DRILLING FOR DISCLOSURE AFTER *API V. SEC*: INCENTIVIZING VOLUNTARY PAYMENT TRANSPARENCY IN THE RESOURCE EXTRACTION INDUSTRY THROUGH EXEMPTIONS TO SECTION 1504 OF THE DODD-FRANK ACT

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I. INTRODUCTION: THE CURRENT STATE OF AFFAIRS BETWEEN THE RESOURCE EXTRACTION INDUSTRY AND THE SECURITIES AND EXCHANGE COMMISSION

The Dodd-Frank Wall Street Reform and Consumer Protection Act (Dodd-Frank Act) mandated more than twenty federal agencies to promulgate nearly 400 new Federal regulations.[1] The Securities and Exchange Commission's (SEC) final rules, promulgated pursuant to the Dodd-Frank Act, have been challenged over six times in the D.C. Circuit.[2] The SEC has lost almost every time.[3] On October 3, 2012, in a scathing editorial in the *Wall Street Journal*, the central litigator in halting the implementation of these rules chastised the SEC's lackluster economic analysis.[4] He decried the *New York Times*' characterization of the D.C. Circuit judges as Wall Street's "judicial activists."[5] The truth—according to counsel—was that due process required heightened standards of economic analysis which the agency simply refused to do.[6]

On July 2, 2013, in *American Petroleum Institute v. SEC*,[7] this well documented trend of *vacatur* in the D.C. Circuit repeated itself. In *API*, the district court held that the SEC abdicated its responsibility for reasoned decision-making by dismissing the cost to companies and the burden to competitors in the name of a stated Congressional goal,

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1. Paul Rose & Christopher J. Walker, Dodd-Frank Regulators, Cost-Benefit Analysis, and Agency Capture, 66 Stan. L. Rev. Online 9, 9 (Apr. 29, 2013), http://www.stanfordlawreview.org/sites/default/files/online/articles/DoddFrankFinal.pdf; *see* Dodd-Frank Wall Street Reform and Consumer Protection Act, Pub. L. No. 111-203, 124 Stat. 1376 (2010) (codified as amended in scattered sections of U.S.C.).

2. Eugene Scalia, Op-Ed., *Why Dodd-Frank Rules Keep Losing in Court*, WALL ST. J., Oct. 4, 2012, at A25.

3. *Id.*

4. *See id.*

5. *Id.*

6. *Id.* ("SEC's defenders bridle at the requirement for cost-benefit analysis—it's so hard!").

7. Am. Petroleum Inst. v. SEC, 953 F. Supp. 2d 5 (D.D.C. 2013) (following the dismissal of a simultaneous petition filed by API challenging the SEC's rule).

which was to increase transparency in the resource extraction industry.[8] The court vacated the SEC's rule on "Disclosure of Payments by Resource Extraction Issuers" on two independent grounds.[9] First, the court found that the SEC misread its mandate under Section 1504 of the Dodd Frank Act in its reading of the "compilation" to be publicly available.[10] Second, the SEC's decision to not allow exemptions to the disclosure requirements of Section 1504 was found to be "arbitrary and capricious" in light of the legislative intent and the SEC's economic analysis on the administrative record.[11]

This article will solely focus on the second ground of *vacatur*—the SEC's decision to not allow exemptions for host country prohibitions on disclosures of payments made by resource extraction issuers for the commercial development of oil, natural gas, and minerals. Section 1504 of the Dodd-Frank Act began as the Extractive Industry Transparency in Disclosure Act (EITD).[12] But the enacted language was the Energy Security Through Transparency Act (ESTT), otherwise known as the Cardin-Lugar Amendment to the Dodd-Frank Act.[13] This shift legislated "practicable" support of the federal government's international payment transparency efforts in the resource extraction industry.[14] In *API*, the district court made clear that in light of this legislative intent, the SEC had the discretion to authorize exemptions and failed to justify its decision not to include exemptions that were within its authority.[15] *Vacatur* of the rule was the appropriate remedy under the "arbitrary and capricious" standard of review used by the D.C. Circuit.[16] This remedy is applied if an agency has either relied on factors which Congress has not intended it to consider, entirely failed to consider a factor at all, offered an explanation for its decision that runs counter to the evidence, or is so implausible that it could not be ascribed to a difference in view or product of agency expertise.[17] In *API*, the SEC failed to consider—in addition to investor benefits—the

8. *Id.* at 21-25.

9. *Id.* at 11.

10. *Id.* at 24.

11. *Id.* at 25.

12. *Legislative History of § 1504 of the Dodd-Frank Act*, PUBLISH WHAT YOU PAY U.S., http://www.pwypusa.org/sites/default/files/Legislative%History%20Timeline_1504_.pdf (last visited Jan. 29, 2015) [hereinafter *Legislative History*].

13. *Id.*

14. Dodd-Frank Wall Street Reform and Consumer Protection Act, Pub. L. No. 111-203, 124 Stat. 1376, 2220-22 (2010) (codified as amendment to 15 U.S.C. 78m).

15. *Am. Petroleum Inst.*, 953 F. Supp. 2d. at 22-23.

16. *Id.* at 24.

17. Motor Vehicle Mfrs. Ass'n v. State Farm Mut. Auto. Ins. Co., 463 U.S. 29, 43 (1983).

impact that a blanket prohibition of exemptions would have on market efficiency, capital formation, and burdens on competition.[18]

As the SEC goes back to drawing board, the agency must conduct high-quality economic analysis that compares, across international stock markets, alternatives to the blanket prohibition and the current status quo of payment transparency in the resource extraction industry. This article supports testing rules that approach exemptions on a country-specific basis and incentivize voluntary disclosure of payment information through the Extractive Industries Transparency Initiative (EITI) or other reporting authorities. Part II argues that the legislative intent of Section 1504 of the Dodd-Frank Act is to address the problem of transparency in the resource extraction industries in order to secure both domestic and foreign policy goals. Part III argues that the D.C. Circuit's review of agency rulemaking under the "arbitrary and capricious" review standard requires the SEC to justify its rulemaking after weighing the costs and benefits of alternatives to action and their projected impact on competition, market efficiency, cost, and benefits to investors.[19] Part IV advocates that in order to secure Section 1504's domestic and foreign policy goals, the SEC should explore using a mandatory reporting requirement to target countries truly plagued by the "resource curse" while allowing for exemptions that are designed to "mainstream" payment transparency as the global norm through voluntary reporting regimes.

II. THE LEGISLATIVE HISTORY OF SECTION 1504 POINTS TO THE "PETROLEUM PARADOX"

Over the past ten years, Congressional Leaders have recognized that opacity in payments by resource extraction issuers to foreign governments for the commercial development of natural resources contributes to the cycle of the "resource curse."[20] As early as 2004, Congressional Subcommittees were alerted to the adverse impacts of opacity in the resource extraction industries as a matter of national security.[21] Section 1504 of the Dodd-Frank Act is the end product of the Senate Committee on Foreign Relations staff report entitled, *The Petroleum and Poverty Paradox*.[22] The "paradox" is that historically

18. *Am. Petroleum Inst.*, 953 F. Supp. at 22-23.

19. *Id.* (indicating that the SEC "undertook no such specific analysis").

20. *See Legislative History*, *supra* note 12.

21. MINORITY STAFF OF THE PERMANENT SUBCOMM. ON INVESTIGATIONS, COMM. ON GOVERNMENTAL AFFAIRS, 108th Cong., Money Laundering and Foreign Corruption: Enforcement and Effectiveness of the Patriot Act 126 (Comm. Print 2004).

22. S. REP. NO. 110-49 (2008).

an abundance of natural resources can be a bane for many poor countries rather than a blessing, as it leads to fraud, corruption, wasteful spending, military adventurism, and instability.[23] The "paradox" produces 3.5 billion people from countries plentiful in oil, gas, and minerals, who live on less than $2 a day.[24] The "resource curse" is the product of multiple factors[25] but its effects damage both foreign and domestic policy in the U.S.[26] Focusing on its effect on U.S. domestic policy, social unrest in economically poor but resource rich countries, buoyed by perceived injustice in the expenditure of oil revenue and use of oil as a currency of conflict, destabilizes the reliability of oil supplies.[27] Since economically poor but resource rich countries tend to be more prone to conflict, producing oil, gas, and minerals becomes more expensive because of risk.[28] Historically, the cost of risk inflates prices at U.S. gas pumps and causes a massive wealth transfer out of the United States.[29]

While the "resource curse" is a major problem for national governments, it certainly affects resource extraction companies and their investors.[30] The nature of the oil, gas, and mining sector means that companies often have to operate in countries that are autocratic, un-

23. *See id.* at 11-12.

24. *The Link Between Revenue Transparency and Human Rights: Hearing Before the Comm'n on Sec. and Cooperation in Eur.*, 111th Cong. 30 (2010) (statement of Daniel B. Baer, Deputy Assistant Secretary, Bureau of Democracy, Human Rights, and Labor, U.S. Department of State) [hereinafter *Link Between Revenue Transparency and Human Rights*].

