SEC Rulemaking on Dodd Frank
How Sections 1502 (Conflict Minerals) and 1504 (Transparency) Impact the Oil & Gas Sector

The Institute For Energy Law’s Oilfield Services Committee

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“…Congress enacted Section 1504 to increase the transparency of payments made by oil, natural gas, and mining companies to governments for the purpose of the commercial development of their oil, natural gas, and minerals.”*

Oilfield Service Companies – Are they Resource Extractors Under the rule?

If so, What is the consequence under Rule 13q-1?

Final Rule 13q-1 - Discussion Topics

- Payment Transparency - Brief history of §1504 leading to final rule.
- Application of the rule depends on whether an issuer engages in “Commercial Development” of Oil, Natural Gas, or Minerals.
- What is “Commercial Development?”
- Reportable payments.
- Related global developments.
- Controversy over the rule in the U.S.
- If the rule applies, what to do to prepare.
Rule 13q-1

- Applies to all U.S. companies and foreign companies that are required to file annual reports with the Commission AND are involved in the commercial development of oil, natural gas, or minerals (Resource Extraction Issuer).

- Requires annual disclosure of non *de minimis* payments made directly to the U.S. Federal Government or to a Foreign Government by Issuer, by Subsidiary, or by Entity under control for the purpose of the commercial development of oil, natural gas, or minerals.

- Foreign Government includes:
  - National government and instrumentalities thereof.
  - State, province, county, district, municipality, or territory.
  - Company majority owned by foreign government.
History of Section 1504 and Related Global Initiatives*

- **October 2007** – House Financial Services Committee meets to review oil, gas, and mining revenue transparency.

- **Mid-2008** – September 2009 – Various Acts introduced in the U.S. House and Senate designed to increase extractive and energy industry revenue transparency.

- **February 2010** – UK Parliament Motion introduced addressing extractive industry revenue transparency.

- **July 15, 2010** – Dodd-Frank Wall Street Reform and Consumer Protection Act passed, including Section 1504.

- **July 21, 2010** – Dodd-Frank signed into law by President and Congress gives the SEC 270 days to issue final rules.

*Revenue Watch Institute, “Timeline: Dodd Frank Section 1504”, August 16, 2012.*
History of Section 1504 and Related Global Initiatives* (Continued)

- April 14, 2010 – 270 day deadline passed without final rules.
- October 2010 – European Commission proposes country by country and project by project disclosure of government payments in oil, gas, mining, and forestry industries.
- Early 2012 – SEC under pressure not to weaken the Dodd-Frank rules being promulgated; several organizations take out ad in Wall Street Journal supporting transparency; Canadian Parliament considers requiring oil, gas, and mineral companies to disclose payments to the government.

- Mid-2012 – Oxfam sues SEC for delay in promulgating 1504 implementing rules and SEC under pressure from House to release final rules.

August 2012 – Senators Lugar and Cardin (authors of Rule 1504) claim the SEC is “derelict in its duty” and call for investigation.

8/22/2012 – SEC issues final rules implementing 1504.

10/10/2012 – API, Chamber of Commerce, IPAA, and National Foreign Trade Council file suit challenging Section 1504 and the rules.

Commercial Development – What Is It and Does It Apply To Oilfield Service Operations?

- Broader than Extractive Industries Transparency Initiative (EITI) – focus there on exploration and production.
- Includes “exploration, extraction, processing, and export of oil, natural gas, or minerals, or the acquisition of a license for any such activity.” 17 CFR § 240.13q-1(b)(2).
- Final rule and adopting release indicates that the list is all-inclusive.
Commercial Development – What Is It and Does It Apply To Oilfield Service Operations?

(Continued)

- Release provides *some* clarity – only activity “directly related” to each of the above rather than “ancillary or preparatory.”
- Thus, a manufacturer of drill bits or other machinery used in extraction would not come within the rule.
- Adopting release does list types of activities under above categories.
- However, unlike the categories themselves, the release does not indicate that these lists are exhaustive.
Commercial Development – What Is It and Does It Apply To Oilfield Service Operations?

(Continued)

- **Extraction** - “Includes the production of oil and natural gas as well as the extraction of minerals.”

