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US Securities Law Briefing.
Court Reaffirms Conflict Minerals Ruling

On August 18, 2015, the U.S. Court of Appeals for the District of Columbia Circuit (the "D.C. Circuit") in a split 2-1 decision reaffirmed its 2014 ruling invalidating the portion of the conflict minerals disclosure rule issued by the U.S. Securities and Exchange Commission (the "SEC") as violating the First Amendment of the U.S. Constitution.

Because the SEC had already modified the conflict minerals rule through a statement issued in response to the 2014 decision, the new ruling in *National Association of Manufacturers v. SEC* ("*NAM*") does not immediately change the status quo. However, it is possible that the SEC will issue further guidance soon, and/or request a rehearing en banc of the full D.C. Circuit.

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Background

As mandated by the U.S. Dodd-Frank Wall Street Reform and Consumer Protection Act of 2010 (the "Dodd-Frank Act"), the conflicts mineral rule requires any SEC-reporting issuer for whom conflict minerals are necessary to the functionality or production of a product manufactured or contracted to be manufactured by the issuer to conduct a reasonable country of origin inquiry and make certain disclosures regarding the conflict minerals. If the conflict minerals may have originated in the Democratic Republic of Congo or an adjoining country (together, the "DRC countries"), then the issuer must submit an audited report to the SEC describing, among other things, the due diligence measures taken with respect to the source and chain of custody of such conflict minerals, as well as the products that have not been found to be "DRC conflict free."

During a two-year phase-in period, issuers may describe certain products as "DRC conflict undeterminable" instead of conflict-free or not conflict-free, if the issuer cannot determine through due diligence whether its conflict minerals originated in covered countries, or whether its minerals benefitted armed groups. In such case, due diligence and a Conflict Minerals Report is still required, but an audit is not.

In April 2014, the D.C. Circuit issued an opinion holding that the requirement that issuers describe products as not "DRC conflict free" in their SEC reports and on their websites violates the First Amendment. The court rejected, however, all of the other challenges to the rule, including the absence of a de

minimis exception, the due diligence trigger and the application of the rule to retailers and other companies that only contract to manufacture products.

Shortly following the ruling, the SEC issued a statement narrowing the rule to comply with the decision but still requiring companies whose activities brought them within the scope of the rule to file their first Form SD by the original deadline of June 2, 2014. In line with the statement, the SEC stayed the effective date for compliance with those portions of rule that would require the statements by issuers that the D.C. Circuit held would violate the First Amendment.

The statement narrowed the rule as follows:

> Pending further action, an independent private sector audit ("**IPSA**") is not required unless a company voluntarily elects to describe a product as "DRC conflict free" in its Conflict Minerals Report.

> No company is required to describe its products as "DRC conflict free", having "not been found to be 'DRC conflict free'", or "DRC conflict undeterminable."

> However, if a company *voluntarily elects* to describe any of its products as "DRC conflict free" in its Conflict Minerals Report, it may only do so if it has obtained an IPSA as required by the rule.

> A company that manufactures or contracts to manufacture products that would have been described as "not found to be 'DRC conflict free'" or "DRC conflict undeterminable" does not have to identify the products as such, but should disclose, for those products, the facilities used to produce the conflict minerals, the country of origin of the minerals and the efforts to determine the mine or location of origin.

The statement also makes clear that companies that do not need to file a Conflict Minerals Report must still disclose their reasonable country of origin inquiry and briefly describe the inquiry they undertook. Also, for those companies that are required to file a Conflict Minerals Report, the report should include a description of the due diligence that the company undertook.

Rehearing Decision

In November 2014, the US Court of Appeals for the D.C. Circuit granted petitions by the SEC and Amnesty International for a panel rehearing of portions of the court's April 2014 ruling, in order to determine the effect of the D.C. Circuit's decision in *American Meat Institute v. Department of Agriculture* ("*AMI*").

In the 2014 *NAM* decision, the D.C. Circuit held that the requirement that issuers describe products as not "DRC conflict free" in their SEC reports and on their websites violates the First Amendment. Part of the First Amendment rationale in the decision relied upon a narrow reading of the U.S. Supreme Court's opinion in *Zauderer v. Office of Disciplinary Counsel*, which held that "rational basis review" – a level of review that is very deferential to the government – applied to commercial speech regulations requiring disclosure

of "purely factual and uncontroversial information" appropriate to prevent deception in the regulated party's commercial speech. The court held that rational basis review did not apply to the conflict minerals rule because *Zauderer* is limited to cases in which disclosure requirements are reasonably related to the State's interest in preventing deception of consumers, and the purpose of the conflict minerals rule is not to prevent deception.

In the more recent *AMI* decision, however, the D.C. Circuit concluded that the principles articulated in *Zauderer* apply more broadly to factual and uncontroversial disclosures required to serve government interests other than preventing deception. The *AMI* court therefore overruled the portion of the 2014 *NAM* decision holding that the analysis in *Zauderer* was confined to government compelled disclosures designed to prevent the deception of consumers.

In the rehearing decision, however, the D.C. Circuit held that *Zauderer* remained inapplicable because the conflict minerals rule does not involve voluntary commercial advertising. Alternatively, the court also ruled that even if the conflict mineral disclosures are commercial speech and *Zauderer* governs the analysis, the conflict minerals rule still violates the First Amendment because the government's objective of reducing the humanitarian crisis in the DRC countries through disclosure relies on "speculation or conjecture" and the SEC had not demonstrated that the rule "would 'in fact alleviate' the harms it recited 'to a material degree.'" Finally, the court noted that *Zauderer* "requires the disclosure to be of 'purely factual and uncontroversial information' about the good or service being offered," and reiterated its earlier view that whether a product is "conflict free" or "not conflict free" is hardly "factual and non-ideological."

Consequently, the court reaffirmed its earlier judgment that the Dodd-Frank Acts conflict minerals provision and the SEC's conflict minerals rule violate the First Amendment to the extent the statute and rule require companies to report to the SEC and to state on their website that any of their products have "not been found to be DRC conflict free."

Next Steps

SEC-reporting companies should not yet change their current procedures for complying with the conflict minerals rule, as the rehearing decision goes no further than reaffirming the First Amendment portion of the 2014 decision, and the SEC has already modified its rule to comply with that decision.

In light of the split decision, the SEC may decide to seek a rehearing en banc before the full D.C. Circuit panel, though if it does, there is no certainty that any decision would be made before the next Form SD disclosures are due on May 31, 2016. NAM could seek a stay of the entire rule until an en banc decision is issued, but such a request is unlikely to be granted, as both the court and the SEC denied such a request following the 2014 decision.

It is also possible that the SEC will issue further guidance on the conflict minerals rule in the near future, but if the SEC chooses to seek a rehearing en banc, it may decide that the 2014 statement provides sufficient guidance until a further court ruling is made.

We will continue to monitor developments in this area and welcome any queries you may have.

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