Dodd-Frank and the environment: from the belly of the Trojan horse

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Present-day environmental considerations extend far beyond traditional environmental issues, such as clean air, clean water and remediation. Nowhere is this more apparent than in corporate practice. How a company portrays its environmental sensitivities and what disclosures it is required to make about its environmental track record implicates topics ranging from operations and procedures to environmental monitoring; from waste, water and energy audits to due diligence and codes of practice. The Dodd-Frank Act is emblematic of how law-makers are employing novel tools to achieve broad sustainability objectives.

Three provisions tucked into the Dodd-Frank Wall Street Reform and Consumer Protection Act ushered in a series of regulations that will resonate throughout the environmental arena. Congress' use of securities laws to address conflict minerals, mine safety, and payments made to U.S. and foreign governments relating to oil and gas extraction has imposed unfamiliar, policy-based tasks on the Securities and Exchange Commission (the SEC), which has historically been equipped to oversee the orderly function of the U.S. securities markets. This article addresses both the content of the environmental provisions and the context in which they were passed, and examines the complexities of administering a set of rules that lie outside the SEC's traditional areas of expertise.

The Dodd-Frank Wall Street Reform and Consumer Protection Act (Dodd-Frank or the Act)[2] was signed into law by President Barack Obama on July 21, 2010. Passed in response to the financial collapse of 2008, it instituted the most comprehensive financial regulatory reform in the United States since the Great Depression.[3] Dodd-Frank is far-reaching.[4] Aimed at increasing oversight and transparency of the market, the Act implemented changes in the oversight and supervision of financial institutions,[5] touching every aspect of U.S. financial markets: from consumer credit to proprietary trading at financial firms; from OTC derivatives markets to securitization; and from private fund registration and regulation to corporate governance at public companies.[6] The Act consists of 849 pages and requires more than 240 rulemakings and nearly 70 studies.[7] Tucked into this voluminous text are three provisions that have little to do with financial institutions but may have profound financial implications in the environmental arena.

Section 1502 of the Act (Section 1502) consists of "Conflict Minerals Rules", which require companies that are registered with the SEC to disclose whether they manufacture products using so-called "conflict minerals" sourced from the Democratic Republic of Congo (DRC) or adjoining countries.[8] Section 1503 of the Act (Section 1503) instituted new reporting requirements relating to coal and mine safety. Section 1504 of the Act (Section 1504) requires all U.S. and foreign companies registered with the SEC to disclose payments to foreign governments and the U.S. Federal Government relating to oil, gas, and mineral extraction.[9]

The requirements of Sections 1502, 1503 and 1504 (collectively, the Environmental Sections) focus mainly on disclosure under the securities laws. By contrast, the other provisions of the Act have a regulatory thrust. For example, Title I of the Act concerns the regulation of financial institutions; Title IV regulates advisers to hedge funds; Title VII creates new regulations for the trading of swaps; and Title X establishes a new Bureau of Consumer Financial

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2 Dodd-Frank Wall Street Reform and Consumer Protection Act, Pub. L. No. 111-203, 124 Stat. 1376 (2010).

3 "In terms of its breadth and scope, Dodd-Frank is arguably the most significant financial legislation in modern history. The legislation ushers in a breathtaking amount of changes that will result in a tectonic shift in the legal, regulatory and policy landscape affecting our markets and our economy in a relatively short period of time." Kathleen L. Casey, Commissioner, SEC, Directors' Forum 2011 Speech: The Regulatory Implementation and Implications of Dodd-Frank (Jan. 23, 2011).

4 *Ibid.*

5 U.S. Secretary of the Treasury Timothy Geithner stated that the Act "was designed to lay a stronger foundation for innovation, economic growth and job creation with robust protections for consumers and investors and tough constraints on risk-taking". Timothy Geithner, *A Dodd-Frank Retreat Deserves a Veto*, WALL ST. J. July 20, 2011, at A19.

6 *Ibid.*

7 Casey, *supra* n 3.

8 Dodd-Frank Act §1502(a); Exchange Act Release No. 34-63547 (proposed Nov. 18, 2010). ("The term 'adjoining country' is defined in Section 1502(e)(1) of the Act as a country that shares an internationally recognized border with the DRC.")

9 Dodd-Frank Act §1504.

Protection. The Environmental Sections, therefore, appropriately fall under Title XV –Miscellaneous Provisions.

In many respects, the apparent disparity in purpose and focus between the Environmental Sections and the rest of the Act is a byproduct of the urgency in the wake of the financial collapse. With the public focus trained on corporate reform, members of Congress who had tangentially related corporate social policy objectives to achieve, found a viable delivery vehicle in Dodd-Frank where one had been previously lacking. The Environmental Sections were surviving stragglers from earlier legislative battles that had either been lost or not fought to a conclusion on their own terms, the inherent complexities of which were outweighed, or overlooked in the rush to pass Dodd-Frank.

Perhaps not surprisingly, significant complications have already arisen as a result of this amalgamation. On the most basic level, the size and scope of the Act have made it challenging for the SEC to keep pace with the required rulemakings. Remarkably, since its passage over two years ago, only about 30 percent of the Act's provisions have come into effect.[10] Section 1502 and Section 1504, in particular, have been plagued by missed deadlines and postponed final rules.

For the Environmental Sections, these delays are also evidence of deeper structural problems. Sections 1502, 1503, and 1504 have presented substantial challenges to the SEC – tasked by Congress to draft rules to enforce these provisions – because the subject matter of the rules falls outside the SEC's traditional scope of authority.[11] Since its inception, the SEC has been principally dedicated to the elicitation of disclosure for the benefit of investors. While Congress has granted the SEC regulatory authority under some legislation, most notably the Investment Company Act and the Investment Advisers Act, and while the Securities Exchange Act of 1934, as amended (the Exchange Act), contemplates regulation of certain activities of exchanges, securities associations, broker/dealers, transfer agents and clearing agencies, the SEC has not traditionally regulated corporate governance to further a public policy objective outside of the protection of the integrity of the security markets.

10 As of November 1, 2012, a total of 237 Dodd-Frank rulemaking requirement deadlines have passed, of which 144 have been missed and 93 have been met with finalized rules. Davis, Polk and Wardwell, *Dodd-Frank Progress Report*, *available at* http://www.davispolk.com/Dodd-Frank-Rulemaking-Progress-Report/ (last visited Nov. 6, 2012).

11 Chairwoman Mary Schapiro specifically noted that "[b]ecause expertise about these events does not reside within the Commission or our staff, we have drafted these proposed rules carefully to follow the direction of Congress." SEC Open Meeting, SEC, Dec. 15, 2010 *available at* http://www.sec.gov/news/speech/2010/spch121510mls-2.htm (last visited Nov. 13, 2012).

As a matter of both policy and process, the SEC has historically paid close attention to notions of materiality and to cost-benefit analyzes when crafting its disclosure requirements. In adopting Dodd-Frank, however, Congress required that the SEC craft rules to implement three politically sensitive and onerous provisions. This forced the SEC to alter the fundamental makeup of its rules so that they would both cover untraditional substantive areas and do so in an uncharacteristic level of detail. Whether these rules will stand the test of time remains to be seen, but the controversy surrounding them began almost immediately after Dodd-Frank's passage. The particular challenges of each rule are laid out in detail below.

Section 1502 – Conflict Minerals Rules

In adopting Section 1502, Congress stated that "[i]t is the sense of Congress that the exploitation and trade of conflict minerals originating in the Democratic Republic of the Congo is helping to finance conflict characterized by extreme levels of violence … particularly sexual- and gender-based violence, and contributing to an emergency humanitarian situation therein."[12] The goal of the rules is to mitigate this humanitarian crisis by cutting off sources of funding for the violent conflict in the region. Section 1502 amends the Exchange Act to add Section 13(p), which requires the SEC to promulgate disclosure rules concerning the use of certain minerals that originate in the DRC or countries that share an internationally recognized border with the DRC (Covered Countries).[13]

For a number of years prior to Dodd-Frank's passage, Representative Jim McDermott had sponsored a free-standing bill regulating conflict minerals. In 2009, he introduced the Conflict Minerals Trade Act in the House of Representatives.[14] Similarly, in 2009, Senators Sam Brownback, Dick Durbin and Russ Feingold introduced the Congo Conflict Minerals Act of 2009 to "require companies that are involved in commercial activities involving" coltan, casserite, and wolframite "to disclose the country of origin" to the SEC.[15] Neither of these legislative initiatives gained sufficient political support to move forward. In the debate surrounding Dodd-Frank, Senator Brownback re-introduced the legislation, and after a brief debate on the Senate floor, Section 1502 was added.[16]

12 Dodd-Frank Act §1502(a).

13 Securities Exchange Act of 1934, 15 U.S.C. §78(m) (1934).

14 Conflict Minerals Trade Act, H.R. 4128, 111th Cong. (2009).

15 Congo Conflict Minerals Act of 2009, S. 891, 111th Cong., (Apr. 23, 2009).

16 Ben Protess, *Unearthing Exotic Provisions in Dodd-Frank*, N.Y. Times, July 13, 2011, *available at* http://dealbook.nytimes.com/2011/07/13/unearthing-exotic-provisions-buried-in-dodd-frank/.