- **Processing** – “Includes:
  - field processing activities, such as the processing of gas to extract liquid hydrocarbons.
  - the removal of impurities from natural gas after extraction and prior to its transport through the pipeline, and the upgrading of bitumen and heavy oil.
  - the crushing and processing of raw ore prior to the smelting phase.”

  Does *not* include:
  - refining or smelting.
Commercial Development – What Is It and Does It Apply To Oilfield Service Operations?

(Continued)

- **Export** – Export from the host country; does *not* otherwise include transportation payments.

- Anti-evasion provision – Requires disclosure in connection with an activity or payment that, “although not in the form or characterization of one of the commercial development categories…is part of a plan or scheme to evade disclosure.

- Designed to discourage re-characterization of activity.
Reportable Payments

- Those made to further commercial development of oil, gas, natural gas or minerals.

- Added by the final rule:
  - $100,000 or more – Rule set out *de minimis* threshold.
    - Either a single payment or series of related smaller payments in the relevant fiscal year.
  - In-kind payments as well as cash, but social and community payments NOT included.
    - Note that EITI encourages reporting of social and community payments, but does not require.
    - Final Dodd Frank rule commentary excludes, but suggests that final rule is consistent with the EITI.
Reportable Payments (Continued)

- Payments – “Part of the commonly recognized revenue stream”

Payments include:

- Taxes.
  - But can be reported by entity rather than by project.
  - Question remains whether necessity for reporting on new SD form under the rule.
  - Does NOT include consumption taxes, such as VAT, personal income, or sales.
- Royalties.
- Fees – includes rental, entry, and concession fees.
- Production entitlements.
- Bonuses – includes signature, discovery, and production.
- Dividends – but not dividends to a government as ordinary shareholder of the company.
- Includes payments to third parties made for the purposes stated in the rule.
Infrastructure improvements.
- “such as building a road or railway.”
- But not “to build a hospital or school.”
- Final rule commentary states, in connection with the latter, “because it is not clear that these types of payments are part of the commonly recognized revenue stream.”

Final rule does NOT contemplate the list of payment categories on slides 12-13 to be non-exhaustive, which would have required interpretation of “other material benefits”, as some commentators had requested.
Fall 2012 European Parliament Committee On Legal Affairs voted in favor of proposed EU legislation which would broaden and strengthen required government payment transparency disclosures.

- Would apply to extractive, logging, banking, construction and telecommunications sectors.
- Determinative factor no longer materiality to recipient government.
- Instead, any otherwise relevant payment €80,000 or more is reportable.
- Would require project by project reporting for extractive and logging industries.
- Disclosure of payments in kind required.
- Agreement must be reached between Committee and EU Council; then European Parliament plenary vote before legislation becomes law.
Related Global Developments – Outside U.S. and Europe

- Hong Kong - Country by country reporting for public petroleum and mineral companies.
- Canada and Australia considering similar initiatives to that of Rule 13q-1 and EU initiative.
Controversy Over the Rule In the U.S.

- October 2012 the Chamber of Commerce, API, IPAA, and National Foreign Trade Council filed complaint with U.S. District Court District of Columbia and a petition for review with the U.S. Court of Appeals.

- Claims that Rule 13q-1 infringes 1st Amendment rights, violates Administrative Procedure Act in that “arbitrary and capricious”, and violates the Exchange Act of 1934.

- Claims that the SEC’s economic impact analysis was flawed.

- SEC estimated industry compliance cost at $44 million to $1 billion.

- Suit claims costs could be in the billions as a result of loss of trade secret and business opportunities.
Oxfam America filed a Motion to intervene in the suit, as a shareholder of some of the companies to whom the rule applies and claiming that the suit hampered its mission to “ensure citizens in oil and mineral rich countries know how much money their governments receive” from extraction.

Claimants in the suit also filed a Motion to stay with the SEC requesting that the Commission stay the effective date pending the litigation outcome.

The SEC denied the Motion.
Assuming Disclosure Obligations, What To Do To Prepare

- Subject companies must first begin complying, at the earliest, in the first quarter of 2014.
  - For fiscal years ending after September 30, 2013, and no later than 150 days after the end of the company’s most recent fiscal year.
  - Reports must be made on new form SD.
  - Filing on Edgar required with information attached to the form in XBRL format.
  - SEC stated that it believed the requirement would reduce compliance burden; this remains to be seen.
Reporting must be done on project by project basis.