25. Including: (i) "Dutch Disease" an economic scenario in which revenue inflows from a dominant export commodity undermine domestic production and economic growth; (ii) crowding out factors of production by a dominant commodity export industry; (iii) enclave development, in which the dominant industry resource industry develops independently of the wider economy preventing cross-sectoral growth; (iv) long term declines in terms of national trade due to dependence on revenues from the dominant export commodity and declining production yields; (v) increase in state borrowing using future natural resource wealth as collateral, often involving the expenditure of large amounts to credit to meet short term needs. *See* S. REP. NO. 110-49, at 2-3 (2008).

26. *Id.*

27. *Id.*

28. *See Link Between Revenue Transparency and Human Rights*, *supra* note 24, at 3.

29. A case example of this is the 1973-1974 Oil Crisis, when, in response to the outbreak of the Yom Kippur War, Arab member states of the Organization of Petroleum Exporting Countries (OPEC) raised the posted price of crude oil 70% and placed an embargo on exports to the U.S. and other nations allied with Israel. *See generally* G. John Ikenberry, *The Irony of State Strength: Comparative Responses to the Oil Shocks in the 1970s*, 40 INT'L ORG. 105 (1986) (providing statistical evidence to illustrate countries' adjustment strategies to the oil crisis). By January 1974, world oil prices were four times higher than they had been at the state of the crisis. *Id.*

30. PAUL BUGALA, CALVERT INVS., MATERIALITY OF DISCLOSURE REQUIRED BY THE ENERGY SECURITY THROUGH TRANSPARENCY ACT 1 (2010), *available at* https://www.calvert.com / NRC/literature/documents/10003.pdf.

stable, or both.[31] Within these countries and especially in the oil sector, resource extraction companies and investors are detrimentally affected by opaque contracting and unaccountable market processes, which spur and enable corruption and political rent-seeking related to natural resource revenues.[32] This produces a high cost-operating environment.[33] There is also significant uncertainty and risk for investors who need to know the full extent of a company's exposure when that company is operating in a country where it is subject to expropriation, political and social turmoil, and reputational risks.[34]

Investors also feel these risks of significant uncertainty downstream. As capital providers, they are exposed to these risks and need to be sure that the companies they invest in do not engage in illicit or unethical activities.[35] Investment analysts evaluating extractive industry companies try to understand how much money has been spent to acquire reserves and to allocate those expenses to resource production or company cash flows properly.[36] Opacity in the resource extraction industry means that investment analysts have difficulty benchmarking

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31. 156 CONG. REC. 8317 (2010) (statement of Sen. Richard Lugar).

32. S. REP. NO. 110-49, at 10-11.

33. BUGALA, *supra* note 30, at 2.

34. The materiality of these risks cannot be understated. Country-specific risks are best exemplified by Royal Dutch Shell Petroleum's experience in Nigeria. Since 2006, Shell's Nigerian oil exports dropped 20% due to conflict in the Niger River Delta. Dulue Mbachu & Alexander Kwiatkowski, *Shell's Nigerian Exports Face 5th Month of Disruption*, BLOOMBERG (June 17, 2009), http://www.bloomberg.com/apps/news?pid=newsarchive&sid=a7frhAICVp3k. Resource extraction companies also face reputational risks, such as association with corrupt government practices and possible human rights violations. Companies that make legitimate but undisclosed payments to governments may be accused of contributing to the conditions under which corruption and human rights abuses thrive. Another case example of Shell's experience in Nigeria illustrates this point. In the Supreme Court case of *Kiobel v. Royal Dutch Petroleum Co.*, 133 S. Ct. 1659, 1663 (2013), the petitioners alleged that Shell aided and abetted the Nigerian government by "providing the Nigerian forces food, transportation and compensation, as well as by allowing, the Nigerian military to use [their] property as a staging ground for attacks" on Ogoni villagers. *Id.* at 1662-63. The military attacked villagers, "beating, raping, killing, and arresting residents and destroying or looting property." *Id.* at 1662. While the Court held that the Alien Tort Statute does not apply extraterritorially and ruled in favor of Shell, the high profile case tarnished Shell's reputation. Lauren Caraski, Op-Ed., *Kiobel Case: Corporate Accountability for Human Rights Abuses*, ALJAZEERA (Apr. 1, 2013), http://www.aljazeera.com/indepth/opinion/2013/04/20134 1103110790388.html. American oil companies operating in Nigeria, such as Chevron and Exxon, also lost jobs and profits due to the conflict, resulting in higher production costs because of the necessity of additional security measures. 156 CONG. REC. 8316–17.

35. They also have fiduciary responsibilities to their clients. *H.R. 6066, The Extractive Industries Transparency Disclosure Act: Hearing Before the H. Comm. on Fin. Servs.*, 110th Cong. 29–30 (2008) (statement of Robert Jenkins, Chairman of the Investment Management Association of the United Kingdom) [hereinafter *H.R. 6066*].

36. BUGALA, *supra* note 30, at 2.

a company's relative exposure to country-specific risks.[37] This hampers the ability of investment analysts to make informed decisions about a company's future cash flow. It is precisely this opacity that increases the fragility of financial markets.[38] When news of conflict and crisis emerge, investors only have access to limited information to rely on.[39] Once the inklings of a downturn waft through the market, poor transparency makes it difficult for investors to distinguish between healthy and unhealthy firms.[40] Consequently, investors will abandon them all, causing bank runs, and ultimately—the destabilization of economies.[41]

A. *Prescribing Transparency for the "Resource Curse," the Extractive Industries Transparency Initiative, and the International Trend Towards Mandatory Reporting Standards*

While there is no simple cure for the "resource curse," based on the findings in *The Petroleum Paradox* report, transparency[42] is an essential tool to remedy the curse.[43] The purpose of Section 1504 of the Dodd-Frank Act is to "support the commitment of the Federal Government to international transparency promotion efforts relating to the commercial development of oil, natural gas, or minerals."[44] Greater transparency in the resource extraction industry would allow investors to make sound investments, reduce risk, and allow for greater stability in the financial markets.[45] The experience of the 2008 financial crisis[46] alerted legislators that it is crucial that investors have a more complete view of the value of their holdings.[47] Transparency allows for investors to forecast the potential financial implications of

37. *See* 156 CONG. REC. 8318 (2010).
38. *H.R. 6066*, *supra* note 35, at 31–32.
39. *Id.* at 29.
40. *See id.* at 34; *see also* BUGALA, *supra* note 30, at 2.
41. Tara Vishwanath & Daniel Kaufmann, *Toward Transparency: New Approaches and Their Application to Financial Markets*, 16 WORLD BANK RES. OBSERVER 41, 47 (2001).
42. Extractive industry transparency can be divided between payment transparency and expenditure transparency. Payment transparency is the disclosure of payments between companies to governments for the commercial development of oil, natural gas, and minerals. S. REP. NO. 110-49, at 12 (2008). Expenditure transparency is the disclosure of how the government in receivership manages the proceeds of these payments. *Id.*
43. *Id.*
44. 15 U.S.C. §78m(q) (2012).
45. BUGALA, *supra* note 30, at 1.
46. *See generally, Crash Course: The Origins of the Financial Crisis*, ECONOMIST, Sept. 7-13, 2013, at 74 (detailing the 2008 financial crisis).
47. *H.R. 6066*, *supra* note 35, at 29; *see* 156 CONG. REC. 8317 (2010).

disruptions in the commercial production of oil, natural gas, and minerals.[48] It should also be in the self-interest of resource-rich developing countries to promote extractive industry transparency.[49] Such efforts create a more favorable investment climate which can potentially lower the cost of market capital, increase eligibility for attractive financing from the World Bank, and diminish chances of civil unrest.[50] U.S. energy companies may also find it in their interest to press for global standards of transparency.[51] A level playing field in payment transparency between resource extraction companies and governments will allow U.S. energy companies to exploit their technical capabilities over foreign firms that resort to shadowy accounting or corrupt practices.[52]

The legislative history of Section 1504 of the Dodd-Frank Act exemplifies the growing concern over the resource curse, which has pressed advocacy efforts aimed at mitigating its negative consequences. The largest and most well-known international transparency effort is the Extractive Industries Transparency Initiative (EITI), which was launched in 2002 by ex-British Prime Minister Tony Blair, who sought to ground post-9/11 energy security in political stability and good governance.[53] EITI is financed, in part, by the Multi-Donor Trust Fund (MDTF) of the World Bank.[54] Members of EITI include governments, companies, civil society groups, investors, and international organizations.[55] The primary mechanism for implementing EITI is a voluntary agreement signed by a candidate country to abide by EITI principles and criteria, implement EITI goals, and work with civil society and private sector stakeholders to achieve those goals.[56] Core requirements for a candidate country government include appointing a credible and independent administrator, publishing information on all state revenues from the oil, gas, and mining sectors, and

48. *H.R. 6066*, *supra* note 35, at 27 (statement of Alan Detheridge, Retired Vice President for External Affairs at Royal Dutch Shell Group); *see* Vishwanath & Kaufmann, *supra* note 41, at 41.

