

## SEC Adopts New Mining Disclosure Rules

November 15, 2018

On October 31, 2018, the SEC adopted **final rules** modernizing disclosure requirements for companies with material mining operations (excluding oil and gas) as part of its ongoing “disclosure effectiveness initiative” launched in 2013. The rules will implement extensive changes to the existing disclosure regime and are intended to align U.S. disclosure requirements more closely with current industry and global regulatory practices and standards, specifically the Committee for Mineral Reserves International Reporting Standards (CRIRSCO). The rules will replace the SEC’s 30-year old Industry Guide 7 with a single standard applying to SEC filings by companies with mining operations that are material to their business or financial condition, and will cover U.S. companies as well as foreign private issuers that file reports with the SEC. Generally, we believe the changes are welcome and bring U.S. practice into line with practice elsewhere, although there are some aspects of the new regime that are problematic.

Significantly, the rules will:

- Eliminate the existing general prohibition on disclosing mineral “resources” and instead require that companies disclose both mineral resources and material exploration results in addition to mineral “reserves”;
- Require disclosure of exploration results, mineral resources and mineral reserves to be based on supporting documentation prepared by a “qualified person” named in the filing;
- Require the filing of technical report summaries prepared by a qualified person for properties that are individually material, which identify and summarize the information reviewed and conclusions reached by each qualified person about the company’s mineral resources or mineral reserves determined to be on each material property; and
- Allow the usage of forward-looking pricing forecasts when determining and disclosing mineral resources and reserves.

The rules have a two-year phase in period. Companies will not be required to begin to comply with the rules until their first fiscal year beginning on or after January 1, 2021. A company may voluntarily comply with the new rules prior to the compliance date, subject to the SEC’s completion of necessary EDGAR programming changes. Guide 7 will remain effective until all companies are required to comply with the final rules, at which time Guide 7 will be rescinded.

### Principal Changes From Proposed Rules

The final rules include a number of changes to the SEC’s June 2016 proposal (which we discussed [here](#)). These changes more closely align the SEC’s mining property disclosure requirements with the CRIRSCO standards and will thereby help decrease the compliance burden and costs compared to the proposed rules.

For example, the final rules:

- Allow a qualified person to use a forward-looking price for establishing estimates of mineral resources or mineral reserves, as long as the qualified person discloses and explains the reasons for using the selected price;
- Provide that a qualified person will not be subject to expert liability under Section 11 of the Securities Act for findings and conclusions that are based on information provided by the company;

- Eliminate the proposed 10% quantitative presumptions for “materiality” and replace them with a consideration of both quantitative and qualitative factors; and
- Permit the use of historical estimates of mineral resources or reserves in filings pertaining to mergers, acquisitions, or business combinations if the company is unable to update the estimate prior to the completion of the relevant transaction.

## Applicability

### Scope

The final rules confirm that the mining disclosure regime will apply to both traditional and non-traditional resources, by introducing a new definition of “mineral resources” to mean a concentration or occurrence of material of economic interest in or on the earth’s crust in such form, grade, quality or quantity that there are reasonable prospects for economic extraction. Such material of economic interest includes mineralization, dumps and tailings, mineral brines and other resources extracted on or within the earth’s crust (but excluding oil and gas resources, gases and water). In addition, the final rules include a proposed note explaining that a mineral resource is a reasonable estimate of mineralization, taking into account relevant factors such as cut-off grade, likely mining dimensions, location or continuity that, with the assumed and justifiable technical and economic conditions, is likely to, in whole or in part, become economically extractable. It is not merely an inventory of all mineralization drilled or sampled. Geothermal energy is excluded from the definition of “mineral resources.”

### Materiality

The final rules apply to SEC filings by companies with mining operations that in the aggregate are “material” to their business or financial condition. This replaces current concepts of “principal” mines, “other materially important” properties and “significant mining operations” with a single concept of “materiality” defined in the typical manner for SEC disclosure rules: whether or not there is a substantial likelihood that a reasonable investor would attach importance to the information in determining whether to buy or sell the company’s securities. Under the final rules, the determination of materiality relies on a principles-based approach as opposed to a more purely quantitative measure. In determining whether mining operations are material, the rules require a company to:

- Consider both quantitative and qualitative factors, assessed in the context of the company’s overall business and financial condition;
- Aggregate mining operations on all of its mining properties, regardless of the stage of the mining property or size and type of commodity produced, including coal, metalliferous minerals, industrial materials, and mineral brines; and
- Include, for each property, as applicable, all related activities from exploration through extraction to the first point of material external sale, including processing, transportation and warehousing.