Once Dodd-Frank was signed into law on July 21, 2010, the SEC had 270 days to promulgate rules relating to conflict minerals pursuant to Section 1502.[17] After the SEC first issued its Proposed Rules in December 2010, it held over 90 meetings and received over 560 comment letters from various stakeholders.[18] On August 22, 2012, following a 3:2 vote, the SEC adopted its final rules.

Under the final rules, conflict minerals include cassiterite (used to produce tin), columbite-tantalite (from which tantalum is extracted), gold, wolframite (used to produce tungsten), and their derivatives, and any other minerals or their derivatives determined by the Secretary of State to be financing conflict in the Covered Countries.[19] These conflict minerals are commonly used in everyday products such as electronic equipment, wires and jewelry that originate in the Covered Countries. The SEC has anticipated that approximately 1200 companies will be required to file a Conflicts Minerals Report (described below) with the SEC under the rules. The rules require certain companies to disclose their use of conflict minerals that are "necessary to the functionality or production"[20] of products they manufacture. Companies must comply with the final rules for the calendar year beginning January 1, 2013, regardless of their fiscal year end. The first report is due May 31, 2014.

Applicability

Any issuer that files reports with the SEC under Section 13(a) or Section 15(d) of the Exchange Act, including domestic companies, foreign private issuers and smaller reporting companies, will be subject to reporting requirements if conflict minerals are "necessary to the functionality or production" of products manufactured or contracted to be manufactured by the issuer.[21]

Manufactured or Contracted to be Manufactured

While the final rules do not define the term "manufacture," they specify that the SEC would not consider an issuer that only services, maintains or repairs a product containing conflict minerals to be "manufacturing" that product.[22] Meanwhile, whether an issuer "contracts to manufacture" a product depends on the degree of influence it exercises on the manufacturing,[23] based on the facts and circumstances of an issuer's business and industry.[24]

Necessary to the Functionality or Production of a Product

The rules similarly do not define the meaning of "necessary to the functionality" or "necessary to the production of a product." Instead, they list a series of factors that issuers should consider in making their determinations. A conflict mineral is "necessary to the functionality" of a product if it: (1) is intentionally added to a product and is not a naturally-occurring by-product; (2) is necessary to the product's generally expected function, use or purpose; or (3) is incorporated for ornamentation, decoration, or embellishment.[25]

In assessing whether something is "necessary to the production" of a product, factors include whether it is: (1) included in the production process; (2) included in the product; and (3) necessary to produce the product. Under the final rules, for a conflict mineral to be considered "necessary to the production" of a product, the mineral must be <u>both</u> contained in the product *and* necessary to the product's production.

No *De Minimis* Exception

Due to concerns with the cumulative impact of these products, the SEC rejected requests to except products that contain *de minimis* amounts of conflict minerals. This decision may expand the scope of potentially covered issuers quite significantly.[26]

Reporting Obligations Under the Rules: The Three Step Test

Step 1: Does the Issuer Fall Under the Baseline Definition?

An issuer must first determine whether it is a "covered person," meaning one for whom "conflict minerals are necessary to the functionality or production of a product"

17 Dodd-Frank Act §1502(b)(1)(A).
18 Comments in response to Conflict Minerals, Proposed Rule, 75 Fed. Reg. 80948 (proposed Dec. 23, 2012), comments *available at* http://www.sec.gov/comments/s7-40-10/s74010.shtml (last visited Nov. 13, 2012). On October 18, 2011, the SEC held a public roundtable where participants addressed the definitions of "conflict minerals" and "necessary to functionality or production"; the *de minimis* exception; and the parameters of the due diligence required by the Proposed Rules. *See* Roundtable on Issues Relating to Conflict Minerals, 76 Fed. Reg. 63573-74 (Oct. 13, 2011); Conflict Minerals, Rel. No. 34-67716 (Aug. 22, 2012) (Conflict Minerals Adopting Release) at 15, *available at* http://www.sec.gov/rules/final/2012/34-67716.pdf.
19 Dodd-Frank Act §1502(e)(4).
20 17 C.F.R. §240.13p-1 (2012).
21 *Ibid*.
22 Conflict Minerals Adopting Release, *supra* n. 18, at 60–61.
23 Ultimately, a company would not be deemed to have influence over the manufacturing if it merely: (1) specifies or negotiates contractual terms with a manufacturer that do not directly relate to the manufacturing of the product; (2) affixes its brand, marks, logo or label to a generic product manufactured by a third party or (3) services, maintains or repairs a product manufactured by a third party. *Ibid.* at 65.
24 *Ibid.* at 61–67.
25 *Ibid.* at 82.
26 *Ibid.* at 91–94.

it manufactures. If not, the issuer is not required to take any action, make any disclosures, or submit any reports under the final rules. If, however, an issuer meets this definition, it must move on to the second step.[27]

Step 2: Determining Whether Conflict Minerals Originated in the DRC or Other Covered Countries

A company that uses any of the designated minerals is required to conduct a "country of origin" inquiry, performed in good faith and reasonably designed to determine whether any of the minerals in use by the company originated in the Covered Countries or are from scrap or recycled sources.[28]

If a company determines that its conflict minerals did not originate in the Covered Countries or are from recycled or scrap sources, *or* if the company has no reason to believe that the mineral may have originated in the Covered Countries and may not be from scrap or recycled sources, then the inquiry ends. The company must file Form SD (discussed below), disclosing its determination and briefly describing the inquiry it used.[29] The company is required to make its description publicly available on its website and provide the Internet address of that site in its Form SD.[30]

Step Three: Due Diligence on the Source and Chain of Custody of Conflict Minerals

If, however, based on the reasonable country of origin inquiry, the issuer knows, or has reason to believe, that it has conflict minerals that originated in the Covered Countries and they did not come from recycled material or scrap, the company must perform additional diligence on the source and chain of custody of its conflict minerals. The due diligence must conform to a nationally or internationally recognized due diligence framework, such as the guidance approved by the Organization for Economic Cooperation and Development.[31]

Content of Conflict Minerals Report: Are the Company's Minerals DRC Conflict Free?

The issuer must determine whether its minerals fall into one of three categories: (1) "DRC conflict free"; (2) "not DRC conflict free"; or (3) "DRC conflict undeterminable." The extent of the company's reporting obligations depends upon the category into which the minerals fall. The company must then prepare a Conflict Minerals Report, describing its due diligence measures and its results, and may be required to have the report audited by an independent private sector auditing firm.[32] The Conflict Minerals Report must then be filed as an exhibit to Form SD.[33]

DRC Conflict Free

If, after conducting due diligence, a company determines that its products are "DRC conflict free," specifically, that while the conflict minerals the company utilizes may originate from Covered Countries, they do not directly or indirectly finance or benefit armed groups in the Covered Countries, then the company must have its Conflict Minerals Report audited by an independent private sector auditor.[34] The company must also certify that it obtained the audit, include the audit report as part of the Conflict Minerals Report, and disclose the identity of the auditor.[35]

Not DRC Conflict Free

On the other hand, any issuer that manufactures products or contracts for products to be manufactured that have not been found to be "DRC conflict free" must, in its Conflicts Minerals Report, provide a description of those products which are not DRC conflict free; the facilities used to process the necessary conflict minerals in those products; the country of origin of the necessary conflict minerals in those products; and its efforts to determine the mine or location of origin with the greatest possible specificity.[36]

DRC Conflict Undeterminable

For the first two years of reporting under the final rules, or for four years for small companies, an issuer may describe its products as "DRC conflict undeterminable" if it is unable to determine that its minerals meet the statutory definition of "DRC conflict free" for either of two reasons: (1) if, after diligence, the company is unable to determine whether the minerals in its products financed or benefited armed groups in the Covered Countries; or (2) if, after an initial determination that its minerals may have originated in the Covered Countries, the company could not clarify the conflict minerals' country of origin, whether the conflict minerals financed or benefited armed groups in those

27 *Ibid.* at 40–41, 48–52.

28 Conflict Minerals Adopting Release, *supra* n. 18 at 140–41.

29 *Ibid.* at 147–50.

30 *Ibid.* at 162. Note, however, that in this instance, the company would not be required to retain the business records it used to support its country of origin conclusion. *Ibid.*

31 *Ibid.* at 182–83.

32 *Ibid.* at 183. The final rules specify that the audit's objective is to express a conclusion as to whether the design and the company's description of the due diligence measures it performed conform to the criteria set forth in the nationally or internationally recognized framework. *Ibid.*

33 *Ibid.* at 166. The company is also required to make the Conflict Minerals Report publicly available on its website and to provide the Internet address of that site in its Form SD. *Ibid.*

34 Conflict Minerals Adopting Release at 167.

35 *Ibid.* at 171–72.

