Hogan Lovells

# SEC Update

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*This is a commercial communication from Hogan Lovells. See note below.*

## Effective date approaching for new SEC mining property disclosure regime

On October 31, 2018, the SEC released comprehensive property disclosure rules for mining registrants that represent the first major change to the rules since 1982. The new rules require companies with material mining operations to provide disclosure in their SEC filings of their mineral resources, mineral reserves and material exploration results for their material mining operations in the aggregate and for each material mining property, and to include supporting technical report summaries in the filings. The final rules depart in important respects from the rule proposal that was issued in 2016 and attracted widespread criticism.

Since 1982, property disclosures by mining registrants have been governed by Item 102 of Regulation S-K and Industry Guide 7. The new rules rescind Industry Guide 7 as of January 1, 2021 and amend Item 102 to direct mining registrants to a new Subpart 1300 of Regulation S-K (subpart 1300), which will contain all of the requirements for property disclosures by mining registrants from and after January 1, 2021 following the expiration of a transition period for compliance. The rules will apply to foreign private issuers as well as U.S. registrants with material mining operations or individually material mining properties.

The SEC's overarching goals in adopting the new rules are to modernize mining disclosure requirements and to align them with international reporting standards. The rules change or remove requirements that many believe have placed U.S. mining registrants at a competitive disadvantage compared to international mining companies. One of the major changes permits mining registrants, for the first time, to report estimates of mineral resources in their SEC filings. The rules align the SEC's disclosure regime for mining properties with long-standing international standards, including those issued by the Committee for Mineral Reserves International Reporting Standards (CRIRSCO). The new rules, however, will impose substantial additional compliance burdens and expenses on mining registrants that currently provide property disclosure only in compliance with the U.S. mining property disclosure regime.

The SEC's 450-page adopting release (No. 33-10570) can be found here.

### Transition period for compliance

The new rules will become effective on February 25, 2019, but will afford mining registrants a transition period of almost two years before their disclosures must comply with the new requirements.

Under the transition provisions, mining registrants will not be required to comply with subpart 1300 until their first fiscal year beginning on or after January 1, 2021. As a result, calendar-year companies will first be required to comply with the new rules for Securities Act registration statements they file on or after January 1, 2021, and for Form 10-K reports they file for their fiscal year ending December 31, 2021. Industry Guide 7 will remain in effect until all registrants are required to comply with the new rules.

Registrants with material mining properties or interests in such properties may begin filing their registration statements and periodic reports in compliance with the final rules before January 1, 2021 so long as they comply with all aspects of subpart 1300. Some companies that already file reports in jurisdictions that have adopted CRIRSCO-based standards, such as Canada, could decide to comply early. Other such companies may be discouraged from attempting early compliance because the new rules do not provide for reciprocal recognition of technical reports prepared in accordance with international standards.

The SEC must update the EDGAR filing system to accommodate filings under the new rules. It will announce system readiness in a manner similar to agency notices of updates to the EDGAR Filer Manual.

## Threshold materiality standard for mining-related property disclosures

Under the new rules, a registrant must provide summary mining-related property disclosures required by subpart 1300 if its aggregate mining operations are "material" to its business or financial condition. A registrant also will have to provide additional disclosures about individual mining properties when those individual properties themselves are material to the company's business or financial condition.

The SEC decided not to adopt a bright-line test for materiality determinations it had proposed in 2016 that would have defined as material to a company's mining operations an individual mining property that constitutes at least 10% of the company's total assets. Instead, in its adopting release, the SEC refers to the standard for materiality determinations pursuant to Securities Act Rule 405 and Exchange Act Rule 12b-2. Under this standard, a company's mining operations will be considered material to its business or financial condition if there is "a substantial likelihood that a reasonable investor would attach importance" to the information about the mining operations when deciding whether to buy, hold or sell the company's securities.

In accordance with the SEC's long-established approach to materiality determinations, the adopting release instructs companies to consider both quantitative and qualitative factors regarding their overall business and financial condition to determine whether their mining operations are material. When considering the relevant factors, a registrant must aggregate all mining operations, regardless of any individual mining property's stage of development and the size or type of commodity produced.

## Treatment of royalty companies

***Required disclosures.*** Consistent with the proposed rules, the final rules require a royalty company – and other companies with economic interests in mining properties that are similar to royalty interests – to make mining property disclosures if its interests in the properties are material to the royalty company's operations as a whole. A royalty company is a company that, instead of owning or operating a mining property, owns an economic interest in a mining property, such as a right to receive payments from the owner or operator of a property based on mining operations.

Neither Item 102 nor Guide 7 directly addresses whether or to what extent royalty companies are required to disclose information about the mining operations underlying their economic interest. Under the Guide 7 regime, the SEC staff has used the filing review process to express its position on the disclosure requirements applicable to royalty companies.

