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SHAREHOLDER ASSOCIATION
for RESEARCH & EDUCATION

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Re: Feedback on Canadian Mandatory Transparency Reporting in the Extractive Sector Planning Assumptions Chart

The Shareholder Association for Research and Education (SHARE) is an advisor to Canadian institutional investors. Since its creation in 2000, SHARE has provided proxy voting and shareholder engagement services as well as education, policy advocacy and practical research on emerging responsible investment issues.

We are pleased that the Government of Canada is taking steps towards establishing mandatory, comprehensive and effective reporting standards on payments made to governments by the extractive sector, and we hope our comments will assist the Government in determining the appropriate scope and content of those standards.

As a general matter, we have supported and continue to support the efforts of the Resource Revenue Transparency Working Group (RRTWG) and urge the Government of Canada to use the principles outlined by the RRTWG as the basis for any mandatory reporting regime in Canada. The recommendations of the RRTWG represent a consensus between industry and a wide range of stakeholders on acceptable and effective transparency measures and are therefore the best foundation for an initiative on revenue transparency reporting.

Rather than providing comment on all of the assumptions listed in the consultation document, we will comment below only on the assumptions for which we have specific concerns to raise. With regard to the other listed assumptions we have no comment at this time.

Vehicle for Mandatory Reporting

Consistent with the recommendation of the RRTWG, we agree that mandatory reporting obligations should be enacted through provincial/territorial securities regulators. However, the Government of Canada should be prepared to act at the federal level if securities regulators are unable to achieve a mandatory reporting regime within a reasonable period of time. Given that substantial work has already been done within Canada by the RRTWG to achieve consensus on reporting requirements, and that there are existing models in EU and US law to build on, a relatively short time frame should be considered.

Scope

In the consultation document the term "scope" applies to the type or levels of governments for which payments by companies are to be reported. The document mentions "national, sub-nations, and municipal, as well as Aboriginal 'self-government' and settled land claim agreements."

While SHARE wishes to see the broadest "scope" represented here in order to fully capture the range of payments made, the inclusion of payments made to First Nations governments may be complicated by the confidentiality provisions included in many Impact Benefit Agreements and the Constitutionally-protected duty to consult with First Nations prior to undertaking initiatives that may impact on their interests. Ultimately, in the interest of transparency all payments should be recorded, however we stress that the question of including payments to First Nations should be the subject of consultation with First Nations governments before any binding provisions are adopted.

Project-level reporting

The definition of "project" is complex and may be different not only between companies but between projects in the same company. A definition must be comprehensive enough to capture the full scope of a development (for example where a "project" involves several mine sites) but not so large as to obscure information for users interested in assessing the company's contributions to and impacts on their local community. For investors, it is also important that information be comparable between companies.

While the proposed regulations under the Dodd-Frank Act in the US did not define the term "project," leaving it to the individual company to define the term based on their own operations, the regulators did propose guidance on the use of the term, clearly indicating that they believe "the term 'project' requires more granular disclosure than country-level reporting" and that it is also not simply defined as a "reporting" or "operating" unit. If Canadian regulators opt not to include a specific definition of "project" they must, at minimum, provide substantial guidance on what may not be considered an acceptable definition, in order to encourage consistent and comparable reporting.

A more satisfying approach for investors is the approach taken by the European Union in its Transparency Directive (June 2013), which provides a definition of "project" as follows:

> A project should be defined as the operational activities that are governed by a single contract, license, lease, concession or similar legal agreements and form the basis for payment liabilities to a government. Nonetheless, if multiple such agreements are

substantially interconnected, this should be considered a project. 'Substantially interconnected' legal agreements should be understood as a set of operationally and geographically integrated contracts, licenses, leases or concessions or related agreements with substantially similar terms that are signed with a government, giving rise to payment liabilities. Such agreements can be governed by a single contract, joint venture, production sharing agreement, or other overarching legal agreement. [1]

While there is still flexibility within the EU Directive to report at the entity level for payments levied across multiple projects in a country (i.e. income taxes) this definition, in our opinion, gives some additional guidance to reporting issuers.

Reporting threshold

A primary goal of the regulation should be to capture all relevant payments to governments by issuers, which suggests that the reporting threshold should be set at the lowest reasonable level. This is also important to ensure that junior and mid-cap mining interests are included in the regime. At the same time, issuers should not be subject to overly onerous requirements, especially where they contradict requirements of other jurisdictions such that the company is producing multiple and different reports. However, we understand that the primary expense for issuers is setting up systems to capture project-level expenses in a manner that allows compliance with these rules, and that once those systems are operational, the specific financial threshold is less of a concern (since a company must be recording expenses at lower amounts that might, combined with similar costs, pierce the higher threshold).

Therefore we suggest that the threshold be set at a single annual threshold for both TSX and TSX-V issuers of $10,000. In the alternative, a tiered approach in which TSX-V issuers face a lower (e.g. $10,000) threshold and TSX issuers face a higher (e.g. $100,000) threshold may be appropriate.

Conflict of Laws

As a general principle, we do not support exemptions to these reporting requirements.