49. Bugala, *supra* note 30, at 5.

50. *Id.* at 2.

51. S. Rep. No. 110-49, at 12-13 (2008).

52. *Id.* at 13.

53. Grant Aldonas, Split Rock Int'l, Inc., Analysis of Section 1504 of the Wall Street Reform and Consumer Protection Act 5 (2011), *available at* http://www.api.org /~/ media/Files/Policy/Congress/Analysis_Section_1504_paper.ashx.

54. S. Rep. No. 110-49, at 15.

55. *Id.* at 14.

56. *Id.*

establishing a multi-stakeholder group[57] to oversee timely and ongoing publication of such information.[58] Once a country has agreed to implement EITI requirements, the candidate country has two and a half years to fully implement all the requirements.[59] Currently there are twenty-five EITI compliant countries and fifteen EITI candidate countries.[60]

Since the advent of EITI, major stock exchanges have begun requiring listed resource extraction companies to report payments made to governments for the commercial development of extractive resources.[61] Also, reporting across international stock markets has shifted from solely country-by-country payment transparency to include a project-by-project disclosure of payments to governments as well.[62] Another trend amongst the major stock exchanges has been the introduction of ongoing reporting requirements of such payments as opposed to a one-time disclosure during listing application.[63]

In 2009, the Alternative Investment Market (AIM) of the London Stock Exchange (LSE) was the first exchange to require oil, gas, and mining companies to disclose payments made to governments on a country-by-country basis.[64] The LSE guidelines state that a company must disclose "any payments aggregating over £10,000 made to any government or regulatory authority or similar body made by the

57. The multi-stakeholder group is "a group made up of government, company, and civil society representatives that oversee the EITI implementation in a country." *The EITI Glossary*, EXTRACTIVE INDUS. TRANSPARENCY INITIATIVE, https://eiti.org/glossary#Multi-stakeholder_group.

58. S. REP. NO. 110-49, at 14.

59. EXTRACTIVE INDUS. TRANSPARENCY INITIATIVE INT'L SECRETARIAT, THE EITI STANDARD 35 (Sam Bartlett & Dyveke Rogan eds., 2013).

60. There are currently thirty-one EITI compliant countries and seventeen EITI candidate countries. EITI compliant countries include: Albania; Azerbaijan; Burkina Faso; Cameroon; Chad; Côte d'Ivoire; Democratic Republic of Congo; Ghana; Guatemala; Guinea; Indonesia; Iraq; Kazakhstan; Kyrgyz Republic; Liberia; Mali; Mauritania; Mongolia; Mozambique; Niger; Nigeria; Norway; Peru; Republic of the Congo; Sierra Leone; Tanzania; Timor-Leste; Togo; Yemen; and Zambia. EITI candidate countries include: Afghanistan; Colombia; Ethiopia; Honduras; Madagascar; Myanmar; Papua New Guinea; São Tomé and Príncipe; Senegal; Seychelles; Solomon Islands; Tajikistan; the Philippines; Trinidad and Tobago; Ukraine; the United Kingdom; and the United States of America. *EITI Countries*, EXTRACTIVE INDUS. TRANSPARENCY INITIATIVE, http://eiti.org/countries.

61. *See Disclosing Government Payments*, ERNST & YOUNG 1 (2013), *available at* http://www.ey.com/Publication/vwLUAssets/EY_-_Disclosing_government_payments_for_natural_resource_extraction/$FILE/EY-Disclosing-government-payments.pdf.

62. *Id.*

63. *Id.*

64. *Cf.* LONDON STOCK EXCH., AIM NOTE FOR MINING AND OIL & GAS COMPANIES 1, 4 (2009) (describing which companies fall under the perview of AIM and are required to oblige by ongoing responsibilities).

applicant or on its behalf with regards to the acquisition of, or maintenance of, its assets."[65] However, this disclosure requirement was limited to a single disclosure made during the listing application process.[66]

In 2010, the Hong Kong Stock Exchange (HKEx), with Chapter 18 of the HKEx Listing Rules, initiated new reporting standards for the listing process.[67] The HKEx requires any company with more than 25% of assets in natural resources to report country-by-country on tax, royalty, and other payments to host governments for exploration and extraction.[68] Similar to the LSE, HKEx's Chapter 18 rules only apply to companies applying for a listing and only require disclosure during the listing application process.[69] However, companies already listed would be required to make similar disclosures only if they were to conduct a major acquisition or exhaustion of mineral or petroleum assets equivalent to at least 25% of the company's total assets.[70] Since 2010, other stock exchanges have enacted ongoing reporting requirements that include country-by-country and project-by-project payments.[71]

On June 26, 2013, the European Parliament amended its Accounting Directive (2004/109/EC)[72] to require companies involved in the exploration, discovery, development, and extraction of oil, natural gas, minerals, and logging to publish, on an annual basis, full information on their payments to national governments on both a project-by-project and country by-country basis.[73] On the same day, Canada an-

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65. *See id.* at 4.

66. *See id.*

67. H.K. STOCK EXCH., RULES GOVERNING THE LISTING OF SECURITIES ON THE STOCK EXCHANGE OF HONG KONG LIMITED ch. 18, at 1 (2010); *see Hong Kong: Stock Exchange to Require Greater Transparency*, NAT. RESOURCE GOVERNANCE INST. (May 28, 2010), http://www.resourcegovernance.org/news/hong-kong-stock-exchange-require-greater-transparency.

68. *See* H.K. STOCK EXCH., *supra* note 67, ch. 18, at 3, 10.

69. *See id.* ch. 18, at 10.

70. *See id.* ch. 18, at 1-3, 13.

71. *See* Ian Gary, *Global Progress Continues on Oil, Mining Transparency Laws*, HILL (Nov. 2, 2014), http://thehill.com/blogs/congress-blog/energy-environment/222385-global-progress-continues-on-oil-mining-transparency.

72. Directive 2004/109, of the European Parliament and of the Council of 15 December 2004 on the Harmonisation of Transparency Requirements in Relation to Information About Issuers Whose Securities Are Admitted to Trading on a Regulated Market and Amending Directive 2001/34/EC, 2004 O.J. (L 390) 38.

73. Council Directive 2013/34, arts. 41-42, 2013 O.J. (L 182) 52. "The new Accounting Directive, repealing the Fourth and Seventh Accounting Directives on Annual and Consolidated Accounts (78/660/EEC and 83/349/EEC) introduces a new obligation for large extractive and logging companies to report the payments they make to governments (the so called country by country reporting-CBCR). Reporting would also be carried out on a project basis, where pay-

nounced that its federal government would institute national standardized reporting requirements for resource extraction companies.[74] These trends would not have been possible were it not for the experience of the 2008 Financial Crisis and the U.S.' leadership role in establishing ongoing reporting requirements through the ESTT.

B. The 2008 Financial Crisis and the Legislative Backdrop of Section 1504

With the onset of the 2008 Financial Crisis, payment transparency in the extractive industries became a major issue for the House Financial Services Committee and the Senate Banking, Housing, and Urban Affairs Committee.[75] Between May and July 2008, companion versions of the Extractive Industry Transparency in Disclosure Act (EITD), H.R. 6066, and S. 3389, were introduced in the House and Senate by Representative Barney Frank and Senator Chuck Schumer.[76] EITD proposed that the SEC modify its rules to require each resource extraction issuer to file an annual report with the SEC disclosing the total amounts, country-by-country and payment-by-payment, for any and all payments made, directly or indirectly, by the issuer or any of its subsidiaries, to an agency or instrumentality of a foreign government.[77]

EITD's supporters have found that payment transparency in the resource extraction industry furthers the U.S.' interests of promoting better investment climates, more stable commodity supply, and greater energy security.[78] In its findings section, EITD sought to remedy the resource curse by payment transparency, benefitting share-

ments have been attributed to specific projects. The Accounting Directive regulates the information provided in the financial statements of all limited liability companies which are registered in the European Economic Area (EEA)." Memorandum from the Eur. Comm'n on New Disclosure Requirements for the Extractive Industry and Loggers of Primary Forests in the Accounting (and Transparency) Directives (Country by Country Reporting) 1 (June 12, 2013).

74. *See Transparency and Accountability in the Canadian Extractive Sector*, PRIME MINISTER CAN. (June 12, 2013), http://pm.gc.ca/eng/news/2013/06/12/transparency-and-accountability-canadian-extractive-sector. While no details have been released yet, the provision is squarely aimed at preventing duplicative reporting requirements. It is likely the disclosures will require project-by-project and country-by-country reporting to reduce duplication and avoid conflicting reporting requirements between jurisdictions, seeking where possible equivalency with other jurisdictions. THE RESOURCE REVENUE TRANSPARENCY WORKING GROUP, BACKGROUND TO RECOMMENDATIONS ON MANDATORY DISCLOSURE OF PAYMENTS FROM CANADIAN MINING COMPANIES TO GOVERNMENTS 3 (2013).

