Extracting Corruption

Canada's *ESTMA* and the Global Trend towards Transparency

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"The most terrifying words in the English language are: 'I'm from the government and I'm here to help.'"

- Ronald Reagan

In the wake of the Panama Papers, global markets have become attuned to the call for transparency in multi-jurisdictional transactions. Unfortunately for Canada, a recent assessment by the Financial Action Task Force (FATF) identified significant failings in Canadian anti-corruption efforts and expressed concern that the country has failed to make progress on several fronts. Nevertheless, the FATF noted that some recent improvements have brought Canada more in line with global standards.[1] This paper will highlight one such improvement and its attempt to align Canada's anti-corruption laws with a global trend towards transparency. In June 2013, Bill S-14 became law, amending the central statute governing Canada's anti-corruption efforts, the *Corruption of Foreign Public Officials Act* (*CFPOA*).[2] The amendments considerably expanded the purview of the *CFPOA* by imposing a "books and records" provision aimed at accounting practices intended to conceal corruption, and by replacing the "territorial jurisdiction" standard with that of the broader "nationality jurisdiction".[3]

The expansion of the *CFPOA*'s reach is bolstered by complementary efforts in other Canadian legal regimes, such as securities law. On June 1, 2015, the *Extractive Sector Transparency Measures Act* (*ESTMA*)[4] came into force. This new reporting regime for the extractive sector builds on a global trend towards increased disclosure by extractive sector companies with the goal of reducing corruption related to resource development. Its purpose is to improve transparency within the industry and to achieve alignment with similar measures in the European Union and the United States, where mandatory payment reporting requirements have already

been implemented for commercial resource development companies. The *ESTMA* represents a snapshot of Canadian efforts "to participate in the fight against corruption".[5]

Why focus the nation's anti-corruption efforts on the extractive industries? The first great Canadian political economist, Harold Adam Innes, in his seminal work on the Canadian economy, described Canadian foundational industries as a series of staples trades.[6] Canada's resource dominated capital markets are the current manifestation of this legacy. While our modern economy has significant manufacturing and service sectors, the resource industries remain important. In 2015, Canada's GDP was $1.99 trillion, of which mining, quarrying, and oil and gas extraction accounted for 8%.[7] The Canadian stock exchanges have the highest concentration of mining listings in the world: almost 60% of the world's mining companies seek listings on the Toronto Stock Exchange or the TSX Venture Exchange, with over 75% of global public mine financings being conducted by the TSX alone.[8] These figures evidence that the extractive industries are material for Canada's economic well being; instilling safeguards to corruption in this area is crucial.

The *ESTMA* contemplates a "publish what you pay" regime that requires certain entities involved in the extractive industries, including mining, oil and gas, to disclose payments in excess of $100,000 made to foreign and domestic governments. Section 8 sets out the organizations covered by these new reporting obligations:

> (a) an entity that is listed on a stock exchange in Canada;
>
> (b) an entity that has a place of business in Canada, does business in Canada or has assets in Canada and that, based on consolidated financial statements, meets at least two of the following conditions for at least one of its two most recent financial years:
>
> (i) it has at least $20 million in assets,

(ii) it has generated at least $40 million in revenue,

(iii) it employs an average of at least 250 employees; and

(c) any other prescribed entity.[9]

These are independent requirements; if an entity falls within any of (a) to (c), it will be considered a Reporting Entity for the purposes of the *ESTMA*. We note, however, that Bre-x Minerals Limited would not have been required to report as they would likely have not met the $100,000 threshold.

The statute defines "commercial development" very broadly as exploration, extraction or any other prescribed activities in relation to oil, gas or minerals, or acquiring or holding a permit, licence, lease, or any other authorization to participate in any such activities.[10] For clarity in putting the new regime into practice, Natural Resources Canada (NRCan) has issued implementation tools, created in consultation with industry and civil society organizations, provincial governments and Aboriginal experts. These tools include a Guidance to help businesses in the extractive sectors understand their obligations under the *ESTMA*, Technical Reporting Specifications for the reporting process with detailed instructions on how to complete a report and how reports are to be published, and a Reporting Template in multiple formats. [11]

The Guidance outlines the requirements of the *ESTMA* with examples, including important clarification on whether a Canadian extractive organization qualifies as an "entity". The statute defines "entity" as a corporation or a trust, partnership or other unincorporated organization

