Corporate

# The D.C. Circuit's Conflict Minerals Ruling: A Speed Bump, Not A Roadblock

By: Jerry J. Burgdoerfer, William L. Tolbert, Elaine Wolff and Matthew C. Carter

## I. What now?

After taking great pains to comply with the Securities and Exchange Commission's ("SEC's") new conflict minerals rules that implement Section 1502 of the Dodd-Frank Act, companies were primed to make their first filing on new Form SD with the SEC in a little over six weeks from now.[1] That is, until the D.C. Circuit Court's April 14 decision in *Nat'l Ass'n of Mfrs v. SEC.*[2] There, the Court held that the statute and rule violate the First Amendment to the extent that they impose a requirement that a company describe its products as "not found to be 'DRC conflict free'" (the "Disclosure Requirement"). The Court remanded the case "for further proceedings consistent with this opinion."

So—what now? Given this decision, at least some companies face the prospect of being forced to make an unconstitutional disclosure (*see* Section II., below). Considering that risk, the SEC could choose to delay the filing deadline, rather than scramble to reformulate a last-minute rule change that might be rendered moot by a later *en banc* reversal of the panel's decision.[3]

The decision leaves open the possibility of an SEC rulemaking workaround. In the meantime, companies should forge ahead with their due diligence and conflict minerals reports, because it is possible that the District Court may not vacate the Rule prior to the Form SD filing deadline. Even if part of the Rule *were* vacated, companies covered by a redrafted conflict minerals rule would likely still be required to:

- conduct a reasonable country of origin inquiry;
- file Form SD (and where applicable, a conflicts minerals report); and
- "show their work" with regards to their due diligence.

Given the large volume of due diligence data involved, these tasks remain daunting—even with the extra time that the April 14 decision may have bought.

## II. The April 14 Decision

Central Africa's prolonged war and associated humanitarian crisis have been linked to, and funded by, revenue that armed groups derive from mining and trafficking in conflict minerals—defined by statute as the derivative ores of Tantalum, Tin, Tungsten, and Gold ("3TG"). Congress responded in 2010 with Section 1502 of the Dodd-Frank Act, directing the SEC to promulgate a rule requiring greater transparency and disclosure regarding the use of 3TG originating from the Democratic Republic of the Congo ("DRC") and its neighboring countries. This the SEC did, with a final rule becoming effective on November 13, 2012 (the "Rule"), and a first filing deadline of June 2, 2014.

Despite a multipronged attack on the Rule, the trade group plaintiffs saw the D.C. Circuit swat away all of

their challenges brought under the Administrative Procedure Act. In particular, plaintiffs had pinned their hopes on the argument that the SEC had failed to adequately quantify the benefits of the Rule. The Court gave short shrift to this challenge, averring that the SEC was not required to "measure the immeasurable" (in lives saved or rapes prevented) from thousands of miles away.

But the Court *did* credit the plaintiffs' First Amendment challenge to the Rule: that in potentially requiring an issuer to describe its products as not "DRC Conflict-Free" in its reports and on the issuer's website, the SEC unconstitutionally sought to compel speech. Though the First Amendment bars Government from abridging speech, it has been held to bar it from compelling speech as well. In the words of the Court, "some of the (Supreme) Court's leading precedents have established the principle that freedom of speech prohibits the government from telling people what they must say."[4] The Court found that the Disclosure Requirement amounted to, as the Court memorably put it, "compelling an issuer to confess blood on its hands."[5] To the Court, "[t]he label 'conflict free' is a metaphor that conveys moral responsibility for the Congo war. It requires an issuer to tell consumers that its products are ethically tainted, even if they only indirectly finance armed groups. An issuer, including an issuer who condemns the atrocities of the Congo war in the strongest terms, may disagree with that assessment of its moral responsibility." As a result, the Rule's Disclosure Requirement went beyond a "purely factual and uncontroversial" disclosure—and should therefore be subject to greater scrutiny than mere rational basis review.

Finding that at least an intermediate standard of review[6] was therefore appropriate, the Court held the SEC's tailoring of its restrictions on speech to be insufficiently narrow. Specifically, the SEC had presented no evidence that other less-restrictive means of achieving its goals would fail.[7] In one clue as to what an amended Rule might require, the Court approvingly cites the plaintiffs' suggested less restrictive means: issuers might (i) use their own language to describe their products, or (ii) submit the same raw information to the SEC, which could then be interpreted by the SEC and used to compile a government list of products affiliated with the war in the DRC. At a minimum, the SEC would have to weigh these or other alternatives for its disclosure mandates to pass constitutional muster.

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[1] Public companies are required to file Form SD (specialized disclosure) annually by May 31, regardless of their fiscal year. As May 31, 2014 falls on a Saturday, this year's deadline is June 2.

[2] No. 13-5252 (D.C. Cir. Apr. 14, 2014).

[3] Additional clarification may arrive in the form of a similar case currently under *en banc* review by the D.C. Circuit, *Am. Meat Inst. v. USDA*, No. 13-5281 2014 WL 1257959 (D.C. Cir. Mar. 28, 2014).

[4] *Nat'l Ass'n of Mfrs* n. 11.

[5] In reaching its decision, the Court stated that the relaxed rational basis standard for reviewing compelled commercial speech disclosures enunciated in *Zauderer v. Office of Disciplinary Counsel*, 471 U.S. 626, 651 (1985) applies only if a disclosure requirement serves a governmental interest in preventing consumer deception.

[6] *See Central Hudson Gas & Electric Corp. v. Public Service Commission*, 447 U.S. 557, 564-66 (1980) (under which the government must show (1) a substantial government interest that is; (2) directly and materially advanced by the restriction; and (3) that the restriction is narrowly tailored).

[7] The SEC had addressed the First Amendment issue in its discussion of its Rule. There, it suggested that (i) the phase-in delay in implementation, (ii) the ability of issuers to explain the Disclosure Requirement language to consumers in the issuers' own words, (iii) the lack of mandated disclosure labels *on the products themselves*, and (iv) the interim language for disclosing conflict indeterminate products were together enough to mitigate any Constitutional concerns.

## CONTACT US


**Jerry J. Burgdoerfer,** Partner, Jenner & Block LLP