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Complying with the Extractive Sector Transparency Measures Act

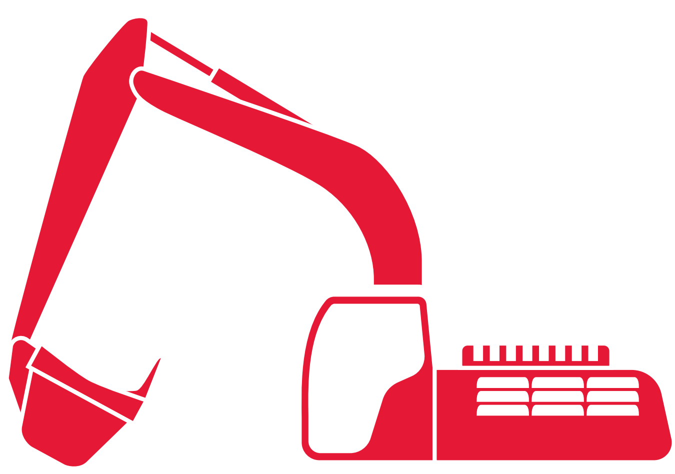
By Michael Dixon and Mark Morrison

The federal *Extractive Sector Transparency Measures Act* (ESTMA) came into effect on June 1, 2015. ESTMA is Canada's latest step in the global fight against corruption. It is in line with similar initiatives in the United States, the United Kingdom and other European Union countries. ESTMA is designed to complement Canada's existing anti-corruption regime in the *Corruption of Foreign Public Officials Act* (CFPOA) by creating greater transparency over payments to a government by entities engaged in the extractive sector — mining, oil and gas.

Because of the significance of the fines, the potential personal liability of directors or officers, and the importance of being able to show due diligence, companies in extractive industries should take proactive steps to implement ESTMA compliance procedures.

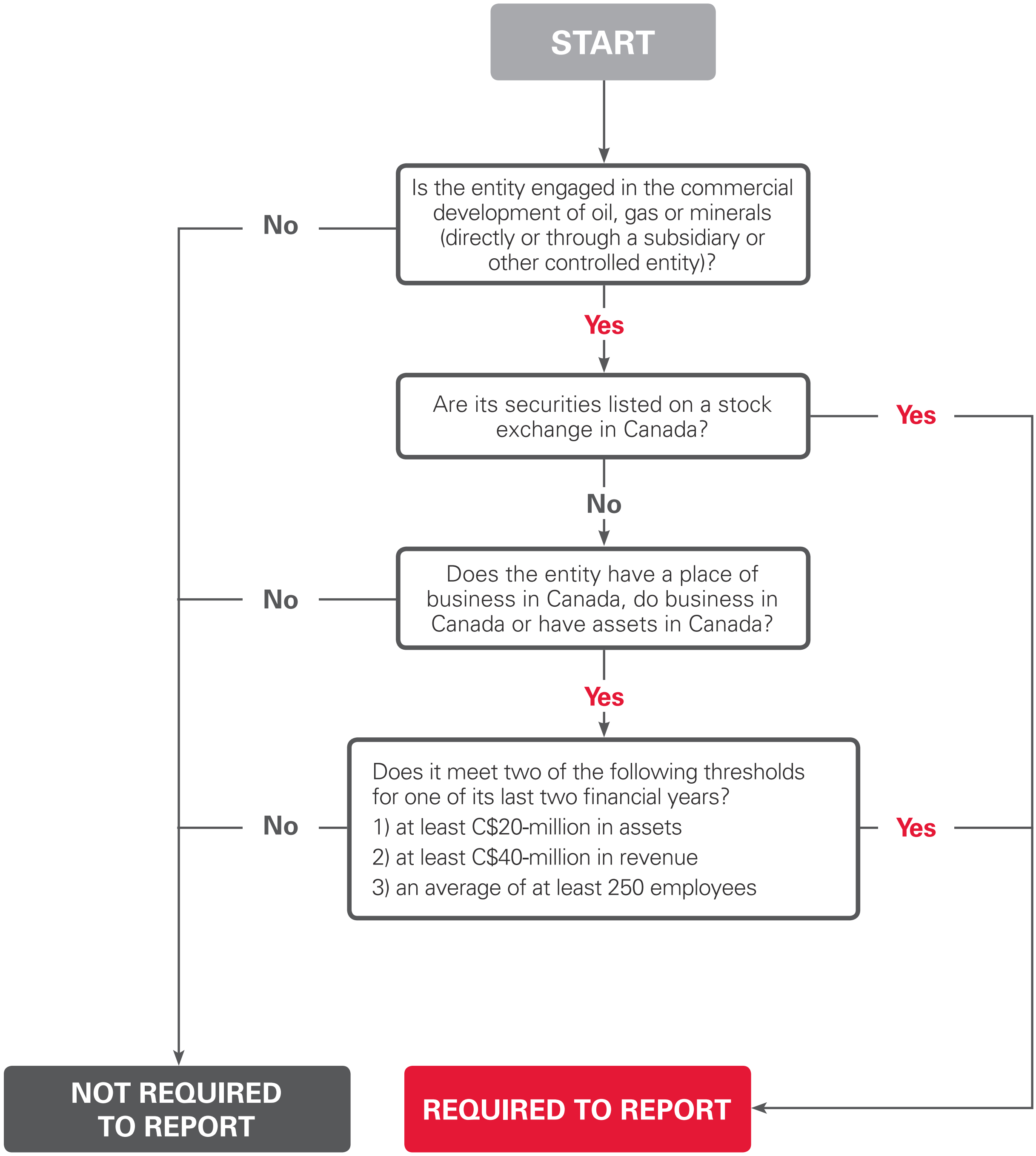
ESTMA requires annual government reporting and public disclosure of certain types of payments made by the extractive sector to governments (and government officials) both domestically and abroad, eventually including aboriginal governments in Canada.

