THE
NATIONAL LAW REVIEW

Federal Appeals Court Holds Securities and Exchange Commission (SEC) Conflict Minerals Rules Violate Free Speech

Monday, April 28, 2014

Reporting Obligations Uncertain as Final Outcome Likely to be Months Away

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On April 14, 2014, a three-judge panel of the U.S. Court of Appeals for the District of Columbia, in an opinion authored by Senior Circuit Judge Randolph, held in ***National Association of Manufacturers, et al. v. Securities and Exchange Commission****, et al.* (Case No. 13-5252), that portions of the SEC's controversial **"Conflict Mineral Rules"** adopted under the Securities Exchange Act of 1934, as amended, and mandated by the Dodd-Frank Act "violate the First Amendment to the extent the [Dodd-Frank] statute and rule require 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.'" Noting, among other things, the general humanitarian purpose behind the statute and the desired effects of Congress' policy choices, the court rejected broader challenges to the Conflict Minerals Rules that asserted the SEC was "arbitrary and capricious" in its rulemaking by not, for example, including a *de minimis* exception for small amounts of minerals in products. As a result, the Court of Appeals reversed, in part, the district court decision that was the subject of the appeal and remanded the case for further proceedings.

The statute and the Rules require SEC-reporting companies that manufacture or contract to manufacture products containing "conflict minerals" (tin, tantalum, and tungsten and their derivatives, and gold) to undertake supply chain diligence to determine if any of the minerals were sourced from smelters or refiners in the Democratic Republic of Congo or adjoining nations that finance or contribute to, directly or indirectly, militant activities or human rights abuses in the region. Companies are then required to report their findings on a calendar-year basis, with the first report on Form SD due May 31, 2014. Industry cost estimates for the initial compliance undertaken by companies throughout the supply chain have been as high as $16 billion.

The court's decision comes as no surprise given that the court's focus on the free speech challenge to the rules and related statutory provisions consumed most of the oral argument held on January 7, 2014. Attorneys for appellants, National Association of Manufacturers, argued that the offending language in the Rules was akin to a "shaming statute" branding companies with a "scarlet letter" in violation of the First Amendment to the extent they were required to publicly disclose in SEC filings and on their website that certain of their products were "not found to be DRC conflict free."

SEC reporting companies are undoubtedly wondering what this means for the upcoming initial compliance deadline at the end of May. Unfortunately, no immediate reprieve from their diligence and disclosure undertakings is in sight unless the SEC voluntarily acts to stay the Rules' application. The court's decision is subject to a number of procedural complexities that will likely delay the decision from becoming final for some time. In particular, the court ordered that the mandate to the D.C. District Court to conduct further proceedings be withheld until seven days after the disposition of any petition for rehearing or a rehearing *en banc* by the full D.C. Court of Appeals. Although the parties have 45 days to petition for a rehearing or rehearing *en banc*, the SEC may decide to quickly petition the court for rehearing *en banc* and seek consolidation of the case with a pending *en banc* appeal in the D.C. Circuit, *American Meat Institute v. United States Department of Agriculture* (Case No. 13-

5281), in which oral argument is set for May 19, 2014. The issues in that case include a similar, although not identical, First Amendment question. Broadly, the debate revolves around the extent to which the federal government can mandate speech under the rubric of commercial regulation. As a related and potentially outcome-determinative sub-issue, the court will likely address the appropriate standard of review in such First Amendment cases, as to which the case law is not fully settled. Both the substantive and procedural issues could well lead to either National Association of Manufacturers or American Meat Institute (or both) being heard by the United States Supreme Court.

Indeed, the D.C. Circuit's opinion in this case invites the parties to seek to participate in the pending *en banc* case. Rejecting the approach suggested in Circuit Judge Srinivasan's concurring opinion (that is, to withhold a ruling on the First Amendment issue until after the *en banc* decision in the *American Meat Institute* case is announced), the majority stated in a footnote that issuing its opinion now would allow the parties to participate in the pending *en banc* case (and also raised the possibility of consolidating the cases for *en banc* consideration).

There is, accordingly, a significant likelihood that a final decision in this case will not come until after the *en banc* court issues a decision on the First Amendment issue and, depending upon the holding in that decision, there could be further proceedings in this case. Hence, it is unlikely that a final resolution will be forthcoming for several months.

In the interim, the National Association of Manufacturers could file a motion in the D.C. Circuit for a stay of the Conflict Mineral Rules pending a final determination of the Rules' validity. The concurring opinion appears to invite such a request. Also, the SEC could voluntarily stay the application of the Rules, including the initial compliance deadline. In the absence of a stay, the SEC would be wise to issue guidance to reporting companies as to how to comply with the Rules given the uncertainty created by the court's decision. Until any guidance is available, however, reporting companies should continue with their conflict mineral diligence and report preparation.