36 *Ibid.* at 235–36.

countries, or whether the conflict minerals came from recycled or scrap sources.[37]

During the transition period, companies with products that may be described as "DRC conflict undeterminable" are not required to have their Conflict Minerals Report audited. Such issuers, however, must still file a Conflict Minerals Report, including a description of those products, the facilities used to process the necessary conflict minerals in those products, the country of origin of the necessary conflict minerals in those products and the efforts to determine the mine or location of origin. Additionally, these companies must describe their due diligence, and must describe the steps they have taken, or will take, to mitigate the risk that their conflict minerals benefit armed groups, including any steps to improve their due diligence.[38]

Special Due Diligence for Recycled or Scrap Material

The SEC determined that a company that uses conflict minerals from recycled or scrap sources may describe its products as "DRC conflict free," despite the fact that the scrap may have originated from conflict minerals. The SEC concluded that once reconstituted, these minerals were not continuing to contribute to the ongoing conflict in the DRC.[39]

The final rules require a company with conflict minerals from recycled or scrap sources to perform due diligence only if, following its reasonable country of origin inquiry, it has reason to believe that the conflict minerals were in fact mined. Under these circumstances, whether the due diligence the company performs is required to conform to a nationally or internationally recognized due diligence framework will depend upon which mineral is in question.[40]

Separate Reporting Requirement and Implications

The final rules require an issuer to provide the conflict minerals disclosures that would have been in the body of the annual report in a new specialized disclosure report on a new form, Form SD. An issuer required to provide a Conflict Minerals Report will provide that report as an exhibit to the specialized disclosure report instead of as an exhibit to its annual report on Form 10-K, Form 20-F or Form 40-F.[41] However, because Form SD is separate from a company's Form 10-K or 20-F, it will not be covered by the CEO and CFO certifications required after Sarbanes-Oxley; nor will it automatically be incorporated into a company's shelf registration statement.[42]

In order to reduce the burden on the supply chain of reconciling multiple fiscal timetables, the final rules require that the specialized disclosure report and/or the Conflict Minerals Report cover the calendar year from January 1 to December 31, regardless of the issuer's fiscal year end, and the specialized disclosure report covering the prior year must be provided each year by May 31.[43] The final rules also require that Form SD, including the conflict minerals information and any Conflict Minerals Report submitted as an exhibit, be "filed" under the Exchange Act, as opposed to being merely "furnished."[44] This subjects the issuer to potential Section 18 Exchange Act liability.

The Challenging Road Ahead

The final Conflict Minerals Rules present a number of practical and ideological challenges. Companies will be hard-pressed to institute due diligence procedures to demonstrate their efforts to achieve compliance. Undoubtedly, many reporting companies will take advantage of the "DRC Conflict Undeterminable" category as they struggle to analyze their supply chains and to gather information from smelters. Due to the complexity of many corporate supply chains,[45] combined with the geopolitical forces on the ground in the DRC and surrounding regions, it will take time and effort to determine whether Conflict Minerals are in play for each link in the chain.

Complicating this fact is the reality that what a reporting company learns over the course of its due diligence will

37 *Ibid.* at 29–30. This is a significant departure from the proposed rules, which would have required companies that were unsure if its conflict minerals met the criterion above to label those conflict minerals "not DRC conflict free". *Ibid.* at 151.

38 *Ibid.* at 186–87.

39 Conflict Minerals Adopting Release, *supra* n. 18, at 229–30.

40 *Ibid.* at 348, 153 n. 455. If, after its inquiry, the company cannot conclude that the gold contained in its products is from recycled or scrap sources, then it is required to undertake due diligence in accordance with the OECD Due Diligence Guidance, and obtain an audit of its Conflict Minerals Report. Gold is specified because it is the only conflict mineral for which a nationally or internationally recognized due diligence framework exists as part of the OECD Due Diligence Guidance. For the other three minerals – cassiterite, columbite-tantalite and wolframite – if, after its inquiry, a company cannot reasonably conclude that they came from recycled or scrap sources, it will have to perform its due diligence without the benefit of such a recognized framework. In this case, until a widely recognized due diligence framework is developed, the company must describe the due diligence measures it used to determine that its conflict minerals were from recycled or scrap sources in its Conflict Minerals Report. The company is not required to obtain an independent private sector audit regarding these conflict minerals. *Ibid.* at 31, 232–33, and 27.

41 *Ibid.* at 27.

42 *Ibid.* at 101–02, 118 n. 343.

43 *Ibid.* at 120.

44 Conflict Minerals Adopting Release, *supra* n. 18, at 23–24.

45 For example "it is not unusual for companies to have 100,000 suppliers or to produce more than 40,000 different products. Many of those products likely include only trace amounts or even untraceable amounts of the minerals in question, sometimes through the use of recycled materials. Now the SEC wants American companies not only to audit their complex supply chains but also monitor those of vendors." *Ibid.*

necessarily trigger reporting requirements under the rules. Thus, companies must use their time wisely to craft thought-out due diligence processes that will allow them to report consistently and honestly and to demonstrate that they are making progress towards eliminating conflict minerals from their supply chains. Ultimately, compliance with the Conflict Minerals Rules will create alliances between the public and private sectors. Broader due diligence frameworks will emerge, and linkages will be created between the upstream and downstream players.

While major companies such as Microsoft, General Electric, Motorola, Intel, HP and Apple had already begun to set up supply-chain analyses ahead of the SEC regulations, many smaller companies have been caught off-guard either by the scope or the reach of the rules.[46] While the rules only apply directly to reporting companies, the SEC created a knock-on problem for non-reporting companies, as the reporting companies seek to certify their own supplies as "DRC Conflict Free." It remains to be seen as to whether reporting companies will be able to pass down the risks of indemnification to non-reporting companies along with the diligence obligations.

In addition, outside the core of tech companies most immediately affected, the rules have implications for a diverse range of businesses, including food manufacturers, clothing retailers, equipment manufacturers, and companies that give away free prizes to consumers.[47] Not surprisingly, some industry estimates place costs on all businesses – large and small, public and private – as high as $16 billion.[48] A Tulane University study commissioned by supporters of the rules put the costs at almost $8 billion, with two-thirds of those falling on small businesses.[49]

Industry opposition to the rules began almost immediately after the passage of Dodd- Frank, as companies recoiled from the scope of their obligations.[50] Recently, the U.S. Chamber of Commerce and the National Association of Manufacturers asked the D.C. Court of Appeals to modify or invalidate the rules in *Nat'l Assoc. of Mfrs. v. SEC*.[51]

SEC Commissioner Troy A. Paredes noted that this rulemaking had proven to be especially difficult "because the Commission has no expertise when it comes to the humanitarian goal of ending the atrocities that besiege the DRC."[52] Commissioner Paredes went on to state that "because the SEC's mission is to protect investors, maintain fair, orderly, and efficient markets, and facilitate capital formation, it is not clear that the SEC and the federal securities laws are the proper instrument for achieving the laudable social objective behind Section 1502."[53]

Against this backdrop, *Nat'l Assoc. of Manufacturers* is the first of what will likely be many challenges to the rules, as industry maps out a path to achieving compliance with the rules without turning its back on all mining activity in the region.

Section 1503 – Reporting Requirements Regarding Coal or Other Mine Safety

Like the Conflict Minerals Rules, the mine safety provisions contained in Section 1503 seek to address matters of public policy through the framework of reporting obligations. In the case of the Conflict Minerals Rules, the sources of tension arise from both the content of the disclosures required and from Congress' use of the SEC as the tool for carrying out the mandated disclosures. In the case of Section 1503's mining disclosure provisions, a sophisticated protocol was already in place to regulate the safety of mine operations. The trigger that expanded the SEC's role into this arena was the public outcry following a mining disaster.

In the Spring of 2010, during the deliberation over the Dodd-Frank Act, mine safety was a topic of significant public attention after an explosion at the Upper Big Branch mine in West Virginia killed 29 miners on April 5, 2010. In response to the tragedy, President Obama ordered a review involving U.S. Department of Labor Secretary Hilda Solis and top officials from the Mine Safety and Health Administration (MSHA).[54] The review called for new authority for the mine safety agency, including changes that would make it easier to list mines as repeat offenders, grant subpoena power for its investigations and give it the ability to increase criminal penalties for violators.[55]

46 Jonathan Hutson, *SEC Adopts Conflict Minerals Rules as Chamber Threatens Lawsuit*, CENTER FOR AMERICAN PROGRESS: ENOUGH PROJECT (Aug. 22, 2012), *available at* http://www.enoughproject.org/news/sec-adopts-conflict-minerals-rules-chamber-threatens-lawsuit.

47 Thomas P. Quaadman, *Broken SEC Pushes Unworkable Rules on 'Conflict Minerals'* (Aug. 21, 2012, 11.51 AM), http://thehill.com/blogs/congress-blog/foreign-policy/244559-broken-sec-pushes-unworkable-rules-on-conflict-minerals.

48 *Ibid*.

49 *Ibid*.

50 Ben Protess, *Unearthing Exotic Provisions in Dodd Frank*, N.Y. Times, July 13, 2011, *available at* http://dealbook.nytimes.com/2011/07/13/unearthing-exotic-provisions-buried-in-dodd-frank/.

51 *See Nat'l Assoc. of Mfrs. v. SEC*, No. 12-1422, (D.C. Cir., Oct. 19, 2012). Briefing to follow.

52 Troy A. Paredes, Commissioner, SEC, Statement at Open Meeting to Adopt a Final Rule Regarding Conflict Minerals Pursuant to Section 1502 of the Dodd-Frank Act (Aug. 22, 2012) *available at* http://www.sec.gov/news/speech/2012/spch082212tap-minerals.htm.

53 *Ibid*.

54 Sheryl Stolberg, *Reviewing Mine Safety, Obama Faults Company and the Government*, N.Y. TIMES, Apr. 16, 2010, *available at* http://www.nytimes.com/2010/04/16/us/politics/16obama.html.