- The rule contains no definition for project.
  - Release says that left undefined to provide flexibility in applying term to different business contexts.
  - This leaves to reporting companies the task of defining company projects in a sufficiently consistent manner across various sectors within the company.
  - Is more granular than country level.
Reporting must be done with electronic tags that identify:

- Total payments, by category.
- Currency used to make payments.
- Financial period in which payments made.
- Business segment that made the payment.
- Government that received payments and country in which located.
- Project of payor to which payment relates.
- Payments must be reported in USD or the issuer’s currency; thus conversion may be necessary.
- Can use any of three methodologies set out in rule for conversion; must state which method used.
Assuming Disclosure Obligations, What To Do To Prepare (Continued)

- Consider some potential problem areas and accounting procedure changes that may be necessary:
  - Definition of “project.”
  - Granular analysis of relevant payments per project.
  - Relevant payments, for example licensing fees, may be made for purposes which fall within the rule and those that do not.
    - Is allocation required?
  - If in-country transportation payments are aggregated with export payments; will need to be disaggregated.
  - How to accurately identify and report third party payments that fall under the rule.
Assuming Disclosure Obligations, What To Do To Prepare (Continued)

- Practical planning thoughts.
  - Who will lead the preparation initiative?
    - Appropriate team.
      - Compliance?
      - Accounting?
      - Operations?
      - Audit?
  - What segments of business are subject to the rule?
    - Should necessary accounting procedure revisions be made only within those segments or is that ultimately counter-productive?
  - What covered payments are made by those segments?
  - Develop logical sequence analysis for identifying payments and then translate into any necessary accounting procedure modifications required for annual identification of payments.
    - Consider whether reportable payments can be captured in “real time”.
To Discuss Further:

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Is your supply chain conflict free?
Oil Field Services Committee discussion

Certain topics discussed in this publication have not yet been fully addressed publicly by the SEC or the SEC staff. Accordingly, the information provided herein is preliminary and is subject to change. PwC will continue to monitor the interpretive guidance provided by the SEC and the SEC staff, and will update the questions/responses as more information becomes available.
Today’s discussion

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**Target:**
By the end of this session, participants will have:

1. An increased level of understanding of the requirements of the Section 1502 rule
2. Explored possible effective compliance approaches, including challenges and benefits
3. Understand steps to manage emerging risks
Section 1

Background
What are conflict minerals?
Conflict minerals finance conflict in the Democratic Republic of the Congo (DRC) and/or adjoining countries.

The four conflict minerals are also referred to as 3TG metals:
- Tantalum
- Tin
- Tungsten
- Gold

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Is your supply chain conflict free? • Boston roundtable discussion
PwC
Dodd-Frank Section 1502 requires companies to determine whether their 3TG metals are conflict free

Who is in scope of Section 1502?

• Any company that files periodic reports under Sections 13(a) or 15(d) of the Exchange Act who:
  - Manufactures or contracts to manufacture products, and
  - Conflict minerals are necessary to the functionality or production of those products
  - Includes domestic, foreign, and voluntary issuers regardless of size

When does compliance begin?

• First filings are due May 31, 2014 for calendar year 2013

Notes:
1. No de minimis exception associated with “necessary”
2. Legislation did not pass committee and was added to the Dodd-Frank Wall Street and Consumer Protection Act

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PwC
December 4, 2012
Conflict minerals present both risks and opportunities for companies

Domestic and foreign issuers have already begun to report on the significant implications of conflict minerals in their supply chains

**Potential risks**
- Minerals availability and cost increase
- Conflict-free supplier availability
- Customer loss
- Costs of compliance
- Brand impact due to inadequate or incorrect public disclosure

**Potential opportunities**
- Improved collaboration with suppliers and NGOs
- Supply resilience through conflict-free sourcing in the affected region
- Potential new markets for conflict-free products
- Increased supply chain transparency

Source: PwC analysis of domestic and foreign filers annual filings as of 4/18/2012.
Section 2

Company perspective: Weatherford
Section 3

Steps to compliance

3
Implement a management system in accordance with the OECD framework

A management system will help to maintain ongoing compliance

Establish strong management systems

- Adopt a company policy to define the level of commitment to ensuring a conflict free supply chain
- Establish project governance and resources to ensure clear oversight and accountability
- Develop project plan for short and long term compliance goals
- Implement controls to reduce the use of conflict minerals in future products as well as detect in current products
  - Supplier selection
  - Supplier contracting
  - Supplier code of conduct
  - NPI
Do you want to be a leader, laggard, or middle of the road?

