

ClientAlert

Capital Markets

July 2013

US District Court Vacates SEC Resource Extraction Payment Disclosure Rules



On July 2, 2013 the US District Court for the District of Columbia granted a motion for summary judgment vacating the rules adopted by the US Securities and Exchange Commission (the "SEC") requiring resource extraction issuers to disclose payments made to governments in connection with the commercial development of oil, natural gas and minerals.¹ The SEC has not revealed how it will respond to the ruling, but it remains obligated under the Dodd-Frank Wall Street Reform and Consumer Protection Act (the "Dodd-Frank Act") to promulgate rules requiring disclosure of such payments. In a separate, parallel case, a similar challenge has been brought against the SEC's conflict mineral disclosure rules, and a ruling in that case is expected shortly. Despite these events, companies subject to the SEC's resource extraction and conflict mineral rules should not assume the rules will be revised significantly, but should continue to collect and document the information required to be disclosed under the conflict mineral and the now-vacated resource extraction rules pending the final outcome of these cases and potential new rulemaking by the SEC.²

Resource Extraction Disclosure Rules Vacated

The Dodd-Frank Act requires the SEC to promulgate rules requiring certain publicly traded companies to disclose payments made to the US Federal government or foreign governments in connection with the commercial development of oil, natural gas or minerals. On August 22, 2012, the SEC adopted final rules (the "Original Rules"), which required resource extraction issuers to disclose information relating to payments made on or after October 1, 2013. Disclosure of such payments were to be filed with the SEC on a new Form SD within 150 days of an issuer's fiscal year-end (i.e., before May 31 for calendar year reporting companies).

The plaintiffs in the case, the American Petroleum Institute, the US Chamber of Commerce, the Independent Petroleum Association and the National Foreign Trade Council, challenged the Original Rules on the grounds that the SEC overreached in its rulemaking by requiring public disclosure of payments and not allowing exemptions for disclosure where disclosure of the payments was prohibited by local law (e.g., Angola, Cameroon, China and Qatar). The plaintiffs also challenged the underlying section of the Dodd-Frank Act on constitutional grounds. The court vacated the Original Rules, but did not consider the plaintiffs' constitutional challenge.

¹ The full text of the decision can be found at this link: https://ecf.dcd.uscourts.gov/cgi-bin/show_public_doc?2012cv1668-51.

² For a detailed discussion of the disclosure requirements of conflict mineral use and government payments by resource extraction companies, see our September 2012 *Client Alert*, "SEC Adopts Conflict Minerals and Resource Extraction Payments Rules," available at <http://www.whitecase.com/alerts-09202012/>.

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In its decision to invalidate the resource extraction rules, the court determined that (i) the SEC misread the statute to mandate public disclosure of such payments, while the statute requires that only a compilation of such information be made public to the extent practicable, and (ii) the SEC's decision to deny any exemption especially, for example, for issuers whose home countries prohibit such disclosures, was "arbitrary and capricious" in light of the limited explanations provided and the SEC's own assessment indicating that the lack of any exemption "drastically increased the [rules'] burden on competition and cost to investors."

As a result of this ruling, issuers are no longer required to comply with the Original Rules. However, the court did not find the underlying statute invalid, so the SEC remains obligated to implement the requirements of the Dodd-Frank Act regarding disclosure of resource extraction payments, now codified as Section 13(q) of the Securities Exchange Act of 1934, as amended (the "Exchange Act"). The SEC has not disclosed how it plans to respond to the court decision, but a number of potential responses are available. For one, the SEC may appeal the ruling and attempt to have the Original Rules reinstated. If the SEC decides to forgo an appeal, or loses an appeal, it would be required to go through a new rulemaking process to implement Section 13(q) of the Exchange Act. This could take the form of a significant rewrite of the Original Rules, or, perhaps more likely given the rule-making backlog at the SEC, the revised rules would address solely the two issues identified by the court.

What you should be doing now

For now, it would be prudent for companies that are subject to the resource extraction rules to continue to compile the information that would have been required to be disclosed pursuant to the Original Rules, while monitoring upcoming developments in the case and potential future rulemaking. If the SEC revises the rules, we expect the revised rules will still require companies to gather similar information regarding resource extraction payments as required by the Original Rules, though the information that is ultimately required to be made public may be more limited.

Conflict Minerals Rules Challenged; Decision Expected Soon

In a separate, parallel case, the US Chamber of Commerce and the Business Roundtable have challenged the SEC's conflict minerals rules implementing another provision of the Dodd-Frank Act that requires public companies to disclose whether certain minerals originating in the Democratic Republic of Congo or adjoining countries are necessary to the functionality or production of products that they manufacture or contract to be manufactured. Interestingly, the SEC issued the conflict minerals rules and the resource extraction rules at the same hearing on August 22, 2012; both sets of rules were subsequently challenged and both cases took similar procedural paths (i.e., with the relevant parties in each case ultimately agreeing that the case would be decided on the briefs that had already been filed with the District of Columbia Circuit Court of Appeals). Oral arguments were heard on cross-motions for summary judgment on June 7, 2013 in the conflict minerals rules challenge and on July 1, 2013 in the resource extraction rules challenge, respectively. The arguments raised in the conflict minerals rules challenge are similar to some of the claims made against the SEC's resource extraction rules and the court's decision in the case is expected shortly.

What you should be doing now

Because the effect of the court's decision in the resource extraction rules case on the conflict minerals rules challenge is uncertain, companies that are subject to the conflict minerals rules should continue to compile the information necessary to make the required conflict minerals disclosures covering the 2013 calendar year, while closely monitoring developments in this case.

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