In its July 2 ruling in *American Petroleum Institute (API) v Securities and Exchange Commission (SEC)*, the U.S. District Court struck down the SEC's Final Rule on disclosure of payments by resource extraction issuers partly on the basis that the SEC did not allow an exemption for issuers with projects in four specific countries (Angola, Cameroon, China and Qatar) whose laws forbid public disclosure of payments.[2] The SEC's two main concerns were that an

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[1] *Directive 2013/34/EU* of the European Parliament and of The Council of 26 June 2013 on the annual financial statements, consolidated financial statements and related reports of certain types of undertakings, amending *Directive 2006/43/EC* of the European Parliament and of the Council and repealing Council *Directives 78/660/EEC* and *83/349/EEC*
[2] *Am. Petroleum Inst., et al. v. SEC*, CA No. 12-1668 (D. D.C. July 2, 2013)

exemption was inconsistent with the structure and language of Section 13(q) the Dodd Frank Act (that instructed the SEC to develop the Rule) and that allowing an exemption could encourage other countries to adopt similar legal impediments to disclosure, and therefore undermine the intent of the Rule.

The Court disagreed with the SEC's interpretation of the Dodd Frank provision, noting that the Act only instructed the SEC to develop transparency rules "to the extent practicable", which in the Court's opinion allowed for exemptions. Further, the Court determined that in the absence of a more extensive analysis of the economic burden on competition and investors (which "by the Commission's own estimates" may equal "billions of dollars") the SEC had not satisfied the requirement of reasoned decision-making.

The SEC's concern – that granting exemptions for countries that disallow public disclosure of payments could undermine the utility of the rule – is a legitimate one. It's important to note that the US District Court's decision vacated the SEC Rule but it was not determinative of what an appropriate rule should be – only that the rule-makers should undertake sufficient analysis of the impact on competition and investors of the decision to refuse exemptions prior to issuing the Rule. Further, the assertion by the Plaintiffs that there would be substantial costs to them if exemptions were not granted was never tested by the Court.

A proper analysis of the issue should therefore start with a comprehensive and reliable assessment of whether the laws of said countries truly prohibit disclosure of payment information or, as some commentators have suggested, only prevent disclosure of geological or technical data, and whether those laws (or contracts under those laws) include exemptions to allow compliance with home state laws – both of which would eliminate a need for exemptions under these regulations. The onus should be on those asserting legal restrictions on payment disclosure to prove that these disclosure requirements would run afoul of another country's laws.

Definition of a "Canadian Company"

With respect to the question of reporting on payments made by subsidiaries or entities under the control of a listed company, for ease of interpretation it would be best to rely on an existing definition under Canadian law such as that of the Canada Business Corporations Act (based on owning a majority of shares).[3] However given the variety of structures commonly used by mining operations (including the use of joint ventures and a number of holding companies) some consideration must be given to instances where an entity is effectively under the control of another without the controlling entity necessarily owning a majority of shares.

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[3] http://laws-lois.justice.gc.ca/eng/acts/C-44/FullText.html

The use of a definition from Canadian securities laws e.g. the definition of a "control person" under the *Ontario Securities Act* might be more appropriate, especially if securities regulators are the enacting bodies for the disclosure rules:

(a) a person or company who holds a sufficient number of the voting rights attached to all outstanding voting securities of an issuer to affect materially the control of the issuer, and, if a person or company holds more than 20 per cent of the voting rights attached to all outstanding voting securities of an issuer, the person or company is deemed, in the absence of evidence to the contrary, to hold a sufficient number of the voting rights to affect materially the control of the issuer, or

(b) each person or company in a combination of persons or companies, acting in concert by virtue of an agreement, arrangement, commitment or understanding, which holds in total a sufficient number of the voting rights attached to all outstanding voting securities of an issuer to affect materially the control of the issuer, and, if a combination of persons or companies holds more than 20 per cent of the voting rights attached to all outstanding voting securities of an issuer, the combination of persons or companies is deemed, in the absence of evidence to the contrary, to hold a sufficient number of the voting rights to affect materially the control of the issuer; ("personne qui a le contrôle")[4]

However this definition should be a starting point for the determination of which entities to include in reporting of payments.

The SEC relied on the broader definition under the US *Securities Exchange Act 1934* in formulating its own Rule: "the possession, direct or indirect, of the power to direct or cause the direction of the management and policies of a person, whether through the ownership of voting securities, by contract, or otherwise" (Rule 12b-2), and also suggested that a review of the "relevant facts and circumstances" rather than a bright-line rule would be appropriate for determining whether to include an entity in reporting.

The European Directive uses a similar approach:

> Control should be based on holding a majority of voting rights, but control may also exist where there are agreements with fellow shareholders or members. In certain circumstances control may be effectively exercised where the parent holds a minority or none of the shares in the subsidiary. Member States should be entitled to require that undertakings not subject to control, but which are managed on a unified basis or have a common administrative, managerial or supervisory body, be included in consolidated financial statements.

[4] http://www.e-laws.gov.on.ca/html/statutes/english/elaws_statutes_90s05_e.htm

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While the European definition (unlike the OSA definition) sets the automatic threshold at a majority of shares, its effort to establish a broader test for control is an appropriate one for this industry.

In essence, the Canadian rule should follow a “relevant facts and circumstances” test for which entities should be included, using the OSC definition as a baseline for that test.

Thank you for the opportunity to comment on the proposed “assumptions” regarding a mandatory revenue reporting framework for public companies in the extractive sector. If you have any questions regarding this submission, please feel free to contact me.

Sincerely,

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