55 *Ibid*.

Additionally, President Obama directed Secretary Solis to work with Congress to strengthen federal laws relating to mine safety.[56] After the catastrophe, rather than instituting an entirely new disclosure rubric, Congress looked to build upon reporting obligations already in place under the Federal Mine Safety and Health Act of 1977 (the Mine Act)[57] and through MSHA.[58] On May 6, 2010, Senator Byrd (D-WV) introduced an amendment to Dodd-Frank which was tabled without a vote.[59] Consequently, the Senate version of the Act did not include Section 1503, but it was ultimately incorporated into the joint conference version which was passed by both houses without amendment.[60]

Ultimately, however, the perceived need for an expansion of public reporting in the wake of the tragedy caused Congress to take a set of preexisting regulations, which were out of harmony with the SEC's traditional disclosure regime and impose them upon a system ill-suited to administer them. Thus, in addition to significantly expanding the level of information required to be publicly disclosed by mining companies in their annual, quarterly and current reports filed with the SEC, Section 1503 also created collateral issues of duplication and substantial "background noise" in the public reporting system.

Required Disclosures Under Section 1503

Under Section 1503(a), the SEC mandated that each issuer required to make periodic disclosure under the Exchange Act that is "an operator or that has a subsidiary that is an operator, of a coal or other mine" – meaning "any owner, lessee or other person who operates, controls or supervises a coal or other mine or any independent contractor performing services or construction at such mine"; the same definition as in Section 3(d) of the Mine Act[61] – must include in its periodic reports filed with the SEC the following critical safety information:

- For each coal or other mine of which the issuer or a subsidiary of the issuer is an operator:[62]
  - the total number of violations of mandatory health or safety standards that could significantly and substantially contribute to a mine safety or health hazard under Section 104 of the Mine Act (30 U.S.C. §814)[63] for which the operator received a citation from MSHA;[64]
  - the total number of orders issued under Section 104(b) of the Mine Act (30 § U.S.C. 814(b));[65]
  - 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 (30 U.S.C. §814(d));
  - the total number of flagrant violations under Section 110(b)(2) of the Mine Act (30 U.S.C. §820(b)(2));
  - the total number of imminent danger orders issued under Section 107(a) of the Mine Act (30 U.S.C. §817(a));
  - the total dollar value of proposed assessments from MSHA under the Mine Act (30 U.S.C. §801 et seq.); and
  - the total number of mining-related fatalities.[66]
- A list of such coal or other mines, of which the issuer or a subsidiary of the issuer is an operator, that receive written notice from MSHA of:
  - 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

56 *Ibid*.
57 30 U.S.C. §801 et seq. (2012).
58 Under the Mine Act, MSHA is required to inspect surface mines at least twice a year and underground mines at least four times a year to determine whether they are complying with health and safety standards and whether any imminent danger exists. 30 U.S.C. §813(a) (2012). MSHA also conducts spot inspections and inspections pursuant to miners' complaints. 30 U.S.C. §813(i), (g) (2012). If violations of safety or health standards are found, MSHA inspectors will issue citations or orders to the mine operators. Among other activities under the Mine Act, MSHA also assesses and collects civil monetary penalties for violations of mine safety and health standards. 30 U.S.C. §820 (2012). MSHA maintains a data retrieval system on its website that allows users to examine, on a mine-by-mine basis, data on inspections, violations and accidents, as well information about dust samplings at all mines in the United States. *See* David M. Lynn, *The Dodd-Frank Act's Specialized Corporate Disclosure: Using the Securities Laws to Address Public Policy Issues*, 6 J. BUS. & TECH. L., no. 2, at 343 (2011).
59 156 Cong. Rec. S. S3364 (May 6, 2010).
60 It should be noted that Senator Byrd died on June 28, 2010 while the bill was still in conference.
61 Dodd-Frank Act §1503(e)(3). 30 U.S.C. §802(d).
62 Dodd-Frank Act §1503(a)(1).
63 Section 104 of the Mine Act requires MSHA inspectors to issue various citations and orders for violations of health and safety standards. 30 U.S.C. §814. A violation of a mandatory safety standard that is reasonably likely to result in a reasonably serious injury or illness under the unique circumstances contributed to by the violation is referred to by MSHA as a "significant and substantial" violation (S&S violation). The MSHA data retrieval system provides information regarding which citations or orders are S&S.
64 Dodd-Frank Act §1503(a)(1)(A).
65 *Ibid.* at §1503(a)(1)(B).
66 Since MSHA provides a comprehensive scheme of regulation, reporting and assessment for mining-related fatalities, the SEC determined that disclosure required by this section includes all fatalities that are required to be disclosed under MSHA, unless the fatality is determined to be "non-chargeable" to the mining industry. *See* U.S. DEP'T. OF LABOR, MSHA, ACCIDENT/ ILLNESS INVESTIGATION PROCEDURES HANDBOOK, Ch. 2, Release 1, p. 21 (June 2011), *available at* http://www.msha.gov/READROOM/HANDBOOK/PH11-I-1.pdf.

Act (30 U.S.C. §814(e)); or
  – the potential to have such a pattern.
- Any pending legal action before the Federal Mine Safety and Health Review Commission involving such coal or other mine.

Pursuant to Section 1503(b) of the Act, each issuer that is an operator, or that has a subsidiary that is an operator, of a coal or other mine is required to file a report with the SEC on Form 8-K disclosing:

- The receipt of an imminent danger order issued under Section 107(a) of the Mine Act (30 U.S.C. §817(a)).
- The receipt of written notice from MSHA that the coal or other mine has:
  – 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 (30 U.S.C. §814(e)); or
  – the potential to have such a pattern.

The Final Rules

The disclosures required under Section 1503 came into effect on August 20, 2010, and were self-implementing despite the fact that the SEC had not adopted any rules governing what form, and where, the disclosures should be made. However, the Act specifically authorized the SEC to issue rules or regulations "necessary or appropriate for the protection of investors and to carry out the purposes of [Section 1503]".[67]

On December 15, 2010, the SEC proposed rule amendments that would implement the Section 1503 requirements by codifying them into its disclosure rules and by specifying their scope and application. The SEC also proposed to require certain additional disclosure to provide context for a number of items required by the Act. In one of its final rulemaking sessions of 2011, the SEC issued final rules implementing Section 1503 which became effective on January 27, 2012, and closely tracked the language of Section 1503.[68] The inherent tensions between the Mine Act and the SEC's traditional framework are evident in the content of the adopting release.

Applicability of the Act under the Final Rules

The Act specifies that the definition of the "coal or other mine" tracks Section 3 of the Mine Act (30 U.S.C. §802(h)(1)-(2)),[69] with the net effect being that the final rules apply only to mines located in the United States. The SEC reasoned that it would be difficult to apply the Act's disclosure requirements to non-U.S. mines and would likely result in different disclosures from jurisdiction to jurisdiction and be incompatible.[70]

Under the final rules, disclosures are required for each distinct mine covered according to the mine's individual MSHA mine identification number. Issuers are not permitted to group mines by project or geographic region.[71]

Independent Contractors

The final rules note that orders and citations issued to independent contractors (who are not subsidiaries of the issuer) who are working at the issuer's mine site would not need to be reported by the issuer.[72] However, the definition of "operator" in the Mine Act includes independent contractors. Therefore, independent contractors that are required to file reports with the SEC pursuant to Section 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 would need to include the disclosure required by Section 1503 in their reports. The SEC acknowledged that, as a result of this approach, some orders or citations may go unreported if the independent contractor is not a reporting company. However, if individual orders or citations or a pattern of violations at mines owned by an issuer but operated by an independent contractor are material to the issuer, disclosure may be required under existing SEC rules pursuant to the applicable items of Regulation S-K, such as Item 303 (Management's Discussion and Analysis of Financial Condition and Results of Operations); Item 503(c) (Risk Factors); Item 101 (Description of Business); or Item 103 (Legal Proceedings).[73]

67 Dodd-Frank Act §1503(d)(2).
68 Specifically, the SEC adopted new Items 104 and 601(b)(95) of Regulation S-K and amended Forms 10-Q, 10-K, 20-F (to add new Item 16H) and 40-F (to add new Paragraph (16) of General Instruction B) under the Exchange Act to implement disclosure requirements set forth in Section 1503(a) of the Act. The SEC also adopted new Item 1.04 of Form 8-K to implement the requirement of Section 1503(b) of the Act. Additionally, the SEC amended General Instruction I.A.3.(b) of Securities Act Form S-3.
69 *Ibid.* at §1503(e)(2).
70 However, while the final rules limited the Act to mines covered by the Mine Act, the SEC emphasized that under current rules, disclosures may nonetheless be required pursuant to Regulation S-K.
71 This is consistent with MSHA's data retrieval system, which uses individual mine identification numbers.
72 Mine Safety Disclosure, Rel. nos. 33-9286;34-66019 (Dec. 21, 2011) ("Mine Safety Adopting Release") at 60, *available at* http://www.sec.gov/news/press/2011/2011-273.htm.
73 *Ibid.* at 13–14.