Many commenters on the rule proposal opposed subjecting royalty companies to disclosure requirements under subpart 1300. The commenters argued that royalty companies generally do not have an executive or operational interest in the properties to which the royalties relate and typically lack access to the technical information about the mining property available to the operator and necessary to prepare reliable disclosure. In crafting the final rules, the SEC continued to be guided by the principle that investors in royalty and similar companies need information about the material mining properties that generate the payments to the registrant in order to be able to assess the amounts, soundness and sustainability of future payments. The agency, however, did accommodate some of the commenters' objections by adopting important exceptions to the general requirement under the new rules that a royalty company must provide the required mining property disclosure.

The rules apply to royalty companies in substantially the same way in which they apply to producing companies. A royalty company must evaluate quantitative and qualitative factors to determine whether its economic interests in an underlying mining property are material to an understanding of its overall business and financial condition. Following an affirmative determination of materiality, the royalty company must provide both summary property disclosure and disclosure for each individually material mining property, and comply with the technical report summary requirements for each such property.

***Disclosure exceptions.*** Various exceptions permit royalty companies to make less extensive disclosures or to omit certain disclosures entirely in specified circumstances. First, a royalty company is required to disclose only information relating to those underlying properties or portions of properties that generate the royalty payments. Similarly, in reporting mineral resources and mineral reserves, a royalty company may disclose only the resources and reserves on the portion of a mining property that generated payments to the royalty company during the reporting period.

Further, the rules do not require a royalty company to file a technical report summary when the company operating the mine already has filed with the SEC a technical report summary relating to the property. In this case, the royalty company need only refer to the producing registrant's previously filed technical report summary. In a change from the proposed rules, a royalty company referring to the operating company's filed technical report summary will not be required to incorporate the technical report summary into the royalty company's filing, although the royalty company may elect to do so. The SEC agreed to eliminate mandatory incorporation in response to commenters' concerns that such a requirement would subject the royalty company to potential liability under the securities laws for information it could not review or verify.

The rules also permit royalty companies under specified conditions to omit some or all of the information generally required to be included in mining property disclosure under the rules. This accommodation reflects the SEC's recognition that a royalty company may lack, and have difficulty obtaining, access to the information and supporting documentation required to comply with these requirements. The royalty company may omit otherwise required information so long as the company:

- specifies the information to which it lacks access;
- explains that it does not have access to the required information either (1) because obtaining it would require unreasonable effort or expense or (2) because it requested the information from a person that is unaffiliated with the royalty company and possesses knowledge of the information, and such person denied the request; and
- provides all required information that it actually possesses or can acquire without unreasonable effort or expense.

For example, under these conditions, a royalty company likely would not have to file a technical report summary for an underlying property where a private operating company has not filed a technical report summary and has denied the royalty company access to the necessary information about the property.

## Treatment of vertically-integrated companies

The definitions of "material" and "mining operations" in the new rules also encompass vertically-integrated companies that conduct mining operations which are secondary to, or in support of, their main non-mining business. Item 102 of Regulation S-K and Industry Guide 7 do not specifically address the issue of whether or when a vertically-integrated manufacturer would be required to make mining-related disclosures. Under the new rules, a manufacturing company that conducts mining operations to supply itself with raw materials necessary for production may be required to make mining-related disclosures – including summary and individual property disclosures and the filing of a technical report summary supporting mineral reserve and mineral resource disclosures at individually material properties – if those operations are material to the company's overall business or financial condition.

## Qualified person requirement and expert liability

The new rules require that disclosures of mineral resources, mineral reserves, and exploration results and targets be based on information and supporting documentation furnished by a "qualified person."

***Definition of "qualified person."*** A "qualified person" is a mineral industry professional who has at least five years of "relevant experience" relating to the types of mineralization and deposits being considered and in the activity which the professional is undertaking on the registrant's behalf. To be qualified, such a person also must be an

eligible member or a licensee in good standing of a "recognized professional organization" at the time the information and documentation is developed. Registrants are responsible for determining that the qualified person possesses the necessary qualifications.

Additional definitions and provisions of the rules round out the definition of a "qualified person."

- First, the term "relevant experience" means that the person has experience in the specific type of activity which the person is undertaking on behalf of the registrant.
- Second, the person also must have relevant experience evaluating the specific type of mineral deposit under consideration.
- Third, the requirement that the qualified person have five years of experience with the type of deposit being evaluated will not be determined strictly on a mineral-by-mineral basis, so that, for example, a person with 20 years' experience in estimating resources for a variety of metalliferous hard-rock deposit types would not necessarily be required to have five years of experience with each particular type of such deposit.
- Fourth, the qualified person must have "sufficient experience" in the sampling, analytical, extraction and processing techniques relevant to the mineral deposit being considered, with sufficient experience consisting of "that level of experience necessary to identify, with substantial confidence, problems that could affect the reliability of data and issues associated with processing."
- Finally, the qualified person must have sufficient knowledge and experience in applying the relevant modifying factors to the mineral deposit under consideration, as well as experience with the geology, geostatistics, mining, extraction and processing applicable to the type of mineral and type of mining being considered.