The basics of ESTMA compliance, including (1) whether a company falls within the ambit of the ESTMA reporting regime, (2) the types of payments that must be reported and (3) organizational and individual liability for failure to comply are outlined in this whitepaper.



WHO MUST REPORT?

ESTMA's reporting requirements only apply to entities engaged in the commercial development of oil, gas or minerals and that meet certain listing or location and size criteria.



Commercial Development of Oil, Gas or Minerals

ESTMA captures all forms of business organizations, such as corporations, trusts, partnerships and other unincorporated entities such as joint ventures, but its reporting requirements do not apply to individuals or sole proprietorships.

In addition, only businesses engaged in the "commercial development of oil, gas or minerals" are subject to ESTMA's reporting requirements. This includes the following activities:

- Oil, gas or mineral exploration and extraction — this potentially encompasses all commercial activity that occurs during the life of an oil, gas or mineral project from the time of prospecting/exploration until the project is complete.
- The acquisition or holding of a permit, licence, lease or any other authorization to carry out the foregoing — this likely includes the entire permitting process, which is one of the highest-risk areas for corrupt payments in the extractive sector.

"Commercial development of oil, gas or minerals" likely does not include preparatory activities such as manufacturing equipment or post-extraction activities such as refining, smelting, processing, transporting or exporting oil, gas or minerals. However, certain initial processing activities that are highly integrated with extraction operations may be considered part of the commercial development of oil, gas or minerals, depending on the circumstances.

While not entirely clear from the face of ESTMA, it is expected that companies providing goods and/or services related to commercial development of oil, gas or minerals but not directly involved in the exploration, extraction or permitting process (such as services companies) are not intended to be captured within the ambit of ESTMA. Whether a particular company is captured will need to be considered on a case-by-case basis depending on the overall degree of integration with the project.

Development of Oil, Gas or Minerals through a Subsidiary or Other Controlled Entity

Where a company engages in commercial development of oil, gas or minerals through a subsidiary or other controlled entity, the controlling company will be required to report under ESTMA if it meets the listing or location and size criteria discussed below. This will be the case whether the controlled business is engaged in commercial development of oil, gas or minerals in Canada or in a foreign jurisdiction. For example, if a TSX-listed corporation controls a joint venture that is engaged in the development of a mine in Chile, the controlling Canadian corporation will be required to report under ESTMA.

ESTMA defines "control" broadly by including direct or indirect control by any means. This likely encompasses the standard accounting definition of control, including:

- Holding a majority of a company's voting shares
- Appointing a majority of the board of directors
- Being or controlling the general partner of a limited partnership
- Holding a majority interest in a joint venture or joint ownership.

Control for the purpose of ESTMA is not limited to direct control. It also extends to indirectly controlled businesses down an organizational chain, such as indirect subsidiaries, partnerships or joint ventures.