Small Reporting Companies and Foreign Private Issuers

The final rules do not provide special treatment for smaller reporting companies or foreign private issuers – both are included within the scope of the rules implementing Section 1503(a) of the Act.[74]

Framework for Disclosure under the Final Rules[75]

Compliance Under Section 1503(a) – Periodic Reports

The final rules require issuers that are obligated to provide disclosure under Section 1503(a)[76] to note that they have mine safety violations or other regulatory matters to report and that the required information is included in an exhibit to the filing and incorporated by reference into the form to which the exhibit is attached. Issuers filing on Form 10-K or Form 10-Q are directed to include the information required by Item 106 of Regulation S-K in the exhibit which closely resemble the required disclosure under Section 1503(a). Issuers filing on Form 20-F or 40-F must include in an exhibit the same information as is required by Item 106 of Regulation S-K.[77] Notwithstanding the additional disclosures mandated by Section 1503, the SEC noted that the new disclosure "would *not* obviate the need" for mine safety disclosure about concerns that should be addressed in other parts of a periodic report, such as risk factors, business description, legal proceedings or management's discussion and analysis.[78]

Period Covered

The final rules require each Form 10-Q to include the required disclosure for the quarter covered by the report. Each form 10-K must include disclosures for the fiscal year only – not also for the fourth quarter.[79] For each of Forms 20-F and 40-F, the disclosures are required for the issuer's fiscal year.[80]

The final rules do not allow issuers to exclude information about orders or citations that were received during the time period covered by the report but subsequently dismissed, reduced or vacated prior to the due date for filing.[81] Thus, issuers are required to include information that they otherwise might have determined to be immaterial. The SEC permits those issuers to provide additional disclosure noting the status of orders and citations received, thereby providing context.[82]

Dollar Amount of Assessments

Disclosure is required in each periodic report of the total dollar amount of assessments proposed by MSHA during the time period covered by the report. These assessments must be disclosed even if they are not final. Issuers may make additional disclosure explaining the status of these orders, citations and assessments, including identifying amounts that are contested.[83]

Mining Related Fatalities

Since MSHA provides a comprehensive scheme of regulation, reporting and assessment for mining-related fatalities, the SEC determined that disclosure required by this section includes all fatalities that are required to be disclosed under MSHA regulations, unless the fatality is determined to be "non-chargeable" to the mining industry.[84]

Legal Actions

The final rules adopted by the SEC require issuers to disclose the identity of each covered mine and the number of legal actions involving such mine pending as of the last day of the period covered by the periodic report, as well as the aggregate number of legal actions instituted and resolved during the reporting period.[85]

In addition, Item 103 of Regulation S-K (Legal Proceedings) continues to apply. Thus, to the extent a legal

74 Furthermore, the final rules do not extend the special provisions of Form 10-K and Form 10-Q that permit the omission of certain information by wholly-owned subsidiaries and asset-backed issuers. *Ibid.* at 14.
75 Unlike the disclosure obligations related to conflict minerals and resource extraction issuers, for which the SEC created new Form SD to accommodate the required disclosures, the disclosure required by Section 1503 will be included on existing Exchange Act forms.
76 The SEC amended Form 10-Q to add a new Item 4 to Part II and Form 10-K to add new Item 4 to Part I, in each case calling for information required by new Items 104 and 601(b)(95) of Regulation S-K. Because Regulation S-K does not apply directly to foreign private issuers under Forms 20-F and 40-F, the SEC amended those forms to include the same disclosure requirements as those applicable to issuers that are not foreign private issuers. The SEC amended Form 20-F to add new Item 16H; and Form 40-F to add new Paragraph (16) of General Instruction B. These new Items are identical and each requires issuers to provide in their periodic reports, and in their exhibits to their periodic reports, the information listed in Section 1503(a).
77 Mine Safety Adopting Release, *supra,* note 72, at 19, 75–76.
78 *Ibid.* at 19–20.
79 *Ibid.* at 24.
80 *Ibid.* at 24–25.
81 The final rules also do not allow issuers to exclude information about orders or citations that it is contesting.
82 Mine Safety Adopting Release, *supra* n. 72, at 25–26.
83 Each Form 10-Q is required to include the dollar amount of assessments proposed by MSHA during the quarter, while the Form 10-K, Form 20-F and Form 40-F must include the dollar amount of assessments proposed by MSHA during the fiscal year. However, the SEC did not require disclosure of the cumulative total of all assessments outstanding as of the last day of the reporting period. Mine Safety Adopting Release, *supra* n. 72, at 32.
84 *See* U.S. Dep't. of Labor, *supra* n. 66.
85 Mine Safety Adopting Release, *supra* n. 72, at 39.

proceeding is required to be disclosed under that item, disclosure and updates for material developments is required.[86]

Overall, the definitions and Section 1503(a) disclosure requirements demonstrate that the reach of the new mining provisions is broad, and the disclosure obligations imposed are duplicative of both pre-existing disclosure obligations under the Mine Act and Regulation S-K. Section 1503(a) adds a third, overlapping layer of obligations, albeit without the filter of the SEC's traditional materiality standard.

Compliance Under Section 1503(b) – Current Reports

In order to implement the reporting requirements of Section 1503(b), the SEC amended Form 8-K to add new Item 1.04, which requires an issuer to file a Form 8-K within four days of its receipt of: (1) An imminent danger order under Section 107(a) of the Mine Act;[87] (2) written notice from MSHA of 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;[88] or (3) written notice from MSHA of the potential to have a pattern of such violations.[89] These orders and notices are also required to be disclosed under Section 1503(a) of the Act in the issuer's periodic reports. [90]

The requirement to file a Form 8-K for any of the above orders or notices marks another significant expansion of the reach of the securities laws. The same information, disclosed in the context of the Mine Act, would be analyzed through the lens of those inside the mining industry and be weighted in a particular context. If any of the above violations rose to the level of materiality, the mining issuer would be required to disclose them pursuant to the applicable portions of Regulation S-K. By requiring mining issuers to file Form 8-K for *every* imminent danger order, notice of a pattern of violations or potential to have such a pattern, the SEC will be sending a signal to the investing public that could well be out of line with the severity of the violation, and thus run the risk of cluttering the S-K emergency channel with the chatter of matters that prove to be immaterial, and even inconsequential.

Liability

Section 1503 states that a violation will be treated in the same manner as a violation of the Exchange Act, and any violator will be subject to the same penalties.[91] The rules provide a limited safe harbor from liability under Section 10(b) or Rule 10b-5 under the Exchange Act for certain Form 8-K items, which require management to make a rapid materiality determination.[92] Under Section 110(b)(2) of the Mine Act, companies that commit violations that are deemed to be "flagrant" may be assessed a maximum civil penalty.[93]

Implications

By essentially lifting MSHA's reporting regime and inserting it into the SEC's periodic reporting obligations in an effort to respond to the Upper Big Branch mine disaster, Congress created a structural and implementation problem for the SEC. Historically, SEC rules, as interpreted by years of case law, have limited the information required to be disclosed to matters "that a reasonable investor would likely find important" in determining whether to buy or sell the registered securities.[94] In establishing this standard, the SEC highlighted information that, if omitted or mis-stated, would significantly alter the "total mix" of information pertinent to an investor, and also to avoid management's fear of exposing itself to substantial liability caused disclosure of an avalanche of trivial information – a result that is hardly conducive to informed decision-making. [95]

The Section 1503 disclosures, however, were originally fashioned as a tool for industry participants under the Mine Act and do not necessarily prioritize information that would be material to understanding an issuer's mining operation or the risk factors that would be of material import to an investor. Furthermore, other provisions of SEC reporting obligations such as Items 101, 103, 303,and 503(c) of Regulation S-K already required disclosure of material information relating to an issuer's mining operation. In this way, the disclosures required by Section 1503 by-passed the SEC's traditional thresholds while at the same time requiring certain duplicative disclosures.

It is instructive to compare Section 1503's deviation from the materiality standard to the SECs early attempts

86 *Ibid.* at 42.
87 30 U.S.C. §817(a) (2012).
88 *Ibid.* at §814(e).
89 *Ibid*.
90 The final rule does not extend the requirement to file current reports on Form 8-K to foreign private issuers. However, foreign private issuers will not be able to avoid disclosure of the orders and notices specified in Item 1.04 of Form 8-K. This information will instead need to be disclosed in the new amendments to Form 20-F or 40-F, which incorporate the requirements of Section 1503(a) of the Act.

91 Dodd-Frank Act §1503(d)(1).
92 Mine Safety Adopting Release, *supra* n 72, at 55.
93 *Ibid.* at 46.
94 17 C.F.R. §240.12b-2 (1986). *See also*, *TSC Industries, Inc. v. Norway, Inc.*, 426 U.S. 438, 449 (1976) (materiality requires "a showing of substantial likelihood that … the omitted fact would have assumed actual significance in the deliberations of the reasonable shareholder").
95 *TSC Industries, Inc.*, 426 U.S. at 448–49.

to compel enhanced environmental disclosure. In 1982, responding to similar public pressure and heightened awareness in the environmental arena, the SEC adopted Instruction 5(C) to Item 103 of Regulation S-K.[96] Item 103 provides generally that any material pending legal proceedings, "other than ordinary routine litigation incidental to the business," must be described by the company.[97] However, Instruction 5(C) to Item 103 requires the disclosure of administrative or judicial proceedings arising under any Federal, State or local laws that regulate the discharge of materials into the environment if a governmental authority is a party to the proceeding and it involves potential monetary sanctions, unless the registrant reasonably believes that it "will result in no monetary sanctions, or in monetary sanctions, exclusive of interest and costs, of less than \$100,000".[98] Instruction 5(C) to Item 103, imposes no disclosure duty if the company reasonably believes that the action will result in monetary sanctions of less than \$100,000.

