

Federal District Court Strikes Down SEC Rule 13q-1

On July 2, 2013, the U.S. District Court for the District of Columbia vacated a rule promulgated by the Securities and Exchange Commission (“SEC”) that would have required resource extraction issuers to publicly disclose payments made to foreign governments for the purpose of oil, natural gas, or mineral development.¹

Rule 13q-1, adopted pursuant to Section 1504 of the Dodd-Frank Wall Street Reform and Consumer Protection Act (“Dodd-Frank”),² was intended by the SEC to increase the transparency of resource development companies by enhancing the disclosure of payments these companies make to foreign governments. Under the rule, companies would have been required to publicly file individualized payment reports on a new, specialized reporting form. The rule was set to go into effect on October 1, 2013, but trade groups – including the American Petroleum Institute and the U.S. Chamber of Commerce – filed suit. The groups argued in part that the SEC should have allowed companies to submit payment information confidentially to the SEC with the SEC making public only a compilation of the information, rather than individualized reports.

In vacating the rule and remanding to the SEC, the Court found that the SEC “fundamentally miscalculated the scope of its discretion at critical junctures.”³ The Court based its ruling on two substantial errors made by the SEC. It first determined that “the commission misread the [Dodd-Frank provision] to mandate public disclosure of the reports.”⁴ The Court also found the SEC acted in an “arbitrary and capricious” manner in denying public reporting exemptions for payments made to foreign governments that prohibit those disclosures. The Court explained that the SEC failed to articulate a reason meriting a lack of exemption, which was necessary due to the potential economic harm that could stem from requiring companies to disclose payments in direct violation of other countries’ laws. The Court declined to rule on the plaintiffs’ argument that the SEC’s rule and the underlying statute compel political speech in violation of the First Amendment.

The SEC may appeal the Court’s ruling or attempt to go through a new rule-making process to implement Section 13(q). The SEC has not yet announced it plans, but it is required to take action, since the rule-making is mandated by Dodd-Frank.

The Court’s ruling is the second significant recent decision to vacate an SEC rule implementing Dodd-Frank provisions. In 2011, the U.S. Court of Appeals for the D.C. Circuit ruled that the SEC’s “Proxy Access” rule, which would have eased rules allowing corporate shareholders to nominate directors to boards, was arbitrary and capricious because it “fail[ed] to properly consider its potential economic effects.”⁵

The same U.S. District Court is currently deciding the legality of another SEC rule that attempts to fulfill Dodd-Frank requirements. Rule 13(p), the conflict minerals rule, was enacted at the same time as Rule 13(q) and mandates that product manufacturers disclose if their products contain minerals from the Democratic Republic of Congo and surrounding countries.

¹ *American Petroleum Institute v. Securities & Exchange Commission*, No. 12-1668 (July 2, 2013) (the “*Opinion*”), available at https://ecf.dcd.uscourts.gov/cgi-bin/show_public_doc?2012cv1668-51. Rule 13q-1 was adopted pursuant to Section 13(q) under the Securities Exchange Act of 1934, as amended.

² 15 U.S.C. 78m(q).

³ *Opinion* at 29.

⁴ *Id.* at 7.

⁵ See our firm memorandum, *D.C. Circuit Vacates Proxy Access Rule* (July 22, 2011), available at <http://cgrnysps1/Firm%20Memos/D.C.%20Circuit%20Vacates%20Proxy%20Access%20Rule.pdf>.

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If you have any questions about the issues addressed in this memorandum or if you would like a copy of any of the materials mentioned, please do not hesitate to call or email Charles A. Gilman at 212.701.3403 or cgilman@cahill.com; Jon Mark at 212.701.3100 or jmark@cahill.com; or John Schuster at 212.701.3323 or jschuster@cahill.com.

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