Listing, Location and Size Criteria

Even if a business is engaged in the commercial development of oil, gas or minerals (directly or through a subsidiary), it is only required to report if either its securities are listed on a stock exchange in Canada or it meets certain location and size criteria.

Where an entity does not have securities listed on a Canadian stock exchange, it can still be subject to the reporting requirements if it has a place of business in Canada, does business in Canada or has assets in Canada; and meets two of the following size criteria in at least one of its two most recent financial years:

- C$20-million in assets
- C$40-million in revenue
- Employ an average of at least 250 employees.

Both the assets and revenue tests should be construed on a gross basis, as reported in the entity's consolidated financial statements. Assets and revenue in the size criteria are not limited to assets or revenue in Canada or to assets or revenue only from the commercial development of oil, gas or minerals. In determining whether a company has over 250 employees, it should average its number of employees over each of its last two financial years. Full-time, part-time and temporary employees both in Canada and abroad are all likely relevant for this calculation.

WHAT MUST BE REPORTED?

ESTMA requires reporting of payments:

- To a "payee" (e.g., government)
- That total, in aggregate, over C$100,000
- Fall within one of the following categories:
  1. Taxes (other than consumption taxes and personal income taxes)
  2. Royalties
  3. Fees (including rental fees, entry fees and regulatory charges, as well as fees or other consideration for licences, permits or concessions)
  4. Production entitlements
  5. Bonuses (including signature, discovery and production bonuses)
  6. Dividends (other than dividends paid as ordinary shareholders)
  7. Infrastructure improvement payments

Payments that fall outside of the categories listed above do not need to be reported under ESTMA.

A business that is required to report under ESTMA must report all payments made directly by it and all payments by any entity that it controls, including payments made on its behalf by agents.

Categories of Payments

There are seven categories of payments that must be reported when they, in aggregate, total C$100,000 or more to the same payee. Multiple payments to different departments, ministries or bodies within the same level of government in a country will be considered payments to the "same payee."

Reportable payments can be either monetary or in kind. Where a payment has been made in kind, its value is the cost to the company, or if that cannot be determined, the fair market value of the goods or services provided.

Even where a payment is not termed specifically as one of the categories listed in ESTMA but is in substance that type of payment, it may still need to be reported. For example, if a CSR contribution was made to a payee in lieu of one of the payment categories, it may need to be reported.

Taxes	Companies will be required to report all types of taxes paid to a payee, with an exemption for consumption taxes and personal income taxes. Consumption taxes, such as sales tax, goods and services tax, harmonized sales tax, value-added tax and use tax will not be reportable payments even if they relate to commercial development of oil, gas or minerals.
Royalties	All types of royalties paid to payees on oil, gas or minerals are reportable. Royalties paid in kind are subject to cost or fair market valuation for the purposes of reporting.
Fees	The fees category in ESTMA is broad and captures all fee-type payments, including rental fees, entry fees, regulatory charges, and payments for licences, permits or concessions of any kind. However, fees likely do not include ordinary course commercial transactions, such as utility payments to a state-owned enterprise for use of electricity or water.
Production Entitlements	Where a payee is entitled to a share of production of oil, gas or minerals under a contractual or legislated arrangement, such entitlements are reportable payments for the purposes of ESTMA. If production entitlements are paid in kind, they will be subject to the same cost or fair market valuation as other types of in-kind payments.
Bonuses	All types of bonuses paid to payees are intended to be reportable under ESTMA, including signing, discovery and production bonuses.
Dividends	This category is intended to capture dividends that are paid to payees in lieu of bonuses, production entitlements, royalties or other categories of reportable payments. However, where shares have been acquired by a payee on the same terms as other shareholders and a dividend has been paid to that payee as an ordinary shareholder on the same terms as other ordinary shareholders, such dividends are not intended to be reportable under ESTMA.
Infrastructure Improvement Payments	Infrastructure improvement payments that are made to, or required by, a payee, whether under contract, legislation or otherwise, must be reported. However, infrastructure improvements that are predominantly for operational purposes (i.e., building a bridge that will primarily be used by the company for site access) likely do not need to be reported. For example, if a company is obliged by a government department to build a water treatment system (other than where the system is primarily dedicated to the site), the company is likely required to report the cost of building the treatment system.