This provision has long been deemed an outlier in the environmental disclosure regime as it strayed from the SEC's traditional disclosure rubric, creating confusion and leaving room for widely varying interpretations and disclosure responses among reporting companies. Perhaps not surprisingly, a 1998 study conducted by the Office of Enforcement and Compliance Assurance found a non-reporting rate of 74 percent under this provision.[99] Section 1503's disclosure obligations risk a similar fate, although they create a much more far-reaching and detailed regime than Item 103.

As a result of importing existing mining disclosure into the SEC's public reporting system, Section 1503 may increase transparency for investors. However, it will also place added financial burdens on issuers who must comply with the duplicative disclosure obligations and who will have to file reports on Form 8-K with increased frequency. As a result, opponents of Section 1503 question whether the new reporting requirements add value to existing rules or whether they simply run the risk of "creating unnecessary 'noise' in the public reporting" for issuers operating mines.[100]

Section 1504 – Disclosure of Payments by Resource Extraction Issuers

Congress drafted Section 1504 in order to "require the disclosure [to investors] of payments by resource extraction issuers,"[101] thereby allowing investors to know the full extent of a company's exposure "when they are operating in countries where they are subject to expropriation, political and social turmoil, and reputational risks."[102]

Section 1504 began its life on September 23, 2009, when Senator Lugar (R-IN) proposed legislation entitled the Energy Security Through Transparency Act of 2009 (the ESTTA).[103] On the same day, the ESSTA was referred to the Senate Committee on Banking, Housing and Urban Affairs, from which it never emerged. Eight months later, three days before the Senate passed its version of the Act,[104] Senator Cardin (D-MD), a co-sponsor of the ESTTA, included an amendment that would become Section 1504 (the Cardin-Lugar Amendment), the operative language of which closely tracked that of the ESTTA.

The Cardin-Lugar Amendment was tabled on the Senate floor and was not included in the version of the Act passed by the Senate. Senators Cardin and Lugar persisted, however, and were finally successful in having their amendment included (as Section 1504) in the version of the Act that emerged from the joint conference committee and eventually became law.

The SEC has promulgated a final rule implementing Section 1504, which has been challenged by the petitioners in *American Petroleum Institute (API) v. United States Securities and Exchange Commission*,[105] in which the petitioner's chief complaints center on the failure of the SEC to address adequately the burdens on the extractive resource industry.

96 Adoption of Integrated Disclosure System, Securities Act Release No. 6383 (Mar. 3, 1982). At the time, the SEC believed that the \$100,000 threshold would alleviate the problem of cumbersome, relatively unimportant disclosures and would comply with the National Environmental Policy Act (NEPA) by improving the effectiveness and readability of environmental litigation disclosures for investors and shareholders. *See* Proposed Amendments Regarding Disclosure of Certain Environmental Proceedings, Securities Act Release No. 6315 [1981 Transfer Binder] Fed. Sec. L. Rep. (CCH) §82,867 at 84,287 (May 4, 1981).

97 17 C.F.R. §229.103 (2008).

98 *Ibid. at* Instruction 5.

99 EPA, Mem. (Jan. 19, 2011) Guidance on Distributing "Notice of SEC Registrants' Duty to Disclose Environmental Legal Proceedings in EPA Administrative Enforcement Actions", *available at* http://www.epa.gov/oecaerth/resources/policies/incentives/programs/sec-guid-distributionofnotice.pdf.

100 *Ibid.* at 345.

101 156 Cong. Rec. S. 3814 (May 17, 2010).

102 *Ibid.* at S. 3815.

103 Energy Security Through Transparency Act of 2009, S. 1700, 111th Cong., (Sept. 23, 2009).

104 Passed in the Senate on May 20, 2010, amending H.R. 4173.

105 No. 12-1398 (D.C.Cir. Oct 15, 2012). The petitioners are also the plaintiffs in a suit filed in the United States District Court for the District of Columbia; *see American Petroleum Institute (API) v. SEC*, Civ. No. 12-01668 (D.D.C. Oct 10, 2012). The plaintiffs/petitioners filed suit in the District Court and requested review in the Court of Appeals simultaneously because of uncertainty as to which court has jurisdiction to hear the case. At the time of publication of this article, the Court of Appeals has ordered the parties to file briefs in that court, and only the SEC had done so.

Summary of the Law

Section 1504 added a new Section 13(q) to the Exchange Act,[106] entitled "Disclosure of Payments by Resource Extraction Issuers," which required the SEC within 270 days of enactment of the Act to promulgate final rules that would compel issuers in resource extraction industries to include in an annual report information relating to any payment they made to a foreign government or the U.S. Federal Government for the purpose of the commercial development of oil, natural gas or minerals.[107] Section 1504 provides further that, to the extent practicable, the rules promulgated by the SEC "shall support the commitment of the Federal Government to international transparency … relating to the commercial development of oil, natural gas, or minerals."[108] While Section 1504 does not specify which international transparency promotion efforts the SEC's rules should support, the SEC noted that the legislative history indicates that the Extractive Industries Transparency Initiative (the EITI)[109] was considered in connection with Section 1504[110] and, accordingly, the SEC's rules "track the language in the statute, and except where the language or approach of Section 13(q) clearly deviates from the EITI, the final rules are consistent with the EITI."[111]

The SEC issued proposed rules on December 15, 2010,[112] approximately four months before the statutory deadline for issuing final rules and solicited comments from the public. These proved to be extensive. The SEC did not meet the deadline for the issuance of final rules because of what some believed was intense pressure from the resource extraction industry to start the rulemaking process anew or to issue less stringent or less elaborate final rules.[113] When the SEC eventually issued final rules, 15 months after the statutory deadline, they were largely in line with its proposed rules.[114]

The Final Rule and Form SD

The SEC's final rule promulgated pursuant to Section 13(q) (Rule 13q-1), became effective on November 13, 2012, and provides that issuers that (1) are required to file annual reports with the SEC and (2) engage in the commercial development of oil, natural gas or minerals,[115] must file a report on Form SD (the newly created form also used in connection with Section 1502).

Form SD requires a resource extraction issuer to include in an exhibit to Form SD information relating to any payment made during the fiscal year covered by the issuer's annual report to a foreign government or the United States Federal Government, "for the purpose of the commercial development of oil, natural gas, or minerals."[116]

Scope of Rule 13q-1

Resource Extraction Issuer

Notwithstanding appeals by several commentators to exercise its authority to exempt certain issuers from the regulations, the SEC declined to do so and determined that Section 13(q) would apply to all U.S. and foreign companies that are engaged in the commercial development of oil, natural gas or minerals and that are required to file annual reports with the SEC, regardless of the size of the company or the extent of business operations constituting commercial development of oil, natural gas or minerals.

The SEC found that providing an exemption for smaller reporting companies or foreign private issuers "could …

106 15 U.S.C. §78m(q) (2012).
107 *Ibid.* at §78m(q)(2)(A).
108 *Ibid.* at §78m(q)(2)(E).
109 The EITI is a voluntary collation of oil, natural gas and mining companies, foreign governments, investor groups and other international organizations dedicated to fostering and improving transparency and accountability in countries rich in oil, natural gas, and minerals through the publication and verification of company payments and government revenues from oil, natural gas, and mining. *See* THE WORLD BANK, EXTRACTIVE INDUSTRIES TRANSPARENCY INITIATIVE, IMPLEMENTING THE EXTRACTIVE INDUSTRIES TRANSPARENCY INITIATIVE (2008), *available at* http://eiti.org/document/implementingtheeiti.
110 *See, e.g.*, statement by Senator Lugar, 111th Cong. Rec. S. 3816 (May 17, 2010) ("This domestic action will complement multilateral transparency efforts such as the Extractive Industries Transparency Initiative – the EITI – under which some countries are beginning to require all extractive companies operating in their territories to publicly report their payments.").
111 Disclosure of Payments by Resources Extraction Issuers, Exchange Act Release No. 67717 (Aug. 22, 2012), 77 Fed. Reg. 56365, 56367 (Sept. 12, 2012).
112 Disclosure of Payments by Resources Extraction Issuers , Exchange Act Release No. 63549 (Dec. 15, 2010), 75 Fed. Reg. 80978 (Dec. 23, 2010).
113 *See, e.g.*, letter from Harry Ng, Vice President, Gen. Couns. and Corp. Sec'y, American Petroleum Institute to Elizabeth M. Murphy, Sec'y., SEC (May 18, 2012), *available at* http://www.sec.gov/comments/s7-42-10/s74210-385.pdf; letter from Rep. Barney Frank, Rep. José E. Serrano, Rep. Norman D. Dicks, Rep. Henry A. Waxman, Rep. Maxine Waters, Rep. Donald M. Payne, Rep. Nita M. Lowey, Rep. Betty McCollum, Rep. Barbara Lee, Rep. Jesse L. Jackson, Jr., Rep. Alcee L. Hastings, Rep. Gregory W. Meeks, Rep. Rosa L. DeLauro and Rep. Marcy Kaptur, U.S. H.R. to Hon. Mary L. Schapiro, Hon. Elisse B. Walter, Hon. Luis A. Aguilar, Hon. Troy A. Paredes, Hon. Daniel M. Gallagher, SEC (Feb. 15, 2012), *available at* http://www.sec.gov/comments/s7-42-10/s74210-162.pdf.
114 See 77 Fed. Reg. 56365.
115 "Commercial development of oil, natural gas, or minerals," as defined by Rule 13q-1, "includes exploration, extraction, processing, and export of oil, natural gas, or minerals, or the acquisition of a license for any such activity." 17 C.F.R. §240.13q-1 (2012).
116 17 C.F.R. §249b.400 (2012).