Select electronics companies move towards conflict free

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<thead>
<tr>
<th>2011</th>
<th>2012</th>
<th>2013</th>
<th>2014</th>
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<tbody>
<tr>
<td>Mapped over 90% of supply chain</td>
<td>Led development of conflict free smelter audit protocol</td>
<td>Will have conflict free tantalum in all microprocessors</td>
<td>Will have conflict free minerals (all four) in all microprocessors</td>
</tr>
<tr>
<td>Conducted due diligence on suppliers ahead of SEC act</td>
<td>Participating in 1-Yr pilot testing OECD guidelines</td>
<td>Co-developed EICC-GeSI reporting template</td>
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<tr>
<td>Mapped 100% of its supply chain; materials traced back to source</td>
<td>Published status towards conflict free</td>
<td>Trained over 34 smelters on conflict free raw materials and EICC/GeSI certification process</td>
<td></td>
</tr>
<tr>
<td>Launched ‘Solution for Hope Project’ to source conflict free tantalum</td>
<td>Created an initial flow of conflict free tantalum used in capacitors</td>
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Is your supply chain conflict free? • Boston roundtable discussion
PwC

December 4, 2012
The SEC requires four steps to implementing a conflict minerals program

Assess products that fall under Section 1502
- Identify inventory of products which may contain 3TG
- Understand which products may be impacted based on manufacturing role and level of influence over product design and sourcing
- Identify related suppliers to include in reasonable country of origin (RCOI)/DD inquiry

Conduct country of origin enquiry
- Conduct RCOI/DD to identify smelter or mine origin
- Develop assessment approach and management process to conclude sourcing is conflict free
- Assess whether any additional audits on the high risk suppliers /smelters are needed
- Implement data management systems to support RCOI/DD procedure

Acquire independent audit
- Engage auditors early to gain buy-in on approach and to allow for changes
- Maintain appropriate documentation of due diligence procedures including controls

Comply with disclosure requirements
- Be prepared to report on status of conflict minerals sourcing at the product level as well as due diligence efforts and the results of the RCOI
- Disclose similar information on the company website for a minimum of one year
- “File” the information on Form SD

Section 3 – Steps to compliance

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December 4, 2012
Each decision point brings its own unique challenges

1. 3TG Free
2. DRC Conflict Free
3. Not DRC Conflict Free
4. DRC Conflict Undeterminable**

3TG within Product?

Mineral Source Outside DRC*?

Adequate Chain of Custody?

*This includes scrap and recycled materials
**Can only be used for first two operating years (four for smaller companies)

File form SD

File CMR

YES

YES

YES

Unknown

Unknown
**Implement a due diligence program which will both detect and prevent conflict minerals**

Develop a flexible and scalable approach that focuses on building supply chain maturity

<table>
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<tr>
<th>Section 3 – Steps to compliance</th>
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<tbody>
<tr>
<td><strong>Planning</strong></td>
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<tr>
<td>2012</td>
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<tr>
<td>• Identify products &amp; suppliers*</td>
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<tr>
<td>• Define policy</td>
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<tr>
<td>• Develop project plan</td>
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<tr>
<td>• Implement governance</td>
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<th>Assess risks in the supply chain</th>
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<tr>
<td>2012</td>
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<tr>
<td>• Conduct supply chain pilot assessment*</td>
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<th>Manage risks in the supply chain</th>
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<td>2012</td>
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<th>Reporting</th>
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<td>2012</td>
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<td>• Define reporting contents</td>
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*Potential auditor involvement

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Is your supply chain conflict free? • Boston roundtable discussion

PwC
Leverage tools and standards are being implemented to support the tracing mechanisms across the value chain.
Lessons learned

• Engage early
• Rigorously manage and control information
• Develop RCOI and due diligence procedures aligned with industry expectations
• Collaborate and educate both internally and externally
• Leverage what’s already there
Section 4

Company perspective: Weatherford
Section 5
Audits
### What will an audit look like?