The rule defines “mining operations” to include operations on all mining properties that a company:

- Owns or in which it has, or probably will have, a direct or indirect economic interest;
- Operates, or probably will operate, under a lease or other legal agreement that grants the company ownership or similar rights that authorize it, as principal, to sell or otherwise dispose of the mineral; or
- Has, or probably will have, an associated royalty or similar right.

## Vertically Integrated Companies

The rules will apply to all companies with material mining operations, including vertically integrated manufacturers. A company will be required to assess relevant quantitative and qualitative factors to determine if its mining operations are material. For example, a manufacturing company should consider whether it receives a competitive advantage from, or substantially relies upon, its ability to source that particular mineral from its mining operations.

## Multiple Property Ownership

The rules clarify when disclosure is required by multiple or ancillary property owners. For companies that own multiple mining properties, only summary disclosure will be required if none of the properties is individually material. For companies with individually material mining properties, more detailed disclosure will be required. (See “Prescribed Disclosures” below.) Ancillary mining properties would need to be disclosed based on the facts and circumstances.

## Royalty Companies

Companies holding royalty rights or similar interests entitling them to receive payments from an owner or operator of mining properties are subject to the same disclosure requirements if those rights are material to their operations. The final rules require a royalty company to file a technical report summary for each material underlying property; this requirement, however, may be satisfied by referring to a current technical report filed by the producing company. Such reference to another company’s technical report will not be deemed to be incorporated into the royalty company’s filing absent an express statement. If, however, the required information is not known or reasonably available to the royalty company, such information may be excluded.

## “Qualified Person” Requirement

Every disclosure of exploration results, mineral resources and mineral reserves under the rules must be based on, and accurately reflect, information and supporting documentation prepared by a “qualified person.” The rules define a “qualified person” to be an individual who has at least five years of relevant experience, and who is an eligible member or licensee in good standing of a recognized organization. The rules do not provide a list of recognized organizations. It will be the company’s responsibility to determine that the person meets the necessary qualifications.

Consistent with CRIRSCO-based disclosure standards in most jurisdictions, the rules do not impose any independence requirement for qualified persons. This will allow companies to rely on employees or other affiliated individuals to fulfill the role of qualified person. Although there is no requirement to disclose conflicts of interest, companies would be required to disclose any affiliation they have with the qualified person or their employer (if not the company).

In addition, the rules require that a company file a technical report summary from a qualified person or persons as an exhibit to the relevant SEC filing containing information on the company’s mineral resources and reserves on each material property (see “Technical Report Summaries” below). The qualified person will be deemed an “expert” in connection with the technical report summary and the company will be required to obtain (and, in the case of Securities Act filing, file) a signed consent to name him or her in the registration statement. As a result, the qualified person will be subject to liability under Section 11 of the Securities Act with respect to any untrue statement or omission of a material fact contained in the technical report summary. However, the rules do contain some provisions designed to ameliorate liability concerns. For example, the rules allow a technical report to be signed by a third party firm comprising mining experts without naming the individual who prepared the summary, although if a company relies on internal personnel, the individuals at the company must sign such report and bear Section 11 liability. In addition, the rules provide that where the qualified person has relied on information

provided by the company, such information is not considered a part of the registration statement prepared or certified by the qualified person within the meaning of Section 7 and 11 of the Securities Act. However, unlike the case with certain information provided by the company, the rules provide that the qualified person may not disclaim responsibility for any information and documentation prepared by a third-party specialist upon which the qualified person has relied. The SEC notes that the requirement for a technical report and summary is consistent with requirements in Canada and Australia, although we note that the litigation environment is quite different in those countries. We are concerned that this change may result in increased reporting costs and complexities as well as heightened liability concerns for qualified persons.

## Material Exploration Results

Under the rules, disclosure of exploration activity and results will be voluntary until they become material, after which disclosure will be required. If a company is disclosing exploration activity or results for its most recent fiscal year, such disclosure being voluntary or mandatory, then the company is required to include specified disclosure in its SEC filing, and it must be based on information and supporting documentation prepared by a qualified person. Technical reports are not required be filed to support disclosure of exploration results.

To the extent exploration results are not material, companies could continue to voluntarily disclose those results in SEC filings. Understanding that exploration results can be speculative, companies are not permitted to disclose estimates of tonnage or grade, or other quantitative estimates based only on exploration results. Such estimates are permitted only as part of the disclosure of mineral resource and reserve estimates. However, the SEC will permit disclosure of exploration targets, subject to the inclusion of cautionary language set out in the rules.