75. *H.R. 6066, supra* note 35, at 1 (statement of Committee Chairman Barney Frank).

76. *Legislative History, supra* note 12.

77. H.R. 6066, 110th Cong. § 3(a) (2008); S. 3389, 110th Cong. § 3(a) (2008).

78. H.R. 6066 § 2(5); S. 3389 § 2(5).

holders, the citizens of foreign resource rich countries, and improving the business climate of resource extraction through good governance and corporate accountability.[79] Neither of these bills passed, but S. 3389 would gain traction in the Senate Foreign Relations Committee and Judiciary Committee under the respective leadership of Senators Ben Cardin and Richard Lugar.[80] In September 2008, these committees held a series of hearings[81] that culminated in the staff report, *The Petroleum and Poverty Paradox: Assessing U.S. and International Community Efforts to Fight the Resource Curse.*[82] This report resulted in the introduction of Energy Security Through Transparency Act (ESTT).[83] Although the ESTT died in the Senate Banking, Housing, and Urban Affairs Committee,[84] Section 6 of the ESTT would be resurrected in the House version of the Dodd-Frank Wall Street Reform and Consumer Protection Act of 2009 (H.R. 4173) as Section 1504.[85] The conference committee report on the Dodd-Frank Act maintained the practicality limitation on the final rules to be promulgated by the SEC.[86] On July 15, 2010, Congress passed the Dodd-Frank Wall Street Reform and Consumer Protection Act, including Section 1504 on *Disclosure of Payments by Resource Extraction Issuers* that Senators Cardin and Lugar had co-authored.[87]

III. *API v. SEC*: The Road to Vacatur Is Paved With Good Intentions

The SEC received 150 comment letters, 149,000 form letters, and 143,000 petitions from resource extraction corporations, professional associations, non-governmental organizations, law firms, investors, academics, labor unions, employee groups, and domestic and govern-

79. H.R. 6066 § 2(2)-(4); S. 3389 § 2(2)-(4).

80. 156 Cong. Rec. 8319 (2010) (statement of Sen. Christopher Dodd).

81. *Extracting Natural Resources: Corporate Responsibility and the Rule of Law: Hearing Before the Subcomm. on Human Rights and the Law of the Comm. on the Judiciary*, 110th Cong. (2008); *Resource Curse or Blessing? Africa's Management of its Extractive Industries: Hearing Before the Subcomm. on African Affairs of the Comm. on Foreign Relations*, 110th Cong. (2008); 156 Cong. Rec. 8316.

82. S. Rep. No. 110-49, at 14 (2008).

83. S. 1700, 111th Cong. § 1 (2009).

84. *Id.* § 6.

85. H.R. 4173, 111th Cong. § 1504, 124 Stat. 2220 (2010). The Senate version of the bill, the Restoring American Financial Stability Act of 2012 introduced by Senator Chris Dodd did not include Section 1504. *See* S. 3217, 111th Cong. (2010).

86. H.R. Rep. No. 111-517, at 856, 858 (2010) (Conf. Rep.).

87. On July 21, 2010, President Obama signed Dodd-Frank into law, giving the SEC 270 days from the law's enactment to issue practicable, final rules. Dodd-Frank Wall Street Reform and Consumer Protection Act, 15 U.S.C. § 78m(q) (2012).

ment officials concerning Section 1504 of the Dodd-Frank Act.[88] On September 12, 2012, the SEC published its final rules on the *Disclosure of Payments by Resource Extraction Issuers*.[89] The new disclosure requirements would apply to all U.S. and foreign commercial developers of oil, natural gas, and minerals required to file annual reports with the SEC regardless of size, extent of operations within commercial development, or private or government ownership.[90] The final rules did not provide for any exemptions from disclosure requirements for home country laws, listing rules, EITI programs, foreign law prohibitions, or confidentiality provisions in existing or future contracts, or for commercially or competitively sensitive information.[91]

The SEC believed that its mandate was to go beyond EITI and establish a new transparency standard as mandated by Congress.[92] The SEC further argued that it was acting consistently within Section 1504 because the EITI is referenced in the Act and is well recognized for promoting such transparency.[93] The SEC argued that providing exemptions for situations in which foreign laws prohibit payment disclosures would be inconsistent with its congressional mandate and would undermine the statute by encouraging foreign governments to adopt laws or interpret existing laws to specially prohibit the disclosure required under its final rules.[94] Similarly, the SEC argued that allowing exemptions for confidentiality provisions would frustrate the purpose of the ESTT by allowing foreign governments and resource extraction companies to simply contract around the disclosure requirements.[95] The SEC consistently concluded that any exemptions to mandatory disclosure would undermine the legislative intent of Section 1504 and Congress.[96] The SEC's mantra concerning its discretionary authority was one of limited flexibility, stating that "[o]ur [d]iscretionary authority to implement Section 13(q) [of the Exchange Act as Section 1504 of the Dodd-Frank Acts] is limited, we are committed to executing the Congressional mandate."[97]

88. Disclosure of Payments by Resource Extraction Issuers, 77 Fed. Reg. 56,365, 56,367 (Sept. 12, 2012) (to be codified at 17 C.F.R. pts. 240, 249).

89. *Id.* at 56,365.

90. *Id.* at 56,367.

91. *Id.* at 56,368.

92. *Id.* at 56,367.

93. *Id.*

94. *Id.* at 56,372–73.

95. *Id.* at 56,373.

96. *Id.* at 56,368.

97. *Id.* at 56,398.

The American Petroleum Institute (API), a petroleum industry trade organization, brought suit against the SEC following the publication of the final rules.[98] Amongst the plethora of arguments by the plaintiffs, the district court found two errors requiring two independent grounds for *vacatur* of the final rules.[99] One was the "arbitrary and capricious" economic rationale underlying the SEC's decision to deny exemptions to resource extraction issuers operating in host countries that prohibit such disclosure.[100] The SEC's conclusions, based upon the economic analysis provided in the administrative record, did not meet the standard of judicial review of agency action applied by the courts.[101]

A. *The SEC's Hurdle in the D.C. Circuit: "Arbitrary and Capricious" Standard of Judicial Review of Agency Rulemaking*

Judicial review for administrative agency rulemaking is centered around Section 706 of the Administrative Procedures Act (APA).[102] Substantively, agency rulemaking involves a factual determination on the basis of a record created by the agency's procedure, statutory standards, and policy judgments about how best to apply those standards to the facts in the formation of regulations.[103] Courts focus on the reasons the agencies provide, "which must explain how the agency viewed the facts in light of the record, what the agency understood the statutory standards to mean, and why the agency thought that the statute, as applied to the facts, supported its decision."[104] In general, judicial review of agency rulemaking is concerned with whether the agency's reasoning provides a sufficient explanation for why application of the statute to the facts supports the agency decisions.[105]

The most common standard for challenging the validity of an agency's rule is through the "arbitrary and capricious" review standard.[106] When a court reviews an agency's decision-making under the APA, the reviewing court shall "hold unlawful and set aside agency

98. Am. Petroleum Inst. v. SEC, 953 F. Supp. 2d 5 (D.D.C. 2013).

99. *Id.* at 11.

100. *Id.*

101. *Id.*

102. 5 U.S.C. § 706 (2013).

103. ROBERT L. GLICKSMAN & RICHARD E. LEVY, ADMINISTRATIVE LAW: AGENCY IN ACTION IN LEGAL CONTEXT 149 (Foundation Press, 1st ed. 2010).

104. *Id.* at 150.

105. *Id.* at 151.

106. Lawrence D. Rosenberg & Richard M. Re, *Basic Legal Doctrines Frequently Arising in the D.C. Circuit,* AMERICAN BAR ASSOC. (2012), *available at* http://www.americanbar.org/

action, findings and conclusions found to be arbitrary and capricious, an abuse of discretion, or otherwise not in accordance with the law."[107] While the scope of review under the arbitrary and capricious standard is narrow and highly deferential to agency expertise, agency actions are judged on whether there is a rational decision based upon "relevant factors" which Congress intended it to be, or if there existed a clear error of judgment.[108] While the agency enjoys a "presumption of regularity,"[109] the agency has the burden of producing an administrative record that provides a satisfactory explanation based upon a rational connection between the data within the record and the decision under review.[110]

A decision is arbitrary and capricious if it relies on factors that run contrary to the intentions of Congress or the evidence before the agency, or is so implausible that it could not be ascribed to a product of agency expertise.[111] Lower courts often apply a "hard look" review of agency decision-making on the record through a four-part inquiry established by the Supreme Court in *Motor Vehicle Mfrs. Ass'n v. State Farm Mut. Auto. Ins. Co.*[112] The *State Farm* inquiry demands reversal of an agency's action if:

> (1) the agency relied on improper factors; (2) the agency failed to consider an important aspect of the problem; (3) the agency's explanation is counter to the evidence in the record; or (4) the agency's explanation is so implausible that it cannot be ascribed to a difference in view or agency expertise.[113]

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groups/ litigation/committees/appellate/materials.html. Further, a LexisNexis search of the words "arbitrary and capricious" in the D.C. Circuit alone yielded over 2,046 cases.

