

ClientAlert

Capital Markets

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US District Court Upholds SEC Conflict Minerals Disclosure Rules



On July 23, 2013, the US District Court for the District of Columbia upheld the conflict minerals rules (the “Rules”) that require public companies to disclose whether “conflict minerals” are necessary to the functionality or production of products they manufacture or contract to be manufactured.¹ In upholding the Rules, the court concluded that the Rules were not “arbitrary and capricious” and that a requirement to post disclosure on company websites does not violate the First Amendment of the US Constitution. The ruling comes as a welcome development for the Securities and Exchange Commission (the “SEC”) just weeks after the SEC’s most recent loss in a parallel legal challenge to the resource extraction payment rules, which raised similar concerns regarding the SEC’s failure to engage in proper cost benefit analysis and which also focused on Constitutional arguments.²

What Conflict Minerals Rules Require

Section 1502 of the of the Dodd-Frank Wall Street Reform and Consumer Protection Act (the “Dodd-Frank Act”) requires the SEC to promulgate rules requiring certain publicly traded companies to disclose whether specified minerals are necessary to the functionality or production of products they manufacture or contract to be manufactured.³ The SEC adopted the Rules on August 22, 2012, and companies that file reports under Section 13(a) or Section 15(d) of the Exchange Act, including companies that file annual reports with the SEC on Form 10-K, Form 20-F or Form 40-F, are required to comply with the Rules for the year ending December 31, 2013 by filing their conflict minerals disclosure, if required, on the new Form SD by May 31, 2014. “Conflict minerals” are defined as gold, cassiterite, columbite-tantalite and wolframite, and any other minerals or derivatives determined by the US Secretary of State to be financing conflict in the Democratic Republic of Congo (the “DRC”) and adjoining countries. Public companies subject to the Rules must make a “reasonable country of origin inquiry” to determine whether any of the conflict minerals in its products originated in the DRC or adjoining countries and make a corresponding disclosure depending on the results of such inquiry.

¹ The full text of the decision can be found at this link:
https://ecf.dcd.uscourts.gov/cgi-bin/show_public_doc?2013cv0635-37

² See our July 2013 *Client Alert*, “US District Court Vacates SEC Resource Extraction Payment Disclosure Rules.”

³ For a detailed discussion of the disclosure requirements of conflict mineral use, see our September 2012 *Client Alert*, “SEC Adopts Conflict Minerals and Resource Extraction Payments Rules.”

Conflict Minerals Rules Legal Challenge and the Court's Decision

The National Association of Manufacturers, the US Chamber of Commerce and the Business Roundtable (the "Plaintiffs") brought suit against the SEC challenging certain aspects of the Rules as "arbitrary and capricious" under the Administrative Procedure Act and as violating the First Amendment by compelling disclosure on company websites. In rejecting the "arbitrary and capricious" challenge, the court concluded that the Securities Exchange Act of 1934, as amended, requires the SEC to consider the impact that a rule may have on economic-related factors such as efficiency and competition but does not impose an obligation that the SEC "conduct some sort of broader, wide-ranging benefit analysis" particularly where the resulting benefits of the Rules relate to humanitarian and not economic objectives. The court rejected an argument that the Rules would impose an undue burden on companies to track even minimal amounts of conflict minerals in their products and would have disproportionate reputational consequences. Instead, the court agreed with the SEC's argument that the SEC was bound by a mandate from Congress to adopt the Rules without even *de minimis* exceptions. In concluding that the SEC acted within its authority in implementing the Rules, the court focused on the fact that while previous successful rule challenges (such as proxy access rules) "involved rules or regulations that were proposed and adopted by the SEC of its own accord...[in promulgating the Rules, the SEC acted] pursuant to an express, statutory directive from Congress, which was driven by Congress's determination that the due diligence and disclosure requirements it enacted would help to promote peace and security in the DRC." [emphasis in the original].

Finally, the court rejected the Plaintiffs' claim that the Rules violate the First Amendment and amount to "burdensome and stigmatizing speech" by mandating that companies state on their websites that their products are not conflict-free. In so finding, the court reasoned that the Rules do not require website disclosure of any information beyond what is already available in their public filings and permit companies to satisfy the requirement by making their conflict minerals disclosure available on the same webpage that contains other required SEC filings. The court also acknowledged that the Rules permit companies to provide any explanatory information they deem necessary to supplement or further explain their website disclosures.

Next Steps in the Litigation

The final outcome of this challenge remains uncertain as the Plaintiffs have not yet announced whether they plan to appeal. Even if an appeal is brought and is successful, it would be difficult for it to be decided prior to the initial filing deadline.

What You Should Be Doing Now

Following the court's decision, the Rules continue to apply without change. Absent a stay issued upon appeal, as discussed above, the district court's decision makes it more likely that companies subject to the Rules will have to comply with the Rules for the year ending December 31, 2013 by filing their conflict minerals disclosure, if required, on new Form SD by May 31, 2014. Therefore, such companies must continue to compile the required information and engage in the related inquiries while remaining cognizant of potential developments in this case pending its final disposition. Furthermore, audit committees and boards should be updated on the status of compliance efforts under the Rules.

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