<table>
<thead>
<tr>
<th>Generally known</th>
<th>OECD Framework</th>
<th>Audit requirements</th>
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<tbody>
<tr>
<td>Audits will assess the appropriateness of the design</td>
<td>Identify and assess risk in the supply chain</td>
<td>Performance audits vs. attestations</td>
</tr>
<tr>
<td>Audit will assess the accuracy of the description of the design’s execution</td>
<td>Design and implement strategy to respond to identified risks</td>
<td>Evaluate OECD Framework to identify criteria for application of audit procedures – Gold vs. 3Ts?</td>
</tr>
<tr>
<td>Audit will likely be structured and consistent with the OECD framework</td>
<td>Carry out independent 3rd party audit of supply chain</td>
<td>What risk-based approach can be used to perform RCOI / DD on less than 100% of suppliers?</td>
</tr>
<tr>
<td>Audit will not necessarily measure whether the company’s due diligence measures were effective or whether the company is conflict free</td>
<td>Report on supply chain due diligence</td>
<td>Scoping of products and entities</td>
</tr>
<tr>
<td></td>
<td>Establish strong company management systems</td>
<td>Materiality – what exceptions are significant</td>
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<tr>
<td></td>
<td></td>
<td>Reliance of the work of others</td>
</tr>
<tr>
<td></td>
<td></td>
<td>Handling of exceptions</td>
</tr>
<tr>
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<td>Other</td>
</tr>
</tbody>
</table>
Preparing the new SEC report

First filings are due May 31, 2014, for calendar year 2013

Form SD

• Determination of the origins of the conflict minerals
• Brief description of the issuer’s RCOI
• Results of the RCOI
• Must be signed on behalf of the registrant by an executive officer
• The registrant must disclose similar information on its company website for at least one year

Conflict Minerals Report

• Description of the due diligence performed
• Steps the issuer has taken or will take, if any, since the prior calendar year to mitigate the risk that its conflict minerals benefit armed groups, including any steps to improve its due diligence (only required during the transition period)
• Facilities used to process the conflict minerals, if known
• Efforts to determine the mine or location of origin with the greatest possible specificity, if applicable

Timeline for Reporting and Audit

<table>
<thead>
<tr>
<th>Calendar Year</th>
<th>Origin of 3TG Minerals</th>
<th>File SEC Form SD</th>
<th>Conflict Minerals Report</th>
<th>Independent Audit Required</th>
</tr>
</thead>
<tbody>
<tr>
<td>2013 and 2014</td>
<td>1. DRC and covered countries</td>
<td>Yes</td>
<td>Yes</td>
<td>Yes</td>
</tr>
<tr>
<td></td>
<td>2. Outside the DRC and covered countries</td>
<td>Yes</td>
<td>No</td>
<td>No</td>
</tr>
<tr>
<td></td>
<td>3. Unknown (undeterminable option available only in 2013/2014)</td>
<td>Yes</td>
<td>Yes</td>
<td>No</td>
</tr>
<tr>
<td>After 2014</td>
<td>1. DRC and covered countries</td>
<td>Yes</td>
<td>Yes</td>
<td>Yes</td>
</tr>
<tr>
<td></td>
<td>2. Outside the DRC and covered countries</td>
<td>Yes</td>
<td>No</td>
<td>No</td>
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Section 6

*Broadening the context*
Using conflict minerals work as a foundation from which to get other benefits

Potential benefits from responsible supply chain:
- Reduced costs through strategic sourcing, supplier consolidation and improved energy efficiency
- Reduced reputation risks, e.g. Foxconn for Apple;
- Reduced risk of adverse supply chain events, e.g. access to supply
- Increased sales to customers with sustainability objectives

Designing your conflict minerals program to be scalable will equip your company to respond to:
- Additional reporting requirements, e.g., additional minerals or locations of origin
- Additional product compliance responsibilities, e.g. RoHS, California on lighting and display screens, and others
- Consumer-driven pressure to disclose materials in products
- Future regulatory changes on dimensions beyond conflict minerals
Thank you
www.pwc.com/us/conflictminerals

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