107. 5 U.S.C. § 706(2) (2013).

108. Citizens to Pres. Overton Park, Inc. v. Volpe, 401 U.S. 402, 416 (1971) (holding that while the Secretary of Transportation's decision was "entitled to a presumption of regularity," the presumption is not shielded from "a thorough, probing, in-depth review."). *Overton Park* is the most significant case on the "arbitrary and capricious" review standard.

109. *Id.* at 415.

110. Motor Vehicle Mfrs. Ass'n of U.S., Inc. v. State Farm Mut. Auto. Ins. Co., 463 U.S. 29, 43 (1983).

111. *Id.*

112. *Id.*; *see* Citizens to Pres. Overton Park v. Volpe, 401 U.S. 402 (demonstrating a "hard look" review); *see also* Balt. Gas and Elec. Co. v. Natural Res. Def. Council, Inc., 462 U.S. 87, 105 (1983).

113. *State Farm*, 463 U.S. at 55 (holding that the National High Traffic and Safety Administration's (NHTSA) recession of a passive restraint safety standard for new automobiles was "arbitrary and capricious" due to failure to provide clear and convincing reasons for its actions abandoning the system solely on the basis of cost and not the preeminent factor under the organic act of Congress—safety); *see also* Pub. Citizen v. Fed. Motor Carrier Safety Admin., 374 F.3d 1209, 1211 (D.C.C. 2004) (holding Federal Motor Carrier Safety Administration's (FMCSA) decision to revise regulations limiting the hours of driving and work of commercial vehicle operators "arbitrary and capricious" because the agency failed to consider the impact of

When D.C. Circuit[114] courts review SEC rulemaking, "the courts read the statutory provisions of the National Securities Market Improvement Act of 1996 and the Gramm-Leach-Bliley Act of 1999, together with the Administrative Procedure Act (APA)."[115] The D.C. Circuit's judicial review of the Commission's rulemaking, to be in accordance with the law, uses a composite of these provisions. These provisions amend the embodying acts[116] of the SEC to require the Commission to consider efficiency, competition, and capital formation whenever it is "engaged in rulemaking and is required to consider or determine whether an action is necessary or appropriate in the public interest."[117] Additionally, the Commission must consider the impact on competition of any rule promulgated under the Exchange Act.[118] To this end, the Commission must include in the rule's statement of basis and purpose why any burden on competition is necessary in furtherance of the purposes of the Exchange Act.[119] The promotion of efficiency, competition, and capital formation have become the factors of consideration necessary for the court to appraise the Commission's rulemaking under its statutory obligation to determine, as best as it can, the economic implications of its proposed course of regulatory action.[120]

The precedent cited in *API*'s finding of arbitrary and capricious decision-making begins with *Chamber of Commerce v. SEC* (*Chamber I*).[121] In *Chamber I*, the Plaintiffs argued, in part, that the Commis-

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the rules, the primary factor of consideration mandated by congress, and the health of drivers). In both *State Farm* and *Public Citizen*, the cost benefit analysis proffered by the agencies failed to consider factors implicit in the Congressional action that created the agency's jurisdiction over the industry. For *Public Citizen*, the mistakenly unconsidered factor was the health of the driver. *Id.* In *State Farm*, the mistakenly unconsidered factor was safety of the driver. *State Farm*, 463 U.S. at 54.

114. Richard J. Pierce, Jr., *The Relationship Between the District of Columbia Circuit and Its Critics*, 67 GEO. WASH. L. REV. 797, 797 (1999) (stating the D.C. Circuit is the highest court of administrative law and "second only to the U.S. Supreme Court").

115. Memorandum from SEC's Div. of Risk, Strategy and Fin. Innovation and Office of Gen. Counsel, to Staff of the Rulewriting Divs. and Offices (Mar. 16, 2012) *available at* http://www.sec.gov/division/riskfin/rsfi_guidance_econ_analy_secrulemaking.pdf [hereinafter RSFI/OGC Memorandum].

116. These acts include the Securities Act of the 1933, the Securities Exchange Act of 1934, the Trust Indenture Act of 1939, and their respective amendments.

117. 15 U.S.C. § 77b(b) (2012).

118. RSFI/OGC Memorandum, *supra* note 115, at 3.

119. *Id.*

120. Business Roundtable v. SEC, 647 F.3d 1144, 1148 (D.C.C. 2011) (citing Chamber of Commerce v. SEC, 412 F.3d 133, 143 (D.C.C. 2005)).

121. James D. Cox & Benjamin J.C. Baucom, *The Emperor Has No Clothes: Confronting the D.C. Circuit's Usurpation of SEC Rulemaking Authority*, 90 TEX. L. REV. 1811, 1816 (2012).

sion's rule did not adhere to the requirements of the APA because the SEC: (1) failed to justify the abuses that prompted the rulemaking and the new conditions; (2) did not consider whether those conditions "will promote efficiency, competition and capital formation"; and (3) did not consider reasonable alternatives to its chosen rule.[122] The D.C. Circuit Court of Appeals found the SEC violated the APA by failing to adequately consider the costs and alternatives proposed during public comment.[123] The court held that while the SEC adequately justified its rules as "precautionary or prophylactic responses to perceived risks," the SEC failed to consider costs and alternatives to its final rules.[124] Uncertainty in quantifying potential costs did not excuse the SEC of appraising the economic consequences of its final rules.[125] While the SEC did not need to develop new empirical data to consider the impact of its rules, the SEC must estimate costs of the uncertain conditions it was imposing on efficiency, competition, and capital formation.[126] Additionally, while the SEC is not required to consider every conceivable or frivolous alternative, the Court of Appeals declared that the Commission must use just as much expertise in its evaluation of its action as the in the formulation of the action itself.[127]

This evaluative rulemaking standard requires the agency to consider sensible alternatives (including the status quo) and proposed action against the evaluative criteria of efficiency, competition, and capital formation.[128] On July 22, 2011, in *Business Roundtable,*[129] the D.C. Circuit applied the arbitrary and capricious standard of review for the first time to SEC rules promulgated under Dodd-Frank.[130] In *Business Roundtable*, the SEC published a rule requiring public companies to provide shareholders with information about—and their ability to vote for—shareholder nominated candidates for the board

122. Chamber of Commerce of the United States v. SEC, 412 F.3d 133, 140 (D.C.C. 2005) (citing 15 U.S.C. §80a-2(c)).

123. *Id.* at 145.

124. *Id.* at 141, 144-45.

125. *Id.* at 143.

126. *Id.* at 144 ("And, as we have just seen, uncertainty may limit what the Commission can do, but it does not excuse the Commission from its statutory obligation to do what it can to appraise itself—and hence the public and the Congress—of the economic consequences of a proposed regulation before the SEC decides whether to adopt the measure.").

127. *Id.* at 145.

128. Business Roundtable v. SEC, 647 F.3d 1144, 1148 (D.C.C. 2011) (finding that the Commission had failed "adequately to assess the economic effects of a new rule").

129. *See generally id.*

130. *See id.* at 1148.

of directors.[131] In discussing the SEC's failure to adequately consider the economic consequences of its rule, the court found that the SEC relied on insufficient empirical data to cite benefits, improperly discounted costs, and failed to respond to comments adequately.[132] The SEC's decision-making was arbitrary and capricious because it failed to assess the potential economic impact[133] of the proposed rule, as well as reasonable alternatives by considering the best available evidence of the quantitative and qualitative costs and benefits of each.[134]

The demand of producing a justifiable approach within the administrative record incentivizes stakeholders to submit information, arguments, and alternatives to the agency to establish a basis in the record for a potential appeal.[135] As directed by Section 706 of the APA, reviewing courts test the administrative record.[136] If the SEC fails to evaluate its proposed rule and reasonable alternatives (raised by stakeholders during public comment) against the criteria of market efficiency, competition, capital formation, and benefit to the investing public, then the SEC has breached its statutory duty in making a reasoned determination that adopting a rule is in the public interest.[137] Synthesizing the holdings of *Business Roundtable* and *Chamber I*, it is clear that the administrative record cited by the Commission must identify and evaluate reasonable alternatives to the proposed regulatory approach.[138] Then the Commission must justify its proposed regulatory approach after assessing the potential economic impact[139] of the proposed rule and reasonable alternatives[140] by citing in the re-

131. As in *Chamber I*, the D.C. Circuit held vacated the rule because the Commission failed to meet the "arbitrary and capricious" standard of review by not adequately considering the rule's effect upon efficiency, competition and capital formation, as required by the Exchange Act. *Id.* at 1146 (citing 15 U.S.C. §78c(f) and 15 U.S.C. §80a-2(c)).

132. "By ducking serious evaluation of the costs that could be imposed upon companies from use of the rule . . . we think the Commission acted arbitrarily. . . . [However,] [t]he Commission did not completely ignore these potential costs, but neither did it adequately address them." Business Roundtable, 647 F.3d at 1152.