## Mineral Resources

The rules eliminate the existing limitation on disclosing mineral resources, which currently applies to all reporting companies unless disclosure is required by foreign or state law (which the SEC has historically interpreted quite narrowly). Under the new rules, companies with material mining operations that have mineral resources will be required to disclose mineral resources, consistent with most CRIRSCO-based disclosure regimes. Consistent with current practice, companies are not required to establish resources and reserves, and may instead disclose that they do not have verified mineral resources or reserves.

Any disclosure of mineral resources must be based on an initial assessment prepared by a qualified person. The rules set out certain criteria applicable to initial assessments. Significantly, an initial assessment must include the qualified person's qualitative evaluation of relevant technical and economic factors, along with any other relevant factors that are necessary to demonstrate there are reasonable prospects for economic extractions. The rules' definition of mineral resources includes concentration or occurrence of material of economic interest in or on the earth's crust in such form, grade or quality, and quantity that there are reasonable prospects for economic extraction. The rules clarify that "reasonable prospects for a mineral resource's economic extraction" does not mean that extraction must occur immediately. A qualified person must establish the "reasonable prospects" of economic extraction by estimating or interpreting key geological characteristics from specific geological evidence, including an estimate of tonnage and grade that has reasonable prospects of economic extraction. For bulk minerals and commodities (i.e. coal, iron ore, bauxite), it may be reasonable to consider economic extraction as occurring over a time period of 50 or more years when determining whether the deposit is a mineral resource. For smaller mineral deposits, it would likely be reasonable to consider economic extraction as occurring over a much shorter time period, for example, no more than 10 to 15 years. The qualified person will choose the appropriate time period when determining whether mineral resources exist and, if the property is material, must explain his or her choice in the technical report summary.

## Classification of Mineral Resources

Consistent with industry standards, the rules require companies to classify mineral resources into CRIRSCO-based categories of inferred, indicated and measured mineral resources based on the level of underlying geological evidence.

The rules encourage, but do not require, the qualified person to quantify and disclose the uncertainty associated with production estimates that are derived from indicated and measured mineral resources. If the risk is not quantified, then the qualified person must disclose the criteria used to classify a resource as inferred and to justify the classification. This disclosure must include a discussion of the uncertainty in the inferred resource estimates, the sources of the uncertainty, and how those sources were considered in the estimates.

## Mineral Reserves

The rules continue to require disclosure of mineral reserves. However, the framework for applying modifying factors to indicated or measured mineral resources in order to convert them to mineral reserves for disclosure will follow the CRIRSCO framework, and be based on a qualified person's evaluation of the modifying factors as applied to indicated or measured mineral resources which then indicate the economic viability of the mining property or project. The adopted framework includes a series of definitions that describe the relationship between the different classes of mineral resources and reserves and underscores the incremental nature of mineral resource and reserve determination. The rules provide that "economically viable" means that the qualified person has determined, using a discounted cash flow analysis, or has otherwise analytically determined, that extraction of the indicated or measured mineral reserve is economically viable under reasonable investment and market assumptions. Any disclosure of mineral reserves must be based on either a preliminary feasibility study or a final feasibility study prepared by a qualified person, using detailed evaluation of all applicable modifying factors to demonstrate "economic viability". Adding the option of preliminary feasibility study is a change to the current Guide 7 disclosure requirements. While both a pre-feasibility and feasibility study are comprehensive technical and economic studies, a pre-feasibility study is less comprehensive and results in a lower confidence level than a feasibility study. This is because of the key differences between a pre-feasibility study and a (final) feasibility study, which include that:

- A pre-feasibility study discusses a "range of options" for the technical and economic viability of a mineral project, whereas a feasibility study focuses on a particular option selected for the development of the project;
- A pre-feasibility study generally has a less detailed assessment of the modifying factors necessary to demonstrate that extraction is economically viable than the corresponding assessment in a feasibility study; and
- A pre-feasibility study generally has a less detailed financial analysis that is based on less firm budgetary considerations (e.g., historical costs rather than actual, firm quotations for major capital items) and more assumptions than the financial analysis in a feasibility study.

Although preliminary and final feasibility studies are not required to be filed with the SEC, they will need to be identified and summarized in filed technical report summaries to the extent they relate to a material property.

## Classification of Mineral Reserves

The rules require that companies classify mineral reserves into CRIRSCO-based categories of probable and proven mineral reserves based on the qualified person's level of confidence in the estimates. Under this approach, companies are not permitted to reclassify an inferred mineral resource into a more definitive category of mineral reserve unless new evidence is available to support reclassification.