The rules do not contain an approved list of "recognized professional organizations" because the SEC believes that a principles-based approach provides registrants with more flexibility in evaluating candidates for service as qualified persons and does not unduly restrict the potential pool of such candidates.

The rules define a "recognized professional organization" as either (1) an organization that is recognized within the mining industry as a reputable professional organization or (2) a board authorized by U.S. federal, state or foreign statute to regulate professionals in the mining, geoscience or related field. In addition, the organization must admit eligible members primarily on the basis of their academic qualifications and experience, establish and require compliance with professional standards of competence and ethics, require or encourage continuing professional development, possess and apply disciplinary powers (including the power to suspend or expel a member regardless of where the member practices or resides), and provide a public list of members in good standing.

***Expert liability of qualified persons.*** The proposed rules would have required an individual qualified person to sign a technical report summary personally and to provide a written consent for the registrant to use in its filing the qualified person's name and the information developed by the person. This requirement would have subjected the qualified person to personal liability as an "expert" under Securities Act Section 11 for material misstatements or omissions in the registrant's technical report summary included or incorporated by reference into a Securities Act registration statement. Commenters opposing this proposed requirement argued that such liability exposure would discourage service as qualified persons by individuals with the necessary experience and would increase compliance costs for registrants and the qualified persons.

Recognizing the concerns of these commenters, the SEC modified the qualified person requirement in the final rules to provide that a *third-party firm* staffed by mining experts may sign the technical report summary without naming the employee, member or other affiliated person who prepared the summary. Similar to the regime applicable to legal and financial experts, a firm signing the technical report summary must provide its written consent in connection with the registrant's use of the information in a Securities Act registration statement and assume liability for material misstatements or omissions in such information. Registrants should be aware, however, that if the qualified person is an employee of the *registrant* instead of a third-party firm, the individual must provide the consent, and therefore incur potential liability, on an individual basis.

## Requirements for summary and individual property disclosures

***Summary disclosure of material mining operations.*** Under the new rules, a registrant with material mining operations that owns or has an interest in two or more mining properties must provide summary disclosure concerning its mining operations in the aggregate. This requirement applies to all registrants with material mining operations and multiple mining properties, even if no individual mining property is itself material.

The proposed rules would have required summary disclosure in a designated table detailing total production at each of the company's 20 properties with the highest asset value during each of the three most recently ended fiscal years. However, in response to comments that criticized the tabular presentation and asset-value test for being overly prescriptive, the final rules permit registrants to provide an overview of their mining operations in either a narrative or tabular format and to provide aggregated production data for each of the three most recently ended fiscal years.

The rules require registrants to provide an overview of their mining properties that should include the following information, to the extent relevant:

- the location of the properties;
- the amount and type of ownership interests;
- the identity of the operators;
- key permit conditions;
- mine types and mineralization styles; and
- processing plants and other available facilities.

The rules also require that an overview of mining operations include "the amount and type of disclosure … that is material to an investor's understanding of the registrant's properties and mining operations in the aggregate." The increased flexibility provided by these revised summary disclosure requirements should help ease the compliance burden for many registrants that already file similar disclosures in other jurisdictions, but it also introduces some uncertainty in terms of what information ultimately will be considered material.

Registrants also will be required to provide a summary of mineral resources and mineral reserves – to the extent these have been determined – at the end of their most recently completed fiscal year. The summary of resources and the summary of reserves must be provided in separate tables to minimize the possibility of investor confusion. The tables will require a quantified prospect of economic extraction, although registrants may choose a reasonable and justifiable price estimate selected by the qualified person. Despite many commenters' concerns that the tabular presentation of resources and reserves presented in the rule proposal was unduly prescriptive, the SEC retained this presentation, but emphasized that a registrant could modify the tables to enhance the clarity of its disclosure and to fit its particular business.

***Disclosure concerning individual material mining properties.*** The new rules require specific disclosures relating to individual material mining properties to provide investors with a more complete picture of a company's mining operations. In the SEC's view, summary disclosure of material operations does not provide enough information about companies with individually material mining properties. A company that has material mining operations in the aggregate but no individually material mining properties is not required to provide separate individual disclosure in addition to its summary disclosure. A company with only one material mining property is not required to provide summary disclosure, but instead must provide only individual disclosure to the extent that its individual mining property is material to its business or financial condition.