raise competitiveness concerns for large companies and domestic companies."[117] The SEC further determined that "the transparency objectives of Section 13(q) are best served by requiring disclosure from all resource extraction issuers"[118] and that adopting exemptions "would be inconsistent with the structure and language of Section 13(q)".[119]

Commercial Development of Oil, Natural Gas or Minerals

Section 13(q), which defines "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, or the acquisition of a license for any such activity, as determined by the Commission",[120] invites the SEC to vary in its discretion. Consistent with the SEC's commitment to publish rules in line with the EITI except where the statutory language deviates from the EITI, however, Rule 13q-1 includes in the definition of "commercial development of oil, natural gas, or minerals" all the activities specified in Section 13(q) (and nothing more), "even though the statute includes activities beyond what is currently contemplated by the EITI".[121]

To avoid confusion, the SEC attempted to provide a series of examples of the actions referred to above in the Rule 13q-1 Release. For example, "extraction" includes the production of oil and natural gas in addition to the extraction of minerals; "processing" includes extracting liquid hydrocarbons and removing impurities from natural gas and crushing and processing raw ore; and "export" includes the exporting of oil, natural gas or minerals from the host country, but does not include transportation activities within the host country, unless those activities are directly related to the export of oil, natural gas or minerals.[122]

The SEC estimates that Rule 13q-1 will cause approximately 1100 public companies to be subject to the requirements of Section 13(q).

Requirements of Form SD

Form SD sets forth the precise disclosure that must be provided by resource extraction issuers regarding payments made to foreign governments and the U.S. Federal Government. Among other requirements, the form calls for the disclosure of the type and total amount of such payments made for each project relating to the commercial development of oil, natural gas or minerals; the type and total amount of such payments made to each government; the business segment of the resource extraction issuer that made the payments; the government that received the payments; and the specific project to which each payment relates.[123]

Payment

Section 13(q) defines "payment" as something that furthers the commercial development of oil, natural gas or minerals that is not *de minimis*,[124] including taxes, royalties, fees, production entitlements and bonuses.[125] The provision, however, allows the SEC to exercise its discretion in including other types of payments that, consistent with the EITI guidelines, "are part of the commonly recognized revenue stream for the commercial development of oil, natural gas, or minerals."[126]

By contrast to the list of activities included in the definition of "commercial development of oil, natural gas or minerals" in Section 13(q), which was more extensive than the activities called for by the EITI guidelines, the SEC found that the definition of "payments" in Section 13(q) omitted two classes of payments included in the EITI guidelines: dividends and payments for infrastructure improvements. Accordingly, the definition of "payment" set forth on Form SD includes each payment listed in Section 13(q) and adds dividends and payments for infrastructure improvements.[127]

If a payment made by a resource extraction issuer does not fall within one of the listed classes of payments, the company does not need to disclose such payment on Form SD. The same is true for payments that are considered "*de minimis*."[128]

Not *De Minimis*

Section 13(q) does not define *de minimis*. The SEC considered three general approaches offered by commentators. Some commentators stated that no definition was necessary, as the term is generally understood within the industry.[129] Several

117 *Ibid.* (internal citations omitted).
118 77 Fed. Reg. at 56373.
119 Rule 13q-1 Release at 56372-73 (internal citations omitted).
120 15 U.S.C. §13(q)(1)(A) (2012).
121 77 Fed. Reg. at 56375.
122 *Ibid.* at 56375–76.

123 *Ibid.*
124 15 U.S.C. §78m(q)(1)(C) (2012).
125 *Ibid.*
126 *Ibid.*
127 17 C.F.R. §249b.400 (Item 2.01(c)(6)(iii)) (2012).
128 77 Fed. Reg. at 56379.
129 *See*, *e.g.*, letter from Cleary Gottlieb Steen & Hamilton to Elizabeth M. Murphy, Sec'y, SEC (Mar. 2, 2011), *available at* http://www.sec.gov/comments/s7-42-10/s74210-64.pdf; letter from Rio Tinto plc to Elizabeth M. Murphy, Sec'y, SEC (Mar. 2, 2011), *available at* http://www.sec.gov/comments/s7-42-10/s74210-44.pdf.

commentators argued that "not *de minimis*" should be defined as meaning material.[130] Other commentators reasoned that Congress knows how to use the term material and, as such, the term "not *de minimis*" should be given a quantitative value.[131]

The SEC agreed with the third group of commentators and determined that adopting a definition of "not *de minimis*" would provide clear disclosure.[132] Accordingly, "any payment, whether made as a single payment or a series of related payments, that equals or exceeds $100,000"[133] is not *de minimis*.

Project

Section 13(q) requires a resource extraction issuer to disclose information regarding the type and total amount 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, but Section 13(q) does not define "project". The SEC elected to not define the term.

Notwithstanding pressure from various interested parties, including some who became litigants challenging the rule to provide a definition, the SEC stated that by leaving it undefined, issuers have flexibility in applying the term to different business contexts".[134]

Foreign Government and Federal Government

Section 13(q) draws a distinction in scope between foreign governments and the U.S. government.[135] Section 13(q) defines "foreign government", one of the receiving entities that would trigger a disclosure obligation, as "a foreign government, a department, agency, or instrumentality of a foreign government, or a company owned by a foreign government, as determined by the Commission",[136] including entities listed in Section 13(q), as well as "a foreign subnational government, such as the government of a state, province, county, district, municipality, or territory under a foreign national government".[137] The instructions to Form SD make clear that to be considered "owned by a foreign government" a company must be at least majority-owned by the foreign government.[138]

By contrast, the Rule 13q-1 Release clarifies that payments to the "Federal Government", as used in Section 13(q), means payments made to the United States Federal Government and not to state and local governments.[139]

Enforcement

A resource extraction issuer has two general obligations to fulfill in order to comply with Section 13(q). First, it must file its Form SD in a timely fashion. Second, it must ensure that the disclosure on Form SD is accurate and complete.[140]

Timely Filing

The failure of a resource extraction issuer to timely file a Form SD may subject the issuer and its shareholders to a variety of adverse consequences. Such failure, for instance, is a violation of Section 13(a) of the Exchange Act,[141] for which the SEC could institute administrative proceedings under Section 21A[142] seeking, among other things, revocation of the issuer's registration under the Exchange Act.[143] Failure to timely file a Form SD may also cause an issuer to lose its eligibility to use Form S-3 and Form S-8, as well as deny its shareholders the option to use Rule 144 of the Securities Act of 1933, for resales of the issuer's securities. Each penalty would restrict the issuer's access to the capital markets.[144]

Accurate and Complete Disclosure

Rule 13q-1 provides that Form SD must be filed with (instead of "furnished" to) the SEC. The requirement to

130 *See*, *e.g.*, letter from Kyle Isakower, Vice President of Regulatory and Economic Policy and Patrick T. Mulva, Chairman of API Corporate Finance Committee, American Petroleum Institute to Elizabeth M. Murphy, Sec'y, SEC, (Jan. 28, 2011), *available at* http://www.sec.gov/comments/s7-42-10/s74210-10.pdf; letter from Patrick T. Mulva, Vice President and Controller, ExxonMobil to Elizabeth M. Murphy, Sec'y, SEC, (Mar. 15, 2011), *available at* http://www.sec.gov/comments/s7-42-10/s74210-73.pdf.
131 *See*, *e.g.*, letter from Jennifer A. Mazin, Senior Counsel, Barrick Gold Corporation to Elizabeth M. Murphy, Sec'y, SEC, (Feb. 28, 2011), *available at* http://www.sec.gov/comments/s7-40-10/s74010-86.pdf.
132 77 Fed. Reg. at 56382.
133 17 C.F.R. §249b.400 (Item 2.01(c)(7)).
134 77 Fed. Reg. at 56385.
135 15 U.S.C. §78m(q)(2(A) (2012).
136 *Ibid.* at §78m(q)(1)(B).
137 17 C.F.R. §249b.400 (Item 2.01(c)(2)).
138 *Ibid.* at instruction 4.
139 77 Fed. Reg. at 56389.
140 The following discussion on Timely Filing and Accurate and Complete Disclosure with respect to a resource extraction issuer's Form SD also applies in the context of an issuer filing a Conflict Minerals Report pursuant to Section 1502.
141 15 U.S.C. §78m(a) (2012). Section 13(a) provides, in pertinent part: "Every issuer of a security registered pursuant to section 12 of this title shall file with the Commission, in accordance with such rules and regulations as the Commission may prescribe as necessary or appropriate for the proper protection of investors and to insure fair dealing in the security … such information and documents (and such copies thereof) as the Commission shall require … ."
142 15 U.S.C. §78u-3 (2012).
143 These proceedings, however, are rare and are typically aimed at recurring and egregious violations.
144 For a discussion on the securities laws impact of the failure to timely file a Form SD, *see* Jeffrey T. Hartlin, *Steps to Avoid Losing Form S-3 Eligibility & Incurring Other Penalties after a Late Exchange Act Filing, Part 1*, 12 Wall St. Lawyer, Issue 10 (Oct. 2008), *available at* http://www.paulhastings.com/assets/publications/1097.pdf.

file the Form SD subjects resource extraction issuers to liability under Section 18(a) of the Exchange Act.[145] Under Section 18(a), an issuer that includes a false or misleading statement in its Form SD is liable to an investor (1) that did not know such statement was false or misleading and that (2) purchased or sold a security of such issuer in reliance upon such false or misleading statement at a price that was affected by the statement.[146] The issuer would be liable for damages caused by such reliance.

