Federal Court Strikes Down SEC Resource Extraction Rule

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On July 2, 2013, the United States District Court in Washington, D.C. invalidated Rule 13q-1 under the Securities Exchange Act of 1934 implementing the Dodd-Frank Act "resource extraction" provision requiring disclosure of payments to foreign and U.S. governments by companies involving oil, gas and mining projects.

Rule 13q-1 would have required an issuer that is engaged in the commercial development of oil, natural gas, or minerals, including exploration, extraction, processing (but not refining) and export from the host country, to disclose annually by public filing on the SEC's EDGAR system all payments of any kind (or collection of related payments) of $100,000 or more to foreign and U.S. government entities relating to such activities and to identify the project to which the payments relate. The Rule was set to take effect in late 2013.

The Challenge

Industry groups challenged the law in federal court in October 2012 on grounds that the SEC had failed to consider adequately the billions of dollars in costs that would be imposed by the Rule, that the SEC had altogether failed to follow the Dodd-Frank mandate, which only required the SEC to make public a compilation of company reporting without requiring public disclosure of each company report itself, and that the Rule as promulgated would require companies to disclose publicly sensitive commercial information in violation of their First Amendment free speech rights.

The Court's Ruling

United States District Judge John Bates vacated the Rule on grounds that the SEC had misread the Dodd-Frank statute in promulgating the Rule. The court explained that the Dodd-Frank mandate only required the SEC to "make available online, to the public, a compilation of the information required to be submitted" by issuers and the "plain language" of Dodd-Frank in no way required that any actual specific reports by companies be made public.

Judge Bates also found that the SEC had acted "arbitrarily and capriciously" in failing to provide a disclosure exemption for instances in which foreign governments, including oil-rich Qatar as well as China and a few others, prohibit disclosure of such payments.

The Road Ahead

The good news for affected issuers is that they need not comply with the invalidated Rule. In the meantime, it will be up to the SEC to promulgate a rule consistent with the court's decision, or to appeal the decision.

The decision also foreshadows an anticipated ruling in the pending challenge to an equally controversial and costly "conflict minerals" rule, which requires an issuer to disclose whether its products contain certain metals or minerals originating in the Democratic Republic of the Congo of any of its nine bordering countries. The United States District Court in Washington, D.C. heard argument in early July on similar challenges to the conflict mineral rule and a decision is anticipated later this year.

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