133. The impact on the relevant factors of benefit to investors, efficiency, competition and capital formation. *Id.* at 1148.

134. RSFI/OGC Memorandum, *supra* note 115, at 1-2.

135. GLICKSMAN & LEVY, *supra* note 103, at 149.

136. *Id.* at 242.

137. "It ensures that decisions to propose and adopt rules are informed by the best available information about a rule's likely economic consequences, and allows the Commission to meaningfully compare the proposed action with reasonable alternatives, including the alternative of not adopting a rule." RSFI/OGC Memorandum, *supra* note 115, at 1.

138. Chamber of Commerce v. SEC, 412 F.3d 133, 144-45 (D.C.C. 2005).

139. The impact on the relevant factors of benefit to investors, efficiency, competition and capital formation. RSFI/OGC Memorandum, *supra* note 115, at 1-2.

140. Including the alternative of not adopting a rule. *Id.*

cord evidence of the costs and benefits of each.[141] Failure to weigh proposed alternatives against the proposed rule will result in *vacatur*.[142]

B. The SEC's Economic Analysis Behind the Final Rules

While the SEC is often authorized to promulgate rules where costs and benefits are speculative, Section 1504 of the Dodd Frank Act intends a social benefit that differs from the investor protection benefits the SEC rules typically strive to achieve.[143] This delegation to the SEC to promulgate rules pursuant to Section 1504—with adequate economic analysis—is a difficult proposition, especially after *Chambers I* and *Business Roundtable.* Given the high-bar of economic analysis set in the D.C. Circuit after *Business Roundtable*, the SEC's actual economic analysis was lackluster.

The SEC's economic analysis published in its rule release clearly laid out its statutory obligation to consider, in addition to the protection of investors, the necessity to the public interest and promoting efficiency competition and capital formation.[144] However, the SEC's analytical approach was to bring about payment transparency regardless of the burden to competition.[145] In its consideration of the rules' impact on efficiency, competition, and capital formation, the SEC conducted a cost-benefit analysis of the impact of the proposed final rule. The costs were easily quantifiable and staggeringly high.[146] On the other hand, benefits stemming from the intended outcomes of SEC's final rules were attenuated.[147] The benefits from mandatory disclosure on a country-by-country and project-by-project basis would provide

141. *See* Business Roundtable v. SEC, 647 F.3d 1144, 1149 (D.C.C. 2011).

142. Am. Petroleum Inst. v. SEC, 953 F. Supp. 2d 5, 24 (D.D.C. 2013).

143. Accountability of governments to their citizens in resource-rich countries for the wealth generated by those resources. Disclosure of Payments by Resource Extraction Issuers, 77 Fed. Reg. 56,365, 56,402 (Sept. 12, 2012) (to be codified at 17 C.F.R. pt. 240, 249).

144. *Id.* at 56, 397.

145. "[W]e recognize that the rules will impose a burden on competition, but we believe that any such burden that may result is necessary in furtherance of the purposes of Exchange Act Section 13(q)." *Id.* at 56,398.

146. The SEC believes it is likely that the total initial cost of compliance for all issuers is approximately $1 billion and the ongoing cost of compliance is between $200 million and $400 million. *See id.* at 56,398. Comments from API and ExxonMobil cited in the SEC's publication of the final rules stated that tens of millions of dollars for large issuers and millions of dollars for many small issuers. *Id.* at n. 532.

147. The SEC stated that the rules would increase the accountability of governments to their citizens in resource-rich countries for the wealth generated by those resources, thereby, promoting accountability, stability, and good governance. *Id.* at 56,398. The SEC notes that while the objectives of Section 13(q) do not appear to be ones that will necessarily generate measurable, direct economic benefits to investors or issuers, investors have stated that the disclosures re-

greater accuracy of published information that benefits citizens and investors.[148] This would reduce information asymmetry and provide more security and certainty to investors as to extractive companies' level of risk exposure.[149] Capital costs and risk premiums would decline as a result of improved stability stemming from the statutory requirements.[150]

With respect to competitive effects, the SEC recognized that the statute could be economically adverse to issuers that have reporting obligations under Section 1504.[151] These issuers could be placed at a competitive disadvantage with respect to private and foreign companies that are not subject to the reporting requirements of the U.S. federal securities laws and therefore not under such an obligation.[152] However, this burden would be alleviated to the extent that other jurisdictions, such as the European Union, adopt laws to require disclosure similar to Section 1504 and related rules.[153] A burden that would not be as assuaged would be one borne by foreign countries which institute non-disclosure laws. Issuers operating in these countries could bear substantial costs because issuers may have to choose between ceasing operations in certain countries or breaching local law.[154] Industry commentators noted that Angola, Cameroon, China, and Qatar have such laws, and U.S. companies like ExxonMobil could stand to lose hundreds of millions of dollars.[155] At the same time, transparency advocacy groups and even some industry experts noted that such a doomsday scenario was speculative.[156] However, the SEC noted that it was certainly plausible for a foreign private issuer operating or domiciled in a country that prohibits disclosure of covered payments to face significant costs that may result in a decision to delist and cease reporting.[157] The consequences for delisting would be even

quired by Section 13(q) have value to investors and can "materially and substantially improve investment decision-making." *Id.*

148. *Id.* at 56,403.

149. *Id.*

150. *Id.*

151. *Id.* at 56,402.

152. *Id.*

153. If both the U.S. and EU implement disclosure requirements regarding payments to governments "around 90% of the world's extractive companies will be covered by the Rules." *Id.* at n. 570.

154. *Id.* at 56,402.

155. *Id.* at 56,399.

156. *Id.* at 56,402.

157. But, this would cost issuers capital and future earnings. *Id.* at 56,403.

more adverse for shareholders—who could lose up to tens of billions of dollars in investments—should issuers delist.[158]

With such burdens on cost and competition, it would seem clear that in following *Chamber I* and *Business Roundtable* the SEC would weigh the costs and benefits of the final rules against alternatives, including the status quo, before foreclosing on the possibility of exemptions. However, the publication of the final rules did no such thing. The SEC stated that it considered alternatives to the approach adopted in the final rules, including providing certain exemptions from the disclosure requirements mandated by Section 1504.[159] But it concluded that adopting any of the alternatives would be inconsistent with Section 1504 and would undermine Congress's intent to promote international transparency efforts.[160] To the contrary, the SEC proposed steps the industry could undertake to mitigate its losses rather than elaborating on alternatives the Commission could have implemented to ease the burden on competition, market efficiency, and capital formation.[161]

C. *Applying the "Arbitrary and Capricious" Standard of Review to the SEC's Final Rules*

The SEC once again dug its own grave in light of the arbitrary and capricious standard of judicial review. While Congress intended Section 1504 to increase accountability of foreign governments to their citizens in resource-rich countries, the Legislature had given the SEC discretion to design "practicable" rules in accordance with Section 1504(2)(E).[162] The SEC failed to meet its statutory obligations both within Section 1504 and the broader Exchange Act in two ways.

First, the SEC's view of international transparency at all costs, regardless of exemptive authority, ran contrary to the enabling act's emphasis on practicality.[163] By creating a blanket prohibition on exemptions for foreign laws in conflict with disclosure, the SEC had not

158. *Id.* at 56,402.

159. *Id.*

160. *Id.*

161. The SEC recognized that host country laws that prohibit the type of disclosure required under the final rules could be very costly, but stated that potential loss to issuers could be mitigated by the presence of other similar opportunities or third parties willing to buy the assets at fair market values in Angola, Cameroon, China, and Qatar. *Id.* at 56,403.

162. 15 U.S.C. § 78m (2012).

163. *Id.*

considered the burden on competition to make the exemptions unwarranted.[164]

Second, the SEC failed to weigh the alternatives to mandatory reporting requirements for affected issuers operating in Angola, Cameroon, China, and Qatar after commentators had expressed concern about potential losses of billions of dollars.[165] It was relevant to the court's holding that the SEC did not consider whether a certain country or certain issuer represents a high portion of the burden on competition to make an exemption unwarranted.[166]

The SEC's counterargument—that any exemptions would create a perverse effect where foreign governments would adopt laws or interpret existing laws to prohibit disclosures under the final rules—did not further its position because, as the district court found, the SEC did not explore alternatives on the record before reaching that conclusion.[167] Specifically, the SEC did not explore alternatives that would allow exemptions and mitigate the perverse effect.[168] The district court went further to castigate the SEC for its lackluster exemption analysis resulting in an arbitrary and capricious rule that formed an independent ground for invalidation: "Averse to sacrificing any aims no matter the cost, the Commission abdicated its statutory responsibility to investors."[169] While the District Court conceded that a broadly written exemption would "eviscerate" Section 1504 by allowing any country to avoid disclosure by enacting a disclosure-barring law, the court correctly enforced the SEC's statutory obligation to provide a more robust economic analysis of its final rules before denying exemptions for host country laws across the board.[170]

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164. Am. Petroleum Inst. v. SEC, 953 F. Supp. 2d 5, 22 (D.D.C. 2013).