Concept of "Payee"

ESTMA defines a "payee" as:

- Any government in Canada or a foreign state
- A body that is established by two or more governments
- Any trust, board, commission, corporation or other body that exercises or performs a power, duty or function for a government or body established by two or more governments.

The definition of payee is intended to be construed broadly, which includes:

- All governments at a national, regional, state/provincial or local/municipal level
- All public international organizations, such as the United Nations
- Any crown corporations, sovereign wealth funds and other state-owned enterprises that are exercising or performing a power, duty or function of government.

Given the breadth of the definition of a "payee," aboriginal and indigenous groups within Canada and abroad may be regarded as governments and therefore a "payee" for the purpose of ESTMA. This is subject to a two-year deferral expiring on June 1, 2017, during which payments to aboriginal governments in Canada do not need to be reported.

Deeming Provisions

ESTMA contains deeming provisions that are intended to capture all payments to government officials or employees and payments made indirectly to a payee on behalf of an entity. These include:

- A payment made to an employee or public office holder of a payee is deemed to have been made by the payee (this is especially noteworthy in the anti-corruption context, as it may require reporting of improper payments to government officials that are in violation of CFPOA)
- Payments made by a controlled company are deemed to have been made by the controlling company
- Payments made indirectly (such as through a services or management company) on behalf of a company are deemed to have been made by the company.

Form of Reporting

ESTMA's reporting requirements will apply to payments made during each financial year commencing after June 1, 2015, and reporting must be undertaken within 150 days following the conclusion of each financial year. Reporting must be filed with the Minister of Natural Resources and made available to the public by posting it on the Internet for at least five years.

Payments must be broken down to indicate which payee received the payment. Further, payments must also be broken down to the project level when they can be attributed to a specific project. Where a payment is made that is not attributable to a specific project, it may be disclosed in the report without splitting or disaggregating the payment to allocate it to a specific project. The report must also include the total of each payment category to each payee and project where applicable. The form of reporting will also require an attestation statement from an appropriate company official or its auditor swearing to the contents and accuracy of the annual report.

To avoid duplicate reporting, the Minister has the power to substitute Canada's payment reporting requirements with those of another jurisdiction. As a positive step for entities subject to reporting obligations in multiple jurisdictions, the Minister has recently issued a direction specifying that compliance with the European Union's Accounting and Transparency Directives are an acceptable substitute for reporting under ESTMA. Accordingly, reports submitted under the EU Directive may also be submitted to the Minister as a substitute for a report under ESTMA. When submitting an EU report in Canada, it must be accompanied by a substitution form that includes an attestation statement from a director, officer or independent auditor.

Record-Keeping Requirements

ESTMA will require each entity to keep records of its payments made in a financial year for a period of seven years from the date that the entity provides its report to the Minister. This records retention obligation should be read in conjunction with section 4 of CFPOA, which creates an offence for destroying accounting records earlier than permitted by law for the purpose of concealing bribery. Accordingly, non-compliance with the record-keeping obligations under ESTMA may also be punishable by criminal sanction under CFPOA if done for a bribery-related purpose.

OFFENCES AND DIRECTORS' AND OFFICERS' LIABILITY

ESTMA creates three separate offences relating to non-compliance, providing misleading statements and general anti-avoidance:

- Any person or entity failing to comply with the reporting and public disclosure obligations of ESTMA
- Knowingly making or providing any false or misleading statement or information
- It is illegal for an entity to structure its payments, any other financial obligation or gifts that relate to commercial development of oil, gas or minerals to avoid the requirement to report such payments.

Offences are punishable by a fine of up to C$250,000 for each day the violation continues.

Where an entity commits an offence under ESTMA, any director or officer who directed, authorized, assented to, acquiesced in or participated in its commission is also guilty of the offence and personally liable for a fine of up to C$250,000 for each day of the violation. This would be subject to a defence of due diligence, where it would be open for the entity or its directors and officers to show that all reasonably prudent compliance measures were implemented, which would typically include considerations such as:

- Establishing policies and procedures (including appropriate data collection systems)
- Training
- Monitoring to ensure effectiveness of policies and procedures
- A system of internal controls to ensure accurate books and records
- Periodic audits of payment records.

For further information or assistance with ESTMA compliance procedures, please contact Michael Dixon, Mark Morrison or any other member of our Business Crimes, Investigations & Compliance group.