The registrant must provide a brief description of each material mining property that includes:

- the location of the property;
- existing infrastructure on the property; and
- a description of the titles, claims, concessions, rights, leases or options that the registrant has or will have in relation to the property.

Beyond the brief description, the registrant is required to provide information about the property that is "substantially similar" to the information that has been required under Industry Guide 7. This additional disclosure must include, as relevant to each property, information about:

- the present condition of the property;
- the work completed on the property;
- the proposed program for exploration or development;
- the current stage of the property (exploration, development or production);
- the age and physical condition of equipment, facilities, infrastructure and underground development;
- the total cost or book value of the property and associated plant and equipment;
- a history of operations, including the names of previous operators, if known; and
- a brief description of the encumbrances on the property.

Registrants are required to disclose the amounts of mineral resources and mineral reserves that have been determined at each material property as of the end of their most recent fiscal year. The disclosures must be made in separate tables to avoid investor confusion. For a disclosure of mineral resources, the registrant must disclose the estimated tonnages and grades for each category of mineral resources (classified as inferred, indicated and measured resources, as described below) along with total estimates of combined indicated and measured resources. For a disclosure of mineral reserves, the registrant must provide estimated tonnages and grades for each class of mineral reserves (consisting of probable and proven reserves, as described below) as well as for combined reserves. The tables disclosing resources and reserves will be modifiable to some extent by the registrant, such as to allow the company to disclose information for all of its properties in one table or to use separate tables when a separate presentation is clearer.

Registrants must compare each material property's mineral resources and mineral reserves for the two most recently ended fiscal years. The rule proposal would have required this comparative information to be presented in tabular format, but the final rules permit the comparative disclosure in either narrative or tabular form. The presentation must include the net difference from one year to the next for both resources and reserves and must explain any discrepancies between the two estimates. This information is intended to help investors understand the reasons for year-over-year changes in resources and reserves and to evaluate a company's prospects. If a registrant is disclosing resources or reserves for the first time or is disclosing material changes to its previously disclosed estimates, it is required to discuss the material assumptions and criteria underlying the estimates and cite to the corresponding sections of the technical report summary.

***Technical report summary requirement.*** In connection with any required disclosure of mineral resources or mineral reserves, a registrant must obtain a dated and signed technical report summary that identifies and summarizes the information reviewed and the conclusions reached by the qualified person about the mineral resources or reserves determined by the qualified person to be on each of the registrant's material properties.

The technical report summary must be filed as an exhibit to the relevant filing when the registrant is disclosing mineral resources or mineral reserves for the first time, or when there has been a material change in the mineral resources or mineral reserves from the last technical report summary filed for the property. The requirements of the technical report summary are based on technical reports prepared in accordance with Canada's National Instrument 43-101F1, which is currently used by many registrants that disclose mining interests under Canadian law. The technical report summary must identify and summarize the scientific and technical information analyzed. The summary also must detail the conclusions reached in "initial assessments" and the results of "pre-feasibility studies" or "final feasibility studies," as described below, used to support a disclosure of mineral resources or reserves. The summary need not be based on a single "technical report," but instead should summarize all applicable sources of information on which the qualified person relied in determining mineral resource or mineral reserve estimates.

Although the technical report summary is required to address scientific and technical information that supports determinations of mineral resources and mineral reserves, qualified persons should exercise caution to avoid violating the restriction that the summary not contain "large amounts of technical or other project data." The

rules encourage the use of plain-English principles to the extent practicable. The SEC's goal is for the technical report summary to be effective in providing information to investors that lack the knowledge or experience needed to evaluate the elaborate scientific and technical information supporting mineral resource and mineral reserve estimates.

## Disclosure regime for mineral resources

Permitting the disclosure of "mineral resources" is at the core of the SEC's effort to modernize mining disclosures and align them more closely with international reporting standards. Industry Guide 7 prohibits the disclosure of mineral resources in Exchange Act reports and Securities Act registration statements even though most international securities regimes require disclosure of mineral resources. The SEC intends through the new rules to "place U.S. registrants on a level playing field with Canadian mining registrants and other non-U.S. mining companies that are subject to one of the CRIRSCO-based mining codes" by allowing U.S. registrants to disclose their mineral resources. The new disclosure regime requires companies to disclose specified information about mineral resources that they have determined to exist based on information and supporting documentation from a qualified person.

The new rules define a mineral resource as "a 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 final rules require mineral resources to be classified into three defined categories:

- inferred mineral resources;
- indicated mineral resources; and
- measured mineral resources.

The classifications are based on the level of certainty with which the qualified person can determine that a resource is capable of future economic extraction.