165. The Commission concluded that "'commentators' concerns that the impact of such host country laws could add billions of dollars of costs to affected issuers, and hence have a significant impact on their profitability and competitive position, appear warranted'" Id. at 21 (citing 77 Fed. Reg. at 56,412 (Sept. 12, 2012)).

166. *Id.* at 22.

167. *Id.* at 23.

168. *Id.*

169. A general statement about incentive problems with a broad version of the exemption (not considering alternatives) does not satisfy the requirement of reasoned decision-making when, by the Commission's own estimates, billions of dollars are on the line. The Commission undertook no such specific analysis, instead focusing heavily on the apparent statutory purpose—a purpose it conceived more broadly than the statutory text that emphasizes practicability. *Id.*

170. *Id.* at 22.

IV. EXPLORING PRACTICABLE ALTERNATIVES IN THE PETROLEUM PARADOX

While the EITD was the first legislative effort by the House to introduce mandatory payment transparency, it was the ESTT that made Section 1504 of the Dodd-Frank Act the law of the land.[171] The ESTT specifies the Congressional duties "Relating to Transparency for Extractive Industries."[172] This section highlights the importance of Congress to assist the Executive work with G8 and G20[173] to establish U.S. global leadership in multilateral, pro-transparency efforts in the extractive industries by enrolling the U.S. in the EITI and supporting the EITI in revenue collection, budgeting, expenditure, and wealth management.[174] Section 6 of the ESTT also introduces "practicability" into the language of the statute that echoes the SEC's statutory obligations to appraise alternatives.[175]

If "practicability" includes the factors of market efficiency, burden on competition, and cost, then establishing mandatory reporting requirements should ideally minimize industry burdens while maximizing the accuracy of reporting. In *API*, the court made it clear that the SEC had discretion to grant exemptions and should undertake a thorough review of alternatives to a blanket prohibition on them.[176] The SEC should follow the recommendations of the *Petroleum Paradox* report as the remedy that Congress sought. The report recommends establishing multilateral reporting requirements that seek to extend the reach of EITI.[177] When the SEC publishes its next set of rules, the SEC should include economic analysis of the benefits and costs of alternatives to the mandatory reporting requirements. The alternatives to be explored should minimize industry burdens by incen-

171. It also delegated to the SEC the authority to require mandatory payment transparency. S. 1700, 111th Cong. § 3 (2009).

172. *See id.*

173. The G8 is comprised of financial ministers from Canada, France, Germany, Italy, Japan, Russia, the United Kingdom, and the United States. The G20 is comprised of financial ministers and central bank governors from Argentina, Australia, Brazil, Canada, China, France, Germany, India, Indonesia, Italy, Japan, Mexico, Russia, Saudi Arabia, South Africa, South Korea, Turkey, the United Kingdom, the United States, and the EU. European Commission, G7/G8, G20 (Jan. 20, 2012), *available at* http://ec.europa.eu/economy_finance/international/forums/g7_g8_g20/index_en.htm.

174. S. 1700 §§ 3(2)(A), 4-5.

175. "International Transparency Efforts – 'To the extent practicable, the rules issued under subparagraph (A) shall support the commitment of the United States Government to international transparency promotion efforts relating to the commercial development of oil, natural gas, or minerals.'" *Id.* § 6(2)(B).

176. Am. Petroleum Inst., 953 F. Supp. at 23.

177. S. REP. NO. 110-49, at 8 (2008).

tivizing the resource extraction industry to make the disclosures required by Section 1504 voluntarily.

Currently, the SEC is not obligated to follow the guidelines of regulatory economic analysis used by executive agencies; however, Executive Order 12866 and the Office of Management and Budget's Circular A-4 provides alternative guidance for regulatory economic analysis.[178] Following these guidelines, a future rule release should identify and discuss reasonable potential alternatives (like the ones mentioned below), and analyze the likely consequences of the proposed rule and alternative regulatory approaches.[179] Both country-specific exemptions and voluntary disclosure exemptions should be explored by the Commission as rulewriting staff work with economists from the Division of Economic Risk Analysis (DERA).[180]

A. *Country-Specific Exemptions*

The Commission is required to consider *reasonable* alternatives proffered during public comment.[181] One "practicable" alternative suggested by the court in *API* was for the SEC to target exemptions to resource extraction issuers operating in China and Qatar because they are not the focus of Section 1504.[182] The court explicitly suggested some "grandfathering in" for China and Qatar.[183] Following this logic, the SEC could develop a yardstick to appraise which countries are sufficiently free of the "resource curse" and exempt those issuers from mandatory reporting requirements. According to the Senate *Petroleum Paradox* report, out of the four problem countries,[184] Angola is the most in need of payment transparency initiatives.[185]

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178. *See generally* Exec. Order No. 12866, 58 Fed. Reg. 190 (Oct. 4, 1993); OFFICE OF MGMT. & BUDGET, *Circular A-4*, (Sept. 17, 2013), *available at* http://www.whitehouse.gov/omb/circulars_a004_a-4.

179. *See* RSFI/OGC Memorandum, *supra* note 115, at 1-2.

180. *About Division of Economic and Risk Analysis*, SEC, http://www.sec.gov/dera/Article/about.html#.VMrd6WjF-Sr (last modified Sept. 15, 2014).

181. Chamber of Commerce v. SEC, 412 F.3d 133, 145 (citing Laclede Gas Co. v. FERC, 873 F.2d 1494, 498 (D.C.C. 1989)).

182. For instance, "it is unlikely that China and Qatar, hardly poor countries, are victims of the resource curse. Vast costs associated with these countries (or the even absent certainty as to their law, a high indicator of vast costs) could then provide reason for an exception." Am. Petroleum Inst. v. SEC, 953 F. Supp. 2d 5, 22 n.8 (D.D.C. 2013).

183. *See id.* at 23.

184. The countries are Angola, Cameroon, China, and Qatar.

185. While Angola has been the top oil producer in sub-Saharan Africa since 1960 and the fastest growing African economy since 2005, Angola suffers from high inflation ("Dutch Disease"), high infant mortality, and short life expectancy. *See* S. REP. NO. 110-49, at 28-29 (2008).

Building on an economic metric like the Human Development Index (HDI),[186] the SEC could strictly target resource extraction issuers operating in economically poor, resource rich countries in need of anti-corruption interventions. However, applying such a metric to a country like Cameroon is problematic because on October 17, 2013, Cameroon was designated as EITI compliant.[187] In fact, Cameroon's economic prosperity is not even close to that of China or Qatar such that it would qualify for an exemption based solely on its HDI score. However, resource extraction issuers operating in Cameroon are already working with the national government to produce material disclosures in line with Section 1504.[188] In light of such circumstances, Section 1504's mandatory reporting requirement has the potential to be used to incentivize greater EITI enrollment and compliance should the Commission find (and produce on the record) that allowing for exemptions for voluntary disclosure programs, like EITI, promote efficiency, competition, and capital formation.

B. *Multilateral Exemptions*

The SEC's final rules recognized that there were some incongruities between the EITI's reporting requirements and Section 1504. However, the agency was explicit that it would not allow for any reporting exemptions for resource extraction issuers making payments to foreign governments that are currently EITI compliant.[189] The SEC's final rules were well intended, but the results were far from the legislative intent. As mentioned above, the legislative intent is mentioned by the authors of the ESTT citing the findings in the Senate *Petroleum Paradox* report, which was the target of the statute's remedy.[190] Rather than utilizing the SEC's unilateral approach, the report is replete with arguments for augmenting existing multilateral transparency initiatives.[191] Senate staff recommended legislative support for a mandatory financial reporting requirement on a multilateral basis by directing the SEC to harmonize these reporting requirements

186. A composite statistic of life expectancy, education, and income indices used to rank countries. United Nations Dev. Programme, *Human Development Index*, UNDP, http://hdr.undp .org/en/content/human-development-index-hdi (last visited Jan. 29, 2015).

187. *See* Extractive Indus. Transparency Initiative Int'l Secretariat, *Cameroon Accepted as EITI Compliant*, EXTRACTIVE INDUS. TRANSPARENCY INITIATIVE, (Oct. 17, 2013, 5:53 PM), http://eiti. org/news/cameroon-accepted-eiti-compliant.

188. *Id.*

189. *See* Disclosure of Payments by Resource Extraction Issuers, 77 Fed. Reg. 56,365, 56,402 (Sept. 12, 2012) (to be codified at 17 C.F.R. pt. 240, 249).

190. *See* 156 CONG. REC. 8,294, 8,319 (2010) (Statement of Sen. Dodd).