## Commodity Pricing Models

Under the final rules, the commodity price used to determine whether there are “reasonable prospects for economic extraction” of mineral resources, or to determine the “economic viability” of mineral reserves, will be determined by the qualified person and should reflect their long-term price expectations. Like most CRIRSCO-based disclosure regimes which permit the use of any reasonable and justifiable price based on a view of long-term market trends, the new rules allow the use of either a historical price or one based on forward-looking pricing forecasts. The pricing for a mineral resource determination may vary from that of a reserve determination; in addition, estimated prices of different commodities may vary as long as those prices are reasonable and justifiable.

## Prescribed Disclosures

### Summary Disclosure

For companies with material mining operations that own or otherwise have an economic interest in two or more mining operations, the rules require summary disclosure of mining operations, either in narrative or tabular format. The summary disclosure should include:

- Annual production, on an aggregated basis, for the company’s mining properties during each of the three most recent fiscal years,
- Specified information for the company’s mining properties considered in the aggregate and only as relevant and material to an investor’s understanding of the company’s properties and mining operations in the aggregate, and
- To the extent the company has already engaged a qualified person to estimate its mineral resources and reserves, a summary of all mineral resources and reserves (in separate tables), in tabular form, as of the end of the most recent fiscal year, including breakdowns by commodity and geographic area, and for each property containing 10% or more of total mineral reserves or 10% or more of combined measured and indicated resources.

In order to further align with CRIRSCO requirements, the rules provide that each mineral and reserve estimate must be based on a reasonable and justifiable price selected by a qualified person.

### Detailed Disclosure for Individual Properties

Detailed individual property disclosure will be required for any property that is individually material to the business or financial condition of the company. In addition to disclosures substantially similar to those required under Guide 7, the new rules require disclosure of the following for each individually material property:

- Classification of a property as exploration, development or production,
- Summary information with respect to exploration activity, material exploration results, and mineral resources and reserves,
- Changes in mineral resources and reserves relative to the prior year end (in either narrative or tabular format), along with an explanation of those changes, and
- Material assumptions and criteria necessary for investors to understand any disclosed mineral resource or reserve estimates or exploration results (but only if the company has not previously disclosed such estimates or results, or if the company is disclosing material changes).

## Technical Report Summaries

The rules include a requirement for a technical report summary prepared by a qualified person regarding mineral resources and reserves for each material mining property. A technical summary for material exploration results is permitted, but not required. The summary must be signed and dated by the qualified person and filed as an exhibit to the SEC filing.

Under the new rules, a technical report summary must identify and summarize scientific and technical information and conclusions reached concerning:

- Initial assessments used to support disclosure of mineral resources for the property, and
- Preliminary or final feasibility studies used to support disclosure of mineral reserves for the property.

The rules prescribe extensive requirements for several subsections of a technical report summary, but requirements for each subsection may be limited by focusing mostly on the subsections that are material for an investor's understanding of the mining operations. The final rules also require disclosure of relevant factors pertaining to environmental compliance, permitting, and local individual and groups which are material. Inclusion of large amounts of technical data (including, for example, the current practice adopted by some companies of providing large amounts of drill hole information as appendices) is prohibited. The final rules provide that in the technical report, the qualified person may rely on certain information provided by the company; however, the rules prohibit reliance on information and documentation provided by third-party specialists. In addition, the technical report summary must include the results of the economic analysis by the qualified person.

Technical report summaries will be required to be filed only when material exploration results or estimates of mineral reserves or resources are first disclosed, or when there is a material change in previously disclosed estimates or results.

## Classification of Mining Properties and Companies

The rules include revisions to existing definitions of "exploration stage," "development stage" and "production stage," and apply those new definitions to individual properties in addition to the company as a whole. These changes are intended to remove ambiguities in the existing Guide 7 definitions, and to align the disclosure requirements with current accounting practices under U.S. GAAP and IFRS. This approach will allow companies to characterize their properties separately as exploration stage, development stage or production stage properties, but imposes limits on how and when companies can characterize their operational stage. For example, a company will not be permitted to characterize itself as a development or production stage company if it does not have any mineral reserves on any of its properties. These changes are intended to give more accurate disclosure about the type of properties and related risks involved.

## Internal Controls

Under the rules, companies will be required to describe the internal controls that apply to ensure reliability of their exploration results and estimates of mineral resources and reserves. Internal controls disclosure will be required to address quality control and quality assurance programs, verification of analytical procedures and comprehensive risk inherent in estimates. This new requirement is consistent with requirements to disclose quality-control and quality-assurance procedures under CRIRSCO-based disclosure regimes in other jurisdictions.

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