U.S. Chamber of Commerce Sues SEC to Overturn Controversial Dodd-Frank Resource Extraction Rule

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On October 10, 2012, the U.S. Chamber of Commerce and three industry groups filed suit against the Securities and Exchange Commission in federal court in Washington, D.C., seeking to overturn the recently-promulgated SEC rule implementing the Dodd-Frank Act provision requiring disclosure of payments to foreign governments relating to oil, gas and mining projects.

The New Rule

In late August 2012, the SEC adopted the "Disclosure of Payments by Resource Extraction Issuers" rule (the Rule), which applies to issuers that are engaged in the commercial development of oil, natural gas, or minerals, which includes exploration, extraction, processing (but not refining) and export from the host country.

Under the new Rule, issuers must disclose all payments (or aggregation of related payments) of $100,000 or more to foreign (and U.S.) governments for such activities. "Payments" are broadly defined to include taxes, royalties, fees, production entitlements, bonuses, dividends and expenditures for infrastructure improvements. Such reports must be made annually on Form SD and must include specific detailed information including the exact amount paid, the recipient government and the particular project to which the payment relates. Issuers will be required to file their first report for the period beginning October 1, 2013 through the end of the company's fiscal year, and annually thereafter.

The SEC estimated that the cost of compliance with the Rule would approach $1 billion initially, with follow-on costs in the $200 million to $400 million range, not counting what the SEC noted could be billions of dollars more in lost business. Skeptics have charged that compliance costs will greatly exceed those estimates.

When the SEC commissioners voted to adopt the Rule, two of the five commissioners, including the Chair, recused themselves. Of the remaining three commissioners, two voted to approve the Rule while the third issued a scathing dissent to the effect that the SEC had not seriously considered the costs or impact of the Rule, that the $100,000 threshold was too low and that the Rule would put U.S. companies at a severe disadvantage to foreign competitors (including state-run enterprises in China, Russia, Iran and elsewhere) who are not required to make such reports.

Controversy over the Rule was also fueled by the fact that the SEC approved by a 3-2 vote the much maligned "conflict minerals" rule under the Dodd-Frank Act the same day.

The Lawsuit

On October 10, 2012, four interest groups filed suit in federal court in Washington, D.C. challenging the Rule

First Amendment:

The lawsuit broadly charges that the required disclosure violates the reporting companies' First Amendment rights by making them engage in speech against their will. While this argument on its own may seem unlikely to succeed, as the entire public company disclosure regime could be similarly attacked, the lawsuit goes on to make the point that the required disclosures will in fact be "disastrous" to the companies that must make them, as they will be required to disclose sensitive project information to competitors and the world.

If successful, this First Amendment challenge could invalidate not only the Rule itself, but more broadly the corresponding provision of Dodd-Frank that directs implementation of the Rule.

Violation of Administrative Procedure Act:

The lawsuit also charges that the SEC violated the Administrative Procedure Act by adopting the Rule without taking into account significant unfriendly public comment that the Rule would have a disastrous impact on U.S. industry. The lawsuit specifically charges that the SEC failed to conduct an adequate cost-benefit analysis as required by law.

The SEC estimated compliance costs would exceed $1 billion, but acknowledged the Rule might cost U.S. businesses many additional “billions of dollars” in lost business without quantifying or further studying such anticipated losses. The complaint quoted the dissenting commissioner, who criticized the SEC for failing adequately to tailor the Rule to avoid significant adverse effects on competition and capital formation and cautioned that “[w]e are not at liberty to ignore selectively the longstanding congressional mandate to consider the impact our rulemaking is likely to have on competition.”

Further, the lawsuit alleges that the SEC improperly failed to provide for exemptions from the Rule when “necessary or appropriate”, as the SEC is empowered to do, and cites the need for exemptions in certain circumstances, such as where foreign governments bar public disclosure of the subject payments.

Failure to Follow Dodd-Frank’s Mandate:

Finally, the complaint charges that the SEC misinterpreted the statute that it purported to implement. Noting that, while one provision of Dodd-Frank directs the SEC to issue rules that require each resource extraction issuer to include in an annual report information relating to payments made to foreign governments for the commercial development of oil, natural gas or minerals, the Act further provides that the SEC “shall make available online, to the public, a compilation of the information required to be submitted” by reporting companies.

Thus, the lawsuit charges that Dodd-Frank requires only that a “compilation” or aggregation of payment information made by U.S. companies be made publicly available, and the SEC “grossly misinterpreted its statutory mandate” by requiring that each U.S. company file a public report detailing each payment made to each and every foreign government, for each and every “project” relating to extractive industries.

The Road Ahead

The litigation is likely to grind on for some time. One question is whether the SEC will voluntarily stay the effective date of the Rule pending resolution of the litigation. While the SEC is not required to do so, it has taken that route in select prior instances and the plaintiffs could ask the court to impose a stay, if necessary.

As for the ultimate outcome, the SEC’s failure fully to assess the economic effects of the Rule and conduct an adequate cost-benefit analysis could prove fatal.

In July 2011 a federal appeals court struck down the direct proxy access regulation, SEC Rule 14a-11, which would have given shareholders the right to have their director nominees included in management’s proxy materials, on grounds that the SEC failed adequately to assess economic impact and conduct a cost-benefit analysis.

This litigation will be closely watched by those interested in challenging the even more controversial and costly “conflict mineral” rule, which has not yet been attacked in court even though it too may be subject to many of the same challenges. This may prove to be the test case for that next round.

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