Lucy Stark

Partner
303.295.8493
Denver
mlstark@hollandhart.com

Impacts of Dodd-Frank Financial Reform Act on Oil, Natural Gas, and Mining Companies

Impacts of Dodd-Frank Financial Reform Act on Oil, Natural Gas, and Mining Companies

Insight — July 26, 2010

On July 21, 2010, President Obama signed the Dodd-Frank Wall Street Reform and Consumer Protection Act (the "Act"), an unprecedented overhaul of the U.S. financial regulatory system. Although the bulk of the bill focuses on increasing regulation of financial system risk, the Act contains a number of provisions that will impact companies in extractive industries. Title XI of the Act, titled "Miscellaneous Provisions" contains numerous new disclosure burdens on public reporting companies in extractive industries. Title VII of the Act establishes a regulatory structure for derivative instruments, including commodity hedges and interest rate swaps.

New Disclosure Requirements for Public Reporting Companies

Extraction Payments to Governments

Section 1504 of the Act requires the Securities and Exchange Commission (SEC) to promulgate new rules under the Securities Exchange Act of 1934 that will require any issuer engaged in "resource extraction" to include in the issuer's annual report information relating to any payment made by the issuer or entity under its control to the U.S. federal government or any foreign government for commercial development of oil, natural gas, or minerals. The required disclosure includes the type and total amount of the payments made on a project-by-project basis as well as the type and total amount of payments made to each government. The disclosure must be made in interactive data format, and the Act includes a list of electronic data tags that must be included in the disclosure.

The Act includes a broad definition of the term "foreign government", which includes any foreign government, department, agency, or instrumentality of a foreign government or a company owned by a foreign government. In addition, the Act broadly defines "payment" to include any payment made to further the commercial development of oil, natural gas and minerals, including any taxes, royalties, fees (including license fees), production entitlements, bonus, and other material benefits that the SEC determines are part of the commonly recognized revenue stream for the commercial development of oil, natural gas or minerals. The SEC is to consider the guidelines of the Extractive Industries Transparency Initiative (EITI) in determining whether a payment is part of this commonly recognized revenue stream. The EITI is a coalition of governments, companies, civil groups, investors and international organizations whose stated goal is "to

strengthen governance by improving transparency and accountability in the extractives sector.

The SEC is required to promulgate the rules effecting Section 1504 by April 17, 2011, which rules may not require issuers to provide this new disclosure until the fiscal year following the SEC's issuance of the rules.

Mine Safety

Section 1503 of the Act requires any issuer that is required to file reports under Section 13(a) or 15(d) of the Securities Exchange Act of 1934 and that operates a mine or has a subsidiary that operates a mine ("Mining Issuers"), to include new information regarding mine safety in each periodic report filed with the SEC. Specifically, a Mining Issuer is required to report the following information:

- For each mine:
  - the total number of violations of mandatory health or safety standards that could significantly and substantially contribute to the cause and effect of a mine safety or health standard under the Federal Mine Safety and Health Act of 1977 (FMSHA) for which the operator received a citation from the Mine Safety and Health Administration (MSHA);
  - the total number of orders issued under FMSHA;
  - the total number of citations and orders for unwarrantable failure of the mine operator to comply with mandatory health or safety standards under FMSHA;
  - the total number of flagrant violations issued under FMSHA;
  - the total number of imminent danger orders issued under FMSHA;
  - the total dollar value of proposed assessments from MSHA; and
  - the total number of mining-related fatalities.
- A list of all mines that have received written notice from MSHA of a pattern or potential 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 mine health or safety standards.
- Any pending legal action before the Federal Mine Safety and Health Review Commission involving a mine.

Mining Issuers are also required to file a current report on Form 8-K if they have received an imminent danger order from MSHA or a written notice from MSHA that a mine has a pattern or potential 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 standards.

Section 1503 does not require further rulemaking from the SEC and becomes effective on August 20, 2010.

Conflict Minerals

Section 1502 of the Act requires the SEC to promulgate new rules under the Exchange Act that will require annual disclosure of whether “conflict minerals” necessary for the production or functionality of a product manufactured by a company originated in the Democratic Republic of Congo (the “DRC”). If a person determines that “conflict minerals” originated in the DRC, the issuer must report the following information:

- a description of the person's due diligence on the source and chain-of-custody of the minerals, including an independent private sector audit of the report; and
- a description of the products manufactured or contracted to be manufactured that are not “DRC conflict-free,” the independent audit firm, the facilities used to process the conflict minerals, the country of origin of the conflict minerals, and the efforts to trace the origin of the conflict minerals.

Conflict minerals are defined in the Act as columbite-tantalite (coltan), cassiterite, gold, wolframite, or their derivatives, or any other mineral determined by the U.S. Secretary of State to be financing conflict in the DRC or an adjoining country. The President of the United States has the authority to revise or waive the requirements of this section.

