conflict Minerals

Continued

- If a company determines (or is unable to determine) that its conflict minerals came from a Covered Country, it must
 - Conduct a **source and chain of custody due diligence** to determine if they came from a Covered Country and financed or benefited armed groups in a Covered Country
 - Disclose the outcome of that due diligence on Form SD and on its website
 - If they do originate in a Covered Country, file a **conflict minerals report** and provide a public sector audit on the design of the due diligence procedures

Conflict Minerals

Continued

- Like the Resource Payments rules, companies need to plan now to put the due diligence process in place
- Fact finding inquiry likely to be more difficult than for resource payments
- Unclear what entities are covered
- Design of the due diligence procedures to be challenged by an audit

Mine Safety

- All SEC-reporting companies that operate a coal or other mine located in the US and otherwise are subject to the US Federal Mine Safety and Health Act of 1977 (the “Mine Act”), are now required to make disclosures regarding mine safety, health citations, imminent danger orders, penalty assessments, mining-related fatalities and pending legal actions
- These new disclosures are to be contained in mine safety reports and filed with each quarterly and annual report

Sanctioned Countries

- For some time, the SEC has required companies to provide detailed disclosures of their activities with sanctioned countries even when the company's activities are not subject to US sanctions
- Countries concerned: Iran, Syria, Sudan, Cuba and North Korea
- The SEC has a dedicated office, The Office of Global Security Risk, to monitor whether the filings of public companies include disclosure regarding global security risk-related issues
- The SEC has approached this from the perspective that investors should not unwittingly invest in companies doing business with sanctioned countries
- Some states prohibit the investment by their pension funds or state-regulated industries in companies doing business in sanctioned countries

Sanctioned Countries

Continued

- **Iran Threat Reduction and Syria Human Rights Act of 2012**
 - provisions in this Act effectively declare the Iranian energy sector off-limits and blacklist any related unauthorised dealings
 - aimed at preventing Iran from repatriating revenue it receives from the sale of crude oil, depriving Iran of hard currency earnings and funds to run its state budget
 - the sale of Iranian crude oil will be sharply limited to only countries that have agreed to significantly reduce their purchase of Iranian crude
 - increases number of mandatory sanctions and the types of sanction

Sanctioned Countries

Continued

- includes financial sanctions aimed at further restricting Iran's access to the international financial system
- includes prohibitions on insurance and shipping
- specified sanctions targeting Iran's Islamic Revolutionary Guard Corp. ("IRGC"). On September 24, 2012 OFAC announced that the National Iranian Oil Company ("NIOC") is an "agent or affiliate" of IRGC
- requires mandatory disclosures to the SEC relating to sanctionable activity
- requires the President to investigate this activity

Cyber-security risks

- Increased risk of cyber incidents – both deliberate attacks and unintentional events
 - theft of information
 - disruption of operations
 - risk to business partners
- SEC has issued guidance to issuers to include disclosure about the risks
- Objective of the disclosure is not to provide a roadmap for how potential hackers could infiltrate a company
- SEC comment letters scrutinizing companies that have been reported in the media to have suffered breaches to their computer systems

In Summary

- “The most effective sanction in this world . . . is the loss of global investor confidence”
- Forcing companies to be transparent tends to change the way they operate