***Inferred mineral resources.*** An "inferred mineral resource" is a mineral resource for which quantity and grade or quality are estimated on the basis of "limited geological evidence" and sampling, so that the evidence is sufficient only to establish that grade and quality continuity are "more likely than not." Inferred mineral resources bear the lowest level of geological confidence of all mineral resources. An inferred mineral resource may not be converted directly into a mineral reserve, but instead must first be converted into an indicated or measured mineral resource before it can be converted into a mineral reserve.

The proposed rules would have required the qualified person to include in the technical report summary a quantitative assessment of the level of geological uncertainty by specifying the minimum percentage of inferred mineral resources that the qualified person believed would be converted into indicated and measured mineral resources with continued exploration. The SEC eliminated this requirement in response to commenters' concerns that the requirement would be impracticable and burdensome. The final rules instead require the qualified person to describe the criteria used to classify a resource as an inferred resource and to justify that classification in a narrative form.

***Indicated and measured mineral resources.*** The new rules define an "indicated mineral resource" as a resource for which quantity and grade or quality are estimated based on "adequate" geological evidence. Indicated mineral resources are further defined in comparison to measured mineral resources, with indicated mineral resources bearing a lower level of confidence than the level of confidence required to determine a measured mineral resource. Because an indicated mineral resource is determined with less confidence than a measured mineral resource, indicated mineral resources may be converted only into "probable mineral reserves," the lower of the two classes of mineral reserves.

A "measured mineral resource" is a mineral resource for which the quantity and grade or quality are estimated on the basis of "conclusive" geological evidence and sampling. The SEC explains in the adopting release that the term "conclusive" means there is "no reasonable doubt" that the amount and quality of the deposit can be estimated with enough accuracy that any difference between the measured resource and the extracted resource would have "an insignificant effect on the potential economic viability." Because a measured mineral resource has a higher level of

confidence associated with it than an indicated mineral resource, a measured mineral resource may be converted into either classification of mineral reserve (probable or proven).

Similar to the rule proposal for inferred mineral resources, the proposed rules would have required the qualified person to quantify the level of geologic uncertainty associated with indicated and measured mineral resources. Although the SEC observes in the adopting release that a quantitative statement of confidence is considered best practice in the industry, the SEC removed the quantitative requirement from the final rules, which instead require the qualified person to describe the criteria used to classify a resource as indicated or measured and to justify the classification. This approach is similar to the standards used in CRIRSCO-based jurisdictions, where the qualified person is permitted, but not required, to state a confidence level in quantitative terms.

## Initial assessment requirement in determining mineral resources

The new rules require that any determination and subsequent disclosure of mineral resources be based on an "initial assessment" made by the qualified person. An initial assessment is a "preliminary technical and economic study of the economic potential of all or parts of mineralization to support the disclosure of mineral resources." To establish the economic potential of the mining property or project, an initial assessment must include the qualified person's qualitative evaluation of relevant technical and economic factors that affect the prospect of economic extraction. The contents required in the initial assessment are based on the technical report format of Canada's National Instrument 43-101F1, which the SEC determined to be clearer than other international standards.

The rules also include pricing guidelines the qualified person must follow. A controversial aspect of the rule proposal would have required the qualified person to use an estimated price that is no higher than the average price of the extractable commodity over the preceding 24 months, or that is the contracted price. Industry practice generally is to use complex price forecasting and modeling to establish a price when determining the viability of a mining prospect.

The SEC responded to commenters' concerns about the proposed pricing methodology by instead allowing a price estimate that "provides a reasonable basis for establishing the prospects of economic extraction for mineral resources." This price estimate model is more closely aligned with the standard under CRIRSCO-based jurisdictions, which requires the qualified person to use "any reasonable and justifiable price." Under the SEC's formulation of the reasonable-price requirement, the qualified person must disclose the estimated price and explain the reasons for selecting it. The estimated price and the assumptions underlying that price must be updated as of the end of the company's most recent fiscal year. Qualified persons may use a price set by contractual arrangement so long as the contractual price is reasonable.

## Defining and determining mineral reserves

The new rules also update the disclosure requirements for mineral reserves.

***Updated definitions for mineral reserves.*** The new rules refine the existing definitions for mineral reserves to track more closely the definitions under CRIRSCO standards. Although Industry Guide 7 defines mineral reserves as those portions of a deposit that are capable of economic and legal extraction or are produced at the time of the reserve determination, the rules provide specific definitions for individual components of the mineral reserve definition and require the qualified person to apply specified "modifying factors" in determining mineral reserves. In a notable departure from the rule proposal, the definition of a mineral reserve in the final rules includes both the volume of diluting materials and allowances for potential losses during extraction. The proposed rules would have required disclosure of "net" reserves excluding dilution and potential losses.