Several provisions of the rule will require clarification by the SEC, including to whom the rule applies and in what report or form the disclosure will be made. Although the statute itself does not make clear that these requirements would apply to only companies filing reports with the SEC, we believe that the SEC will likely clarify this in its rulemaking. The SEC is required to promulgate the rules effecting Section 1502 by April 17, 2011, which rules may not require issuers to provide this new disclosure until the fiscal year following the SEC's issuance of the rules.

Provisions Regarding Derivative Securities

Title VII of the Act contains a new regulatory structure for derivatives. Because hedging of commodity prices has become such an integral part of financial risk management for many oil, gas and mining companies, these new regulations may have a significant impact on such companies.

At the center of the derivatives regulations contained in the Act is a new requirement that derivative contracts be centrally cleared, unless an exception applies. The SEC and the Commodity Futures Trading Commission (the “CFTC”) have been tasked with determining which derivative contracts should be exempt from this centralized clearing requirement. The Act also generally requires centrally-cleared derivative contracts to be exchange-traded.

The Act contains an exemption from the mandatory clearing requirement for so-called “end-users.” A party can qualify for the “end-user” exemption if: (a) it is not a “financial entity,” (b) it is not a “major swap participant,” (c) it uses swaps to hedge or mitigate commercial risk, and (d) it notifies the SEC how it generally meets its financial obligations associated with

entering into non-cleared swaps. In addition, any public company desiring to take advantage of this end-user exemption must obtain the approval of the board of directors or an appropriate committee of the board.

At one point, the draft legislation contained an exemption from the new margin requirements for non-cleared swaps. Although this exemption was deleted from the bill that was ultimately enacted, Senators Dodd and Lincoln wrote a letter to Representatives Frank and Peterson expressing their desire that regulators not impose margin requirements on end-users. However, whether such an exemption actually ends up in the final regulations will be left to the SEC and CFTC to determine. In any case, there is no margin exemption for swap dealers or major swap participants, which means such counterparties will be subject to increased margin requirements and are likely to pass along cost increases to the end-users.

The Act contains grandfathering provisions that permanently exempt existing trades from the centralized clearing requirements. However, existing trades are subject to the new margin and capital requirements.

While it is likely that the cost of hedge and derivative positions for companies qualifying for the end-user exemption will increase, the full impact of the derivatives title of the Act can not be fully understood until the SEC and the CFTC promulgate the regulations implementing it.

Holland & Hart

For more information about Holland & Hart's Mining Practice Group, contact any of the following attorneys:

Steve Barringer (202-654-6934, sgbarringer@hollandhart.com)
Bob Bassett (303-290-1603, bbasset@hollandhart.com)
Jean Feriancek (303-295-8185, jferiancek@hollandhart.com)
Kelly Johnson (202-654-6933, kajohnson@hollandhart.com)
Chris Jones (801-799-5811, cdjones@hollandhart.com)
Paul Schlauch (303-290-1621, pschlauch@hollandhart.com)

For more information about Holland & Hart's Oil and Gas Practice Group, contact any of the following attorneys:

Michael Campbell (505-954-7282, mcampbell@hollandhart.com)
Walter Eggers (307-778-4208, weggers@hollandhart.com)
Chris Jones (801-799-5811, cdjones@hollandhart.com)
Davis O'Connor (303-295-8081, doconnor@hollandhart.com)
Mark Ruppert (307-778-4267, mruppert@hollandhart.com)
John Shepherd (303-295-8309, jshepherd@hollandhart.com)

For more information about Holland & Hart's Securities & Capital Markets Practice Group, click here or contact any of the following attorneys:

David Angerbauer (801-799-5808, dangerbauer@hollandhart.com)
Scott Berdan (303-473-2712, saberdan@hollandhart.com)
Amy Bowler (303-290-1086, abowler@hollandhart.com)
Greg Lindley (801-799-5829, glindley@hollandhart.com)

Holland & Hart

Jeff Sherman (303-295-8149, jasherman@hollandhart.com)
Lucy Stark (303-295-8493, mlstark@hollandhart.com)

This publication is designed to provide general information on pertinent legal topics. The statements made are provided for educational purposes only. They do not constitute legal or financial advice nor do they necessarily reflect the views of Holland & Hart LLP or any of its attorneys other than the author(s). This publication is not intended to create an attorney-client relationship between you and Holland & Hart LLP. Substantive changes in the law subsequent to the date of this publication might affect the analysis or commentary. Similarly, the analysis may differ depending on the jurisdiction or circumstances. If you have specific questions as to the application of the law to your activities, you should seek the advice of your legal counsel.