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Federal Court Vacates the SEC's Section 1504 Reporting Requirements for Payments to Governments by Oil, Gas, and Mining Companies

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Aimed at further combatting corruption and increasing corporate transparency, Section 1504 of the Dodd-Frank Wall Street Reform and Consumer Protection Act ("Dodd-Frank") amended the Securities and Exchange Act of 1934 and directed the Securities and Exchange Commission (the "SEC" or the "Commission") to "issue final rules that require each resource extraction issuer[1] to include in an annual report . . . information relating to any payment made . . . to a foreign government or the [U.S.] Government for the purpose of the commercial development of oil, natural gas, or minerals." 15 U.S.C. § 78m(q)(2)(A). In a separate provision, Dodd-Frank requires that "to the extent practicable," reporting required by Dodd-Frank should be publicly available. 15 U.S.C. § 78m(q)(2)(A).

Pursuant to these provisions, on August 22, 2012, the SEC issued its final Section 1504, Disclosure of Payments by Resource Extraction Issuer rules, requiring annual reporting on a new form—Form SD—of certain details regarding any payment or series of payments to governments aggregating $100,000 or more during an issuer's fiscal year. Form SD called for a significant amount of information relating to qualifying payments, all of which would be made public by the filing of Form SD on the Commission's on-line EDGAR system. The first Forms SD were to be filed in the coming months reporting all payments made on or after October 1, 2013.

On July 2, 2013, Judge John Bates of the United States District Court for the District of Columbia gave issuers what will likely be a significant extension in complying with this Dodd-Frank requirement. Judge Bates's opinion, issued in *American Petroleum Institute, et al., v. Securities and Exchange Commission*, vacated the Section 1504 rules—rules the Commission itself noted were estimated to impact approximately 1,100 issuers at an initial cost of $1 billion—finding that the Commission had committed "two substantial errors." 1:12-cv-01668 (D.C. D.C. July 2, 2013) (the "Opinion").

First, according to the Opinion, the SEC misread Dodd-Frank as mandating complete, public disclosure of all reported payment information. *See* Opinion at 7–22. Though Dodd-Frank specifically requires public disclosure of some portion or compilation of the Section 1504 reports (*see* 15 U.S.C. § 78m(q)(2)(A)), Judge Bates held that the statute did not mandate that *all* reported information be publicly disclosed and that its "to the extent practicable language," specifically contemplated the potential for restricted public disclosure. *See* Opinion at 12. Highlighting comments

received during the rule making process expressing concern that public disclosure of the information contemplated by Section 1504 would result in damaging and/or legally-prohibited dissemination of commercially-sensitive information, Judge Bates noted that "[a] natural reading of [the public disclosure requirement of Dodd-Frank] is that, if disclosing some of the information publically would compromise commercially sensitive information . . . the Commission may selectively omit that information from" public disclosure. *Id.* Because the Commission did not consider whether it should exercise its discretion on the degree of public disclosure required—but instead read the statute as requiring complete disclosure—Judge Bates concluded that the rule-making process was deficient. *Id.* at 22. [2]

The second "serious error . . . independently invalidat[ing]" the rules was the Commission's failure to grant an exception to issuers operating in four countries whose laws expressly prohibit the disclosure: Angola, Cameroon, China, and Qatar. *Id.* at 22–26. The SEC itself found that the failure to include this exemption "could add billions of dollars of costs to affected issuers, and hence have a significant impact on their profitability." *Id.* at 22–23. Nonetheless, the Commission reasoned—and argued to the District Court—that including such an exception would effectively gut the transparency Congress intended in enacting the reporting requirements by incentivizing target nations to prohibit disclosure. *Id.* at 23 (citing 77 Fed. Reg. 56372–73 (Sept. 12, 2012)). Judge Bates rejected this contention and held that "the Commission's view of the statute's purpose—international transparency at all costs"—was both inappropriate and unsupported by the statute. *Id.* at 25. Again, the Court faulted the rule-making process, concluding that "fundamentally, given the proportion of the burdens on competition and investors associated with this single decision, a fuller analysis was warranted." *Id.* at 26 (noting the Commission failed to conduct "reasoned decisionmaking given that by the Commission's own estimates, billions of dollars are on the line").

By vacating the Section 1504 rules, issuers are spared the immediate reporting timeline as they await the next round of rulemaking. Even so, Dodd-Frank's mandate of payment reporting remains intact, and affected issuers are well-advised to continue thoughtful preparations for the inevitable reporting. Indeed, a subsequent rulemaking process that takes account of Judge Bates's concerns could still result in rules substantially similar to those vacated.

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[1] "[R]esource extraction issuer" is defined in the Act as "a company listed on a U.S. stock exchange that 'engages in the commercial development of oil, natural gas, or minerals.'" Opinion at 3 (citing 15 U.S.C. § 78m(q)(1)(D)).

[2] "[I]t is black letter law that an agency regulation must be declared invalid, even though the agency might be able to adopt the regulation in the exercise of its discretion, if it was not based on the agency's own judgment that such a regulation is desired or required. The Rule is invalid here for precisely that reason." *Id.* (internal citations and quotation marks omitted).