*Modifying factors*. "Modifying factors" under the rules are those factors which the qualified person must apply to indicated and measured mineral resources to establish the economic viability of mineral reserves. Consistent with the proposed rules and the CRIRSCO framework from which they were adapted, the final rules do not provide an exhaustive list of the modifying factors which the qualified person must apply. Instead, the definition of "modifying factors" provides examples of such factors that include, among others:

- mining;
- processing;
- metallurgical;

- infrastructure;
- economic;
- marketing;
- legal;
- environmental compliance;
- plans, negotiations and agreements with local individuals or groups; and
- governmental factors.

In the adopting release, the SEC elaborates on the definition by noting that the number and specific characteristics of modifying factors to be applied to a potential mining operation will be specific to each case and depend on the material that is mined, the type of mine (surface or sub-surface) and the location or specific character of the property. The processing factor, for instance, might require evaluating the characteristics of the mineral resource and whether the mineral can be extracted and converted into marketable product using existing technology. The legal factor likely would include an in-depth examination of the host jurisdiction's regulatory regime and the company's ability to comply with rules on permitting, safety and environmental protection.

*Probable and proven mineral reserves*. The definition of "mineral reserves" requires classifying the reserves into two categories, consisting of (1) "probable mineral reserves" and (2) "proven mineral reserves." The distinction between the two categories is based primarily on the level of geological certainty with which the qualified person can make determinations through application of the modifying factors.

The rules define a "probable mineral reserve" as the "economically mineable part of an indicated or, in some cases, a measured mineral resource." The qualified person's level of confidence in applying modifying factors to indicated and measured resources will be lower in determining a probable mineral reserve than it would be in determining a proven mineral reserve. Nevertheless, to classify a deposit as a probable mineral reserve, the qualified person's confidence in the results of applying the modifying factors must still be sufficient to demonstrate that extraction is "economically viable" considering reasonable "investment and market assumptions."

A "proven mineral reserve" is the "economically mineable part of a measured mineral resource." To classify a deposit as a proven mineral reserve, the qualified person must possess a "high degree" of confidence in the estimates of tonnage and grade or quality based on the results of applying the modifying factors.

The rules and the adopting release further refine the concept of economic viability in relation to determining mineral reserves. For a reserve to be "economically viable," the qualified person must use a discounted cash flow analysis or other analytical method to determine that extraction is practicable under reasonable investment and market assumptions. The cash-flow-analysis requirement is consistent with industry practice and CRIRSCO-based codes that require a financial analysis under reasonable assumptions to make a determination of economic viability.

The SEC explains in the adopting release that "investment and market assumptions" include all assumptions regarding prices, exchange rates, interest and discount rates, sales volume, and necessary costs. The proposed rules would have required qualified persons making pricing assumptions for mineral reserve determinations to use an estimated price no higher than the average market price of the finished commodity over the preceding 24 months. The final rules, on the other hand, allow the qualified person to use a price that establishes a reasonable basis for establishing economic viability, including a reasonable contracted price. As with mineral resource estimations, in estimating mineral reserves, the qualified person must explain with particularity the reasons for selecting the price and any material assumptions underlying the decision. The estimated price and the assumptions underlying it must be updated as of the end of the registrant's most recent fiscal year.

***Supporting mineral reserve determinations.*** In a significant change from the disclosure regime under Item 102 and Industry Guide 7, the new rules permit qualified persons to establish mineral reserve estimates by using a pre-feasibility study. Whereas companies historically have been allowed to base disclosed reserve determinations only on the more rigorous final feasibility study, they may make reserve determinations under the new rules on the basis of either a pre-feasibility or final feasibility study. Allowing determinations of mineral reserves to be made on the basis of a pre-feasibility study aligns the new disclosure requirements with CRIRSCO standards and enables

registrants to provide relevant information to potential investors earlier in the mineral exploration and mine planning process. Beyond easing the regulatory burdens on companies that already file mining disclosures in other jurisdictions, this change should help mining companies access the capital markets more quickly because a pre-feasibility study is generally less expensive and much less time-consuming to prepare than a final feasibility study.

*Pre-feasibility study*. The rules define a pre-feasibility study as "a comprehensive study of a range of options for the technical and economic viability of a mineral project" that is advanced enough for a qualified person to have determined a preferred mining method or pit configuration, an effective method of mineral processing, and an effective plan to sell the product. The pre-feasibility study is more comprehensive than the initial assessment required to make mineral resource determinations, but less comprehensive than a final feasibility study. A pre-feasibility study still must present a financial analysis based on reasonable assumptions about, and appropriate testing of, modifying factors and other relevant factors that includes a detailed description of applicable taxes and estimates of projected revenues.

