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Corporate & Securities | Alert

August 2015

Uncertainty Continues for the SEC's Conflict Minerals Reporting Regime After D.C. Circuit Confirms First Amendment Violation

On August 18, 2015, a three-judge panel of the U.S. Court of Appeals for the D.C. Circuit in a 2-1 decision upheld its April 2014 ruling in *National Association of Manufacturers (NAM), et al., v. Securities and Exchange Commission, et al.*, that certain portions of the disclosure requirements adopted by the SEC, in accordance with Section 1502 of the Dodd-Frank Act, violated the First Amendment by compelling "regulated entities to report to the Commission and to state on their website that any of their products have 'not been found to be DRC conflict free.'" The "conflict minerals" provisions contained in Section 13(p) of the Securities Exchange Act of 1934, as amended, have been the subject of significant opposition since codification of the Exchange Act amendment in 2010 and the subsequent adoption of Rule 13p-1 by the SEC in 2012.

The controversy has been sparked by the perceived and actual compliance burdens imposed on SEC-registered companies under the Rule resulting from the Congressional intent of stemming the flow of funds to militant groups in the Democratic Republic of Congo and adjoining countries from the mining and refining of so-called "conflict minerals" -- tin, tantalum, tungsten and gold. The panel's opinion notes that a recent study reports industry compliance costs of over $700 million during the first year of compliance and six million staff hours. The opinion goes on to question how, in light of the significant compliance costs "and the prospect that some companies will therefore boycott mineral suppliers having any connection to this region of Africa…[the reporting requirements would] reduce the humanitarian crisis in the region."

The panel's opinion follows from the SEC's petition for rehearing following the D.C. Circuit's 2014 *en banc* decision in *American Meat Institute (AMI) v. U.S. Department of Agriculture,* which addressed the proper standard of review for compelled commercial speech. In its 2-1 decision, the *NAM* court distinguished the SEC's conflict mineral disclosure requirements from other situations, including *AMI*, where the "disclosure requirements are reasonably related to the State's interest in preventing deception of consumers," a standard adopted by the U.S. Supreme Court in 1985 in *Zauderer v. Office of Disciplinary Counsel of the Supreme Court of Ohio.*

Following the August 2015 *NAM* decision, the future of the SEC's conflict minerals disclosure requirements and reporting regime continues to remain uncertain. To date, the SEC has not commented on the *NAM* ruling other than to say it is studying the decision. However, there are interesting issues here to be considered. First, there is a split in the circuit courts on the interpretation and application of *Zauderer* and its progeny. There is some speculation in the market that the SEC may decide to petition the D.C. Circuit for *en banc* review. Such a process is likely to take at least another 12 months until the full court would render its decision.

Second, from a practical standpoint, issuers and the SEC must confront how future compliance with Rule 13p-1 will be effected in the near-term as well as the long-term absent further judicial review. Guidance issued by the SEC in April 2014 following the D.C. Circuit's initial opinion stated that reporting companies need not "label" their products as "DRC conflict free," "not DRC conflict free," or (during a transitional period) "DRC conflict undeterminable," as required under the Rule and the Instructions to Form SD, the form upon which annual conflict minerals disclosure and reports are to be filed. At a minimum the SEC will need to confirm or update its guidance with respect to the "labelling" of a company's products. Under the guidance, no independent private sector audit (IPSA) is required of the Conflict Minerals Report contained in a Form SD unless the reporting company declares products to be "DRC conflict free." In the event the SEC does not petition for *en banc* review, it will need to adopt conforming amendments to the Rule and Form SD. Again, timing remains unclear.

The question of whether the flaw in the disclosure requirements is the result of the language of Section 1502 of the Dodd-Frank Act itself (as embodied in Section 13(p) of the Exchange Act) or of the SEC's rulemaking remains to be determined, as the three-judge panel did not reach a conclusion either in its initial April 2014 decision or the August 2015 opinion. The origin of the "labelling" requirement with respect to products "not DRC conflict free" can be found in Section 13(p)(1)(A)(ii) of the Exchange Act.

For now, reporting companies will need to assume that the core disclosure requirements for the 2015 calendar year will be substantially similar to the 2014 reporting period. There is some question as to whether the independent private sector audit requirement will be required of all reporting companies who submit a Conflict Minerals Report, since the two-year transition period has expired for all but smaller reporting companies (which will have two additional years to comply). Section 13(p)(1)(A)(i) does not tie the independent private sector audit requirement to the labelling requirement, but rather to the diligence exercised on the source and chain of custody of the minerals.

The reporting requirements embodied in Section 13(p) "terminate on the date on which the President determines and certifies to the appropriate congressional committee, but in no case earlier than the date that is one day after the end of the 5-year period beginning on the date of the enactment of [Section 13(p)], that no armed groups continue to be directly involved and benefitting from commercial activity involving conflict minerals." Hence, it is highly unlikely this disclosure and reporting saga will come to an end any time soon, absent further Congressional action.

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