Compliance

The first Form SD for a resource extraction issuer must be filed for fiscal years ending after September 30, 2013.[147] In the first report, an issuer may provide a partial year report, if its fiscal year began before September 30, 2013.[148] For any fiscal year beginning on or after September 30, 2013, a resource extraction issuer will be required to file a report disclosing payments for the full fiscal year.[149]

The cost of complying with Rule 13q-1 is a matter under dispute. The SEC estimated that the total initial cost of compliance for the entire resource extraction industry will be approximately $1 billion and the ongoing cost of compliance between $200 million and $400 million.[150] The petitioners in *API*, however, have taken issue with the SEC's estimates, stating, in their capacity as plaintiffs in the complaint filed with the United States District Court for the District of Columbia, that the SEC's methodology was fatally flawed and almost certainly underestimated the true costs of the Rule, particularly with respect to smaller issues.[151]

With respect to indirect costs, the SEC observed that "billions of dollars of [additional] costs" may be incurred by resource extraction issuers in countries in which laws prohibit the disclosure required by Section 13(q), specifically Angola, Cameroon, China and Qatar, thereby putting ongoing operations there in doubt.[152] The petitioners in *API* largely agreed with this assertion, but argued that the SEC did not attach appropriate weight to the potential size of such costs. For example, Royal Dutch Shell estimated that its costs due to lost business with the above-mentioned governments could exceed $20 billion.[153]

While the outcome of the legislation surrounding Rule 13q-1 is unknown, the judicial process may not be complete before the first Form SD must be filed. Furthermore, if the courts do not enjoin the effective operation of the Rule, and instead uphold it without granting an extension to comply, resource extraction issuers will shortly be compelled to begin these disclosure efforts.

Conclusion

The Environmental Sections of Dodd-Frank imposed a novel social experiment on the SEC, the results of which remain undeterminable but appear problematic, for a range of reasons both prodedural and substantive. Due to the unique political circumstances surrounding the passage of the Act, provisions which were previously unformed or deemed untenable at earlier points in time, rode into law with the Act – each with its attendant aspirations and flaws. Thus, instead of being analyzed as gate-keeping issues, questions about whether the SEC was qualified to fashion sophisticated rules in the areas covered by Sections 1502, 1503 and 1504, as well as whether the SEC has the ability to enforce the regulations at hand, were bundled unaddressed into what Congress presented to the SEC as a *fait accompli*.

Each of the Environmental Sections, in its own way, departs markedly from a particular tenet of the securities laws. Because the central goal of the federal securities laws is to ensure that buyers and sellers of securities will be adequately informed of material information affecting the

145 15 U.S.C. §78r(a) (2012).
146 For a discussion on Section 18 liability *see* John A. Occhipinti, *Section 18 of the Securities Exchange Act of 1934: Putting the Bite Back Into the Toothless Tiger*, 47 FORDHAM L. REV. 115 (1978); Walter D. Kelley, Jr., *Rule 10b-5: The Circuits Debate the Exclusivity of Remedies, the Purchaser-Seller Requirement, and Constructive Deception*, 37 WASH. & LEE L. REV. 877 (1980).
147 77 Fed. Reg. at 56365. Form SD provides that the form must be filed "no later than 150 days after the end of the issuer's most recent fiscal year."
148 *Ibid*.
149 *Ibid*.
150 77 Fed. Reg. at 56398. In arriving at the initial compliance estimate, the SEC relied on information provided by Barrick Gold and ExxonMobil, and in arriving at the ongoing compliance estimate, the SEC relied on Rio Tinto, the National Mining Association and Barrick Gold. Barrick Gold and ExxonMobil estimated that they would incur initial compliance costs of $500,000. *Ibid.* at 56408. Rio Tinto, the National Mining Association (on behalf of the mining industry) and Barrick Gold estimated that their ongoing compliance costs would be $4 million, $300,000 and $200,000, respectively. *Ibid.* at 56410.
151 *American Petroleum Institute (API) v. United States Securities and Exchange Commission*, Civ. No. 12-01668 (D.D.C. Oct 10, 2012).
152 *Ibid.* at 56412. The SEC stated: "The assumption underlying these estimates is that each firm either sell its assets in that particular country at their accounting value or holds on to them but does not use them in other projects." *Ibid*. The SEC added: "The losses could be larger than the estimates … if these firms are forced to sell their assets in [Angola, Cameroon, China, or Qatar] at fire sale prices." *Ibid*.
153 *See* letter from Martin J. ten Brink, Executive Vice President, Royal Dutch Shell plc to Elizabeth M. Murphy, Sec'y, SEC (Aug. 1, 2011), *available at* http://www.sec.gov/comments/s7-42-10/s74210-104.pdf.
154 *See* Gerard A. Caron, *SEC Disclosure Requirements for Contingent Environmental Liability*, 14 B.C. ENVTL AFF. L. REV. 729, 731 (1987). *See also SEC v. Texas Gulf Sulphur Co.*, 401 F.2d 833, 858 (2d. Cir. 1968), *cert. denied. sub. nom, Coates v. SEC*, 394 U.S. 976 (1969).

value of the securities traded,[154] the SEC intends first and foremost to promote informed investment decisions, rather than to regulate corporate conduct regarding environmental compliance.[155] The SEC has stated that, although it has broad discretion to require disclosure in public filings, its exercise of authority should be limited to the objectives of the federal securities laws.[156] Specifically, the SEC explained:

> [T]he Commission may require disclosure by registrants under the Securities Act and the Securities Exchange Act if it believes that the information would be necessary or appropriate for the protection of investors or for the furtherance of fair, orderly and informed securities markets or for the fair operation of corporate suffrage. Although disclosure requirements may have some indirect effect on corporate conduct, the Commission *may not require* disclosure solely for this purpose.[157] (*emphasis added*)

Furthermore, to ensure meaningful and careful disclosure documents without unreasonable costs to registrants and their shareholders, the SEC also kept in mind the cost-benefit implications of alternative proposals.

All three provisions clearly depart from the objectives of the traditional securities laws as they arise almost entirely from congressional notions of corporate social responsibility regarding issues that the SEC itself believed fell outside its mandate. As Commissioner Gallagher stated in his dissent to the adoption of the rules under Section 1502: "[t]his is not a rule that the Commission would have promulgated voluntarily – we are here today because of a congressional mandate."[158]

The Section 1503 mining provisions added an additional layer of incongruity. Historically, the SEC rules and years of case law have created a definition of what is "material," including limiting the information required "to those matters to which there is a substantial likelihood that a reasonable investor would attach importance in determining whether to buy or sell the registered securities."[159] While the adoption of Instruction 5(C) to Item 103 establishing a $100,000 threshold for disclosure of environmental proceedings in which a governmental authority is a party[160] suggests that the SEC has occasionally deviated from traditional materiality tests, the scope and detail of Section 1503 is unprecedented.

In addition, the SEC's traditional cost-benefit analysis was by-passed by the passage of the Environmental Provisions. The cumulative costs in developing infrastructure to implement and enforce the three rules will be in the billions of dollars. These costs and complications beg the question of whether Congress was employing the wrong tool for the wrong job.

Ultimately, Congress' passage of Dodd-Frank in effect, compelled the SEC to modify the structure and arguably the core purpose of its own regulations, and to do so in the glare of public attention surrounding high profile issues. The resulting burdens are significant and the pitfalls seem inevitable.

155 *See* Notice of Commission Conclusions and Rule-Making Proposals, Securities Act Release No. 5627, [1975-1976 Transfer Binder] Fed. Sec. L. Rep. (CCH) §80,310, 85,713 (Oct. 14, 1975).
156 *Ibid.*
157 *Ibid.*

158 Statement at SEC Open Meeting: Proposed Rule to Implement Section 1502 of the Dodd-Frank Act – the "Conflict Minerals" Provision by Commissioner Daniel M. Gallagher, *SEC,* Washington D.C. Aug 22, 2012.
159 17 C.F.R. §240.12b-2 (1986). *See also*, *TSC Industries, Inc. v. Norway, Inc.*, 426 U.S. 438, 449 (1976) (materiality requires "a showing of substantial likelihood that … the omitted fact would have assumed actual significance in the deliberations of the reasonable shareholder").
160 17 C.F.R. §229.103 (1986).