*Feasibility study*. A feasibility study, in contrast, is a "comprehensive technical and economic study of the selected development option for a mineral extraction project, which includes detailed assessments of all applicable modifying factors … together with any other relevant operational factors, and detailed financial analysis that are necessary to demonstrate, at the time of reporting, that extraction is economically viable." A feasibility study also must contain mining, infrastructure and process designs that are sufficient to serve as the basis for an investment decision or to support project financing. Accordingly, the financial and operational analysis in a final feasibility study should include firm price quotations for major capital expenditures needed to execute the project.

Two departures from the proposed rules increase the flexibility registrants have to make reserve determinations on the basis of either a pre-feasibility or final feasibility study. The rule proposal would have required qualified persons to justify the use of a pre-feasibility instead of a feasibility study. The proposed rules also would have required the use of a final feasibility study in certain high-risk situations. The SEC omitted both of these requirements in the final rules on the basis that the detailed requirements and instructions for preparing a pre-feasibility study will lessen the chances of investor confusion or uncertainty, even in high-risk situations.

## Disclosure of exploration results and exploration targets

***Exploration results.*** The new rules require registrants with individual material mining properties to disclose material "exploration results" in connection with those properties. Such registrants also are permitted, but not required, to disclose related exploration activity and exploration results before they become material, so long as they make disclosures of nonmaterial exploration activity and exploration results in accordance with the rules. Including nonmaterial exploration results within the scope of permissible disclosures is more consistent with CRIRSCO standards for disclosing exploration results.

The rules define "exploration results" as "data and information generated by mineral exploration programs (i.e., programs consisting of sampling, drilling, trenching, analytical testing, assaying, and other similar activities undertaken to locate, investigate, define or delineate a mineral prospect or mineral deposit) that are not part of a disclosure of mineral resources or reserves." In the adopting release, the SEC indicates that a registrant must make a "good faith determination" about the materiality of its exploration results at the end of each fiscal year. The SEC instructs registrants to consider "all relevant facts and circumstances" to determine the materiality of exploration results, including the extent to which information about exploration results is important to assessing the value of a material property or deciding whether to develop a property. The release provides examples of situations in which exploration results might be considered material, such as when exploration results significantly affect a registrant's analysis or estimate of the life of a material mining project.

The rules prohibit registrants from deriving estimates of tonnage, grade and production rates, or from making an assessment of economic viability, based solely on disclosed exploration results. Instead, deriving estimates of tonnage, grade and production rates, and making an assessment of economic viability, must be made only on the basis of mineral resource and mineral reserve estimates. The SEC indicates that this restriction is based on the low level of certainty underlying exploration results. Exploration results must be based on "information and supporting

documentation by a qualified person," although registrants are not required to file a technical report summary in connection with a disclosure of an exploration result.

***Exploration targets.*** The rules also permit companies to disclose "exploration targets." The rule proposal did not discuss exploration targets, but many commenters noted that mining companies commonly discuss exploration activities in terms of an exploration target. The final rules define an "exploration target" as "a statement or estimate of the exploration potential of a mineral deposit in a defined geological setting where the statement or estimate, quoted as a range of tonnage and a range of grade (or quality), relates to mineralization for which there has been insufficient exploration to estimate a mineral resource."

Disclosure of an exploration target must be "based upon and accurately reflect[ ] information and supporting documentation of a qualified person." To reduce the possibility that investors will confuse a disclosure of an exploration target for a disclosure of mineral resource or mineral reserve estimates, the company must disclose an exploration target in a separate section of its filing or technical report summary and must clearly indicate by caption that the disclosure involves a discussion of an exploration target. The section disclosing an exploration target must include a clear and prominent statement that:

- ranges of potential tonnage and grade or quality of the exploration target are conceptual in nature;
- there has been insufficient exploration of the relevant property or properties to estimate a mineral resource;
- it is uncertain whether further exploration will result in the estimation of a mineral resource; and
- the exploration target therefore does not represent, and should not be construed to be, an estimate of a mineral resource or mineral reserve.

Because registrants are not required to file a technical report summary in connection with the disclosure of an exploration target, the disclosure also must include:

- a detailed explanation of the basis for the exploration target, such as the conceptual geological model used to develop the target;
- an explanation of the process used to determine the ranges of tonnage and grade, which must be expressed as approximations;
- a statement clarifying whether the exploration target is based on actual exploration results or on one or more proposed exploration programs, which should include a description of the level of exploration activity already completed, the proposed exploration activities designed to test the validity of the exploration target, and the timeframe in which those activities are expected to be completed; and
- a statement that the ranges of tonnage and grade or quality of the exploration target could change as the proposed exploration activities are completed.