(a) that is engaged in the commercial development of oil, gas or minerals in Canada or elsewhere; or

(b) that controls a corporation or a trust, partnership or other unincorporated organization that is engaged in the commercial development of oil, gas or minerals in Canada or elsewhere.[12]

While the legislative definition is exhaustive, the Guidance suggests that the term "entity" is to be interpreted broadly to include not only those entities explicitly prescribed by the *ESTMA* (any corporation, trust, partnership or other unincorporated organization) but also similar types of organizations, such as unlimited liability corps, limited partnerships and royalty trusts. However, the term does not capture individuals or sole proprietorships[13]

Entities that are either Canadian or maintain operations or assets in Canada are subject to the reporting requirements, even with respect to their non-Canadian operations, if they are engaged in the commercial development of oil, gas or minerals. The Guidance addresses the situation contemplated in section 2(b) whereby an entity is engaged in such development through control of another business enterprise. For the purposes of the *ESTMA*, "control" can be established directly or indirectly, in any manner. The Guidance stipulates that if an entity controls another under the appropriate accounting standards (for example, International Financial Reporting Standards [IFRS] or US Generally Accepted Accounting Principles [GAAP]), it will generally be considered to control that entity for the purposes of ESTMA. This is the case whether the business subject to control is engaged in commercial development in Canada or in a foreign country.[14] Accordingly, the scope of "indirect control" and the potential for non-traditional extractive entities (such as institutional financial or private equity investors) to be caught within the reach of the *ESTMA* is a practical issue to be carefully considered.

Simply qualifying as an Entity under the *ESTMA* does not automatically mean that an organization is subject to reporting obligations; a business must also qualify as a Reporting Entity to be required to report payments pursuant to the *Act*.[15] Pursuant to section 8, an entity that is subject to the *Act* will be required to report payments in either of two circumstances: if the entity or its securities are listed on a Canadian stock exchange, or if the entity has a place of

business in Canada, does business in Canada, or has assets in Canada and meets the enumerated size-related criteria. These two tests are mutually exclusive. For example, an Entity listed on the Toronto Stock Exchange is a Reporting Entity even if it does not have a place of business in Canada or is below all of the size thresholds.[16] The Guidance provides a comprehensive guide to applying the size criteria and also for determining which types of payments must be reported and when.[17]

The *ESTMA* builds on a global trend towards transparency led by the United States and the European Union. In an effort to "implement a statutory mandate and require disclosure consistent with other payment transparency disclosure regimes around the world"[18], the U.S. Securities and Exchange Commission (SEC) has recently adopted new rules under the *Dodd-Frank Wall Street Reform and Consumer Protection Act* (*Dodd-Frank*) that require companies listed on American stock exchanges to disclose payments made to the U.S. federal government or foreign host governments in relation to the commercial development of minerals, natural gas, and oil. The rules require "resource extraction issuers" to file payments that are "not de minimis", defined as any payment or series of related payments that equals or exceeds $100,00 during the same fiscal year, publicly with the Commission on an annual basis. This includes payments made by a subsidiary or other entity controlled by the issuer. [19] The *Dodd-Frank* rules mirror the European Union's approach in its *Transparency Directive*. This legislation, issued in 2004 and revised by E.U. Parliament in 2013, compels oil, gas, mining, and forestry companies to publish payments made to governments and to release information on their earnings in each country. Under the *Directive*, payments of more than €100,000 made to governments in the country in which the European company operates must be reported, and include taxes levied on income, royalties and license fees. [20] While each of the Canadian, U.S. and E.U. payment disclosures must be made at

the project level, rather than simply at the government level, it is curious that only the E.U. regime also applies to the forestry sector; was the Sino-Forest debacle not warning enough?

The Canadian government has already taken steps toward its goal of alignment with similar measures in the E.U. by providing for a substitution authority in the *ESTMA*. As of July 31, 2015, it has been determined that the reporting requirements in the E.U. meet the purpose of *ESTMA*. Accordingly, reports submitted to E.U. and European Economic Area member-states that have implemented the *Transparency Directive* at a national level may be submitted to the Minister of Natural Resources as a substitute for a report prepared under *ESTMA*. To use the substitution determination, reporting entities must include an attestation statement in their report and specify the jurisdiction in which the substituted report was originally filed.[21] With the recent passing of the new *Dodd-Frank* rules, it is conceivable that NRCan will issue a similar substitution determination for the U.S. in an effort to mitigate regulatory dissonance and to harmonize Canada's anti-corruption laws with those of its close trading partners. To this end, the Government of Canada is monitoring risks of potential conflict between the *ESTMA* and the laws of foreign jurisdictions that have the potential to hinder reporting (for example, arrangements involving confidential terms) and engaging directly with jurisdictions where measures exist that may raise concerns regarding the application of the new legal requirements.[22]