191. S. REP. NO. 110-49, at 6 (2008).

among major global stock exchanges through the International Organization of Securities Commission.[192] Senate staff concluded that establishing mandatory reporting requirements on a multilateral basis would be preferable to the U.S. doing so unilaterally, provided it is clear the SEC would not undermine EITI.[193] The purpose of the recommendation was to strengthen the EITI and not place U.S. firms at a competitive disadvantage.[194]

The legislative history of Section 1504 supports this multilateral approach as well. Legislators aimed to correct the status quo on payment transparency in the resource extraction industry by complementing EITI and expanding its reach into both payment and expenditure transparency.[195] A fatal error in applying a blanket prohibition against allowing exemptions for existing voluntary disclosures by resource extraction issuers was that the mandate from Section 1504 mentions EITI as the international standard, but in light of a few incongruencies the SEC erroneously foreclosed exploring exemptions to reporting for issuers already enrolled in EITI programs.[196] In its economic analysis, the Commission posits that the burdens on competition will be mitigated by the widening global influence of EITI and the recent trend of other jurisdictions promoting transparency.[197]

As mentioned above, the Commission recognized that these burdens would be alleviated to the extent that other jurisdictions, such as the European Union, adopt laws to require disclosure similar to the disclosure to Section 1504 and the related rules.[198] It is illogical to not let these mitigating factors breathe. By applying a blanket prohibition on exemptions to mandatory reporting, the Commission smothered

192. *Id.* at 8.

193. *Id.* at 21.

194. *Id.* at 20. "Two principal concerns emerged . . . . [First] from an anti-corruption perspective, it could encourage corrupt governments to seek contracts with firms not covered by the legislation, in effect driving the more transparent companies from the field. [Second] it would 'kill EITI' . . . [if] producing countries would react negatively" and view a mandatory reporting requirement as a violation of the voluntary aspect at the core of EITI and walk away from the initiative. *Id.* at 21; *see* 156 CONG. REC. 8,294, 8,319 (2010).

195. "A number of countries and companies have joined the [EITI], an excellent initiative that has made tremendous strides in changing the cultural secrecy that surrounds extractive industries. But too many countries and too many companies remain outside this voluntary system . . . . This domestic action [§ 1504] will complement multilateral transparency efforts such as the [EITI], under which some countries beginning to require all extractive companies operating in their territories to publicly report their payments." 156 CONG. REC. 8,294, 8,318–19 (2010).

196. *See* Disclosure of Payments by Resource Extraction Issuers, 77 Fed. Reg. at 56,413.

197. *See id.*

198. "[I]f both the US and EU implement disclosure requirements regarding payments to governments 'around 90% of the world's extractive companies will be covered by the rules.'" *Id.* at 56,402 n.570.

the mitigating influence of these global trends. Further, the introduction of "practicability" language in the legislative history of Section 1504 sheds light on the need to explore reducing compliance costs as a means of achieving practicable support for international transparency efforts. Allowing multi-listed resource extraction issuers to choose between foreign disclosure requirements—like the EU's and Section 1504—would allow the issuer to have a say in the matter as well as present comparably strong information for the public interest.

This exemption standard creates positive incentives for foreign governments and resource extractions issuers. It incentivizes greater EITI enrollment and promotes international standardization of payment reporting in the resource extraction industry. Allowing an EITI exemption effectuates the intent of Congress more than a blanket prohibition.[199] It would incentivize companies listed on U.S. stock exchanges to negotiate EITI agreements with foreign governments in order to reduce compliance costs associated with varying reporting requirements.[200] Unlike Section 1504 or other mandatory reporting requirements in other jurisdictions, EITI spans both payment and expenditure transparency.[201] Incentivizing EITI enrollment creates a level playing field that reduces compliance costs for resource extraction issuers and promotes the competition the SEC and Congress was searching for. Allowing resource extraction issuers listed on stock exchanges where they are making the same or nearly the same kinds of disclosures to be exempt promotes greater flexibility and international standardization in reporting efforts. Such an exemption balances practicability and the public interest. Finally, since September 2011, President Obama has been committed to the domestic implementation of EITI.[202] On March 19, 2014, the U.S. was admitted as an EITI candidate country under the stewardship of the Department of the Inte-

199. *H.R.* 6066, *supra* note 35, at 8 (statement of Faith Stevelman, Professor of Law, N.Y. Law Sch.). "For the last [six] years, companies like BP, Shell, Exxon, Chevron, Petrobras and [members of the International Council on Mining and Minerals] have joined forced with [investors], governments, and civil society to develop a voluntary disclosure [initiative]," the Extractive Industries Transparency Initiative (EITI). *Id.* at 6.

200. Disclosure of Payments by Resource Extraction Issuers, 77 Fed. Reg. at 56,402.

201. *See* Extractive Indus. Transparency Initiative, IMPLEMENTING EITI FOR IMPACT: A HANDBOOK FOR POLICY MAKERS AND STAKEHOLDERS 2 (Anwar Ravat & Sridar P. Kannan eds. 2012).

202. Extractive Indus. Transparency Initiative Int'l Secretariat, *President Obama: The US Will Implement the EITI*, EXTRACTIVE INDUSTRIES TRANSPARENCY INITIATIVE (Sept. 20, 2011, 8:15 PM), https://eiti.org/news-events/president-obama-us-will-implement-eiti.

rior.[203] Given the Executive's support of the EITI and U.S.' enrollment in the program, the SEC should seriously consider Section 1504 of the Dodd Frank Act as a complement to EITI's multilateral approach.

V. CONCLUSION

Failing to meet the procedural requirements of judicial review, courts have repeatedly struck down SEC rules promulgated pursuant to Dodd-Frank as "arbitrary and capricious." With respect to Section 1504 of the Dodd Frank Act, the SEC must produce a record that justifies sound decision-making after considering reasonable alternatives that were raised during the public comment period. Reasonable alternatives suggested by the court and this article include country-specific exemptions, as well as exemptions for resource extraction issuers currently disclosing payment information on a country-by-country and project-by-project basis through an existing EITI program or other jurisdictions. Such exemptions are in line with the recommendations of the *Petroleum Paradox* report.

The *Petroleum Paradox* report espouses a multilateral approach. These exemptions have the potential to create a multilateral incentive structure as opposed to the inflexible, unilateral approach rejected by the court in *API*. Based upon the legislative history of Section 1504 and judicial review in the D.C. Circuit, the SEC should adopt a portfolio approach selected after weighing the costs of mandatory reporting without exemptions to market efficiency, capital formulation, and burdens on competition with the benefits to investors and citizens it provides. After formulating this, the Commission should conduct the same level of qualitative and quantitative analysis to the country specific-exemptions suggested in *API* and voluntary disclosure exemptions suggested above. The release should evaluate the costs and benefits of the proposed rule and reasonable alternatives "even-handedly and candidly, acknowledging limitations in the data" while also discussing scenarios that might mitigate costs or enhance benefits, and consider the impact on "efficiency, competition, and capital formation."[204] Only after comparing these results with the status quo

203. Letter from Clare Short, Chair, Extractive Industries Transparency Initiative, on U.S. Designated as EITI Candidate Country, to Sally Jewell, Secretary, Dep't of the Interior (Mar 28. 2014) (on file with author).

204. *See* RSFI/OGC Memorandum, *supra* note 115, at 14; *see also* OFFICE OF INSPECTOR GENERAL, U.S. SEC, REP. NO. 499, FOLLOW-UP REVIEW OF COST-BENEFIT ANALYSES IN SELECTED SEC DODD-FRANK ACT RULEMAKINGS 31 (2012) (stating "rulewriting divisions should consider discontinuing the practice of drafting separate cost-benefit analysis and efficiency, com-

should the SEC promulgate a final rule pursuant to Section 1504.[205] It is also imperative the SEC act without delay in promulgating a new rule.[206] Most importantly, the SEC's rulewriting divisions and offices should heed the recommendations of the SEC's Office of Inspector General, Office General Counsel, and members of Congress—all of whom have suggested earlier, more extensive involvement and integration DERA economists in the rulemaking process to produce more satisfactory analysis on the administrative record.[207]

petition, and capital formation sections and instead provide a more integrated discussion of these issues in rule releases.").

205. "[T]he difficulty of reliably estimating the costs of regulations to the financial services industry and the nation has long been recognized, and the benefits of regulation generally are regarded as even more difficult to measure." U.S. GOV'T ACCOUNTABILITY OFFICE, GAO-12-151, DODD-FRANK ACT REGULATIONS: IMPLEMENTATION COULD BENEFIT FROM ADDITIONAL ANALYSES AND COORDINATION 19 (2011); *see* OFFICE OF INSPECTOR GENERAL, *supra* note 204, at 14 n.37; RSFI/OGC Memorandum, *supra* note 115, at 16-17.

206. For example, on September 18, 2014, Oxfam America filed suit against the SEC because the Commission failed to promulgate a new rule within 270 days of the API decision in violation of Section 1504's timeliness requirement. *See* Complaint at 1, Oxfam America, Inc. v. SEC, No. 14 Civ 13648 (D. Mass. Sept. 18, 2014); *see* also 15 U.S.C. § 78m (2012).

207. OFFICE OF INSPECTOR GENERAL, *supra* note 204, at 15; *see* RSFI/OGC Memorandum, *supra* note 115, at 15.