## Other provisions

***Definitions for exploration, development and production stage properties.*** Industry Guide 7 provides definitions of the terms "exploration stage," "development stage" and "production stage," but applies them only to the registrant as a whole and not on a property-by-property basis. The SEC believes that the definitions in this form are ambiguous and thus have affected investors' ability to evaluate disclosures that accurately reflect a registrant's operational status. The new rules update the definitions and require that registrants apply them both to descriptions of individual properties and to descriptions of the registrant as a whole.

As applied to individual properties, the rules revise the Industry Guide 7 definitions to provide that:

- an "exploration stage property" is a property that has no mineral reserves disclosed;
- a "development stage property" is a property that has mineral reserves disclosed, but where no material extraction has occurred or is occurring; and
- a "production stage property" is a property with material extraction of mineral reserves.

As applied to a registrant as a whole, the rules revise the Industry Guide 7 definitions to provide that:

- an "exploration stage issuer" is one that has no material property with mineral reserves;

- a "development stage issuer" is one that is engaged in the preparation of mineral reserves for extraction on at least one material property; and
- a "production stage issuer" is one that is engaged in material extraction of mineral reserves on at least one material property.

***Disclosure of internal controls.*** Under the new rules, registrants must make disclosures outlining the internal controls used in estimation efforts relating to the determination of exploration results and mineral resources and reserves. A description of internal controls will be required for both summary and individual disclosures to the extent a company is required to make either or both on the basis of its mining operations. These disclosures should address quality control, quality assurance and analytical procedures, and provide a comprehensive assessment of the risk involved in the estimation. Requiring disclosure of internal controls is consistent with requirements in many foreign jurisdictions, and the disclosure requirement adopted by the SEC is similar to the requirement in place in CRIRSCO-based jurisdictions.

***Conforming changes to forms not subject to Regulation S-K.*** In connection with the implementation of subpart 1300, the SEC also will amend its Securities Act and Exchange Act forms that are not inherently subject to the new requirements. The SEC will revise Form 20-F to require foreign private issuers that file Exchange Act reports on Form 20-F and registration statements on Forms F-1, F-3 and F-4 to comply with the mining disclosure requirements of subpart 1300. A foreign private issuer also will be instructed to comply with the technical report summary requirements to the extent such requirements apply to the foreign issuer's business.

The SEC also will amend Form 1-A so that issuers with material mining operations that intend to sell securities under the Securities Act exemption afforded by Regulation A will be required to comply with the disclosure requirements of subpart 1300 and to file as exhibits any applicable technical report summaries. Form 1-A will be amended to direct issuers engaged in mining operations to refer to subpart 1300 and to provide any required disclosures.

## Looking ahead

The new rules go a long way toward aligning the SEC's mining property disclosure requirements with the reporting requirements of foreign mining codes in Canada, Australia, South Africa and other foreign jurisdictions. The new rules reflect the SEC's efforts to respond to the industry's perspective when making changes to the prior disclosure system. On many significant points of contention over the rule proposal, the SEC eliminated proposed prescriptive and quantitative requirements in favor of a more principles-based approach. The new approach affords greater flexibility to registrants and promotes the levelling of compliance burdens for companies that already disclose information about their mining properties in foreign jurisdictions.

The comprehensive and modernizing changes to the SEC's disclosure regime may enhance the ability of mining companies to access U.S. capital markets. Particularly because of the SEC's former prohibition on disclosure of mineral resources, many mining companies considering where to incorporate and raise capital previously have chosen Canada or other jurisdictions in preference to the United States.

Registrants that provide mining property disclosures in jurisdictions that observe CRIRSCO standards may find that they are prepared to begin compliance with the new rules during the transition period and before the 2021 compliance date. Given the lack of reciprocity afforded to CRIRSCO-based technical reports, however, registrants will be required to produce new technical report summaries in compliance with the rules, which will result in significant inconvenience and expense.

Other mining companies, particularly those that currently file only under SEC rules contained in Item 102 and Industry Guide 7, likely will find that they must invest substantial efforts during the transition period to update their reporting to comply with the new requirements. The updating burden will be particularly challenging for royalty and streaming companies that previously have not had to obtain technical reports relating to their mining assets.

All registrants with material mining properties should begin the process of evaluating the new rules and identifying the steps they must take to prepare for compliance by 2021. Advisors to mining companies, including foreign private issuers, that already participate or intend to participate in the U.S. capital markets should work to promote a thorough understanding of the SEC's comprehensive new disclosure regime by those companies.

*This SEC Update is a summary for guidance only and should not be relied on as legal advice in relation to a particular transaction or situation. If you have any questions or would like any additional information regarding this matter, please contact your relationship partner at Hogan Lovells or any of the lawyers listed on the following page of this update.*

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