Conclusion

While Canada has received a lukewarm assessment of its anti-corruption efforts, the *ESTMA* is an example of concrete steps being taken by the Canadian government to bring the country more in line with its international anti-corruption commitments and with measures in other jurisdictions to combat corruption through transparency. We believe, however, that Canada's

fragmented securities regulation system will pose a challenge when it comes to effective enforcement, owing to the limitations of provincial securities commissions to police large-scale trans-jurisdictional corruption. Future developments here and elsewhere, such as issues of less than zealous regulators and penalties too low to act as deterrents in the face of massive potential monetary gains, will determine whether this step towards transparency achieves its goals or merely causes history to repeat itself in a more creative way. Where, oh where is our national securities regulator?

[1] Financial Action Task Force, "Anti-money laundering and counter-terrorist financing measures: Canada - Mutual Evaluation Report" September, 2016.
[2] *Corruption of Foreign Public Officials Act*, S.C. 1998, c. 34, s. 8.
[3] Paul Blyschak, *Coporate Liability for Foreign Corrupt Practices under Canadian Law* (2014) 59:3 McGill LJ 655.
[4] *Extractive Sector Transparency Measures Act*, S.C. 2014, c. 39, s.376 [*ESTMA*].
[5] *Ibid*, preamble.
[6] See Harold A Innis, "A History of the Canadian Pacific Railway" (Toronto: McClelland & Stewart, 1923); and Harold A Innis, "The Cod Fisheries: The History of an International Economy" (New Haven: Yale University Press, 1940).
[7] Statistics Canada, *Gross domestic product at basic prices, by industry (monthly*) online:
< http://www.statcan.gc.ca/tables-tableaux/sum-som/l01/cst01/gdps04a-eng.htm>
[8] Monica Podgorny & James B. Musgrove, *Foreign Corrupt Practices Laws: Implications for the Canadian Natural Resources Sector* (2014) 14 Asper Rev. Int'l Bys. & Trade L. 161.
[9] *ESTMA*, *supra* note 4 at s.8(1).
[10] *Ibid* at s.2 "commercial development of oil, gas or minerals".
[11] Natural Resources Canada, "Tools for Extractive Businesses" online: <http://www.nrcan.gc.ca/mining-materials/estma/18192 >.
[12] *ESTMA*, *supra* note 4 at s.2 "entity".
[13] Natural Resources Canada, "Guidance", online: < http://www.nrcan.gc.ca/sites/www.nrcan.gc.ca/files/mining-materials/PDF/ESTMA-Guidance_e.pdf> at s.2.1 and 2.1.1, p. 7 [Guidance].
[14] *Ibid* at p.8, s.2.1.3.
[15] *Ibid* at p.7, s.2.1.
[16]*Ibid* at p.8-9, s.2.2.
[17] *Ibid* a p.9-17, ss.2.2.2-3.7.
[18] U.S. Securities and Exchange Commission, "Press Release: SEC Proposes Rules for Resource Extraction Issuers Under Dodd-Frank Act", online: <http://www.sec.gov/news/pressrelease/2015-277.html >.
[19] U.S. Securities and Exchange Commission, "Press Release: SEC Adopts Rules for Resource Extraction Issuers Under Dodd-Frank Act", online: <https://www.sec.gov/news/pressrelease/2016-132.html>.
[20] Directive 2004/109/EC of the European Parliament and of the Council, 15 December 2004, online: < http://eurlex.europa.eu/LexUriServ/LexUriServ.do?uri=OJ:L:2004:390:0038:0057:EN:PDF> ; amended by Directive 2011/0307 of the European Parliament and of the Council, online: <http://register.consilium.europa.eu/doc/srv?l=EN&f=PE%2037%202013%20INIT>.
[21] Natural Resources Canada, "Substitution Process and Determination", online: <https://www.nrcan.gc.ca/mining-materials/estma/18196>.
[22] Guidance, *supra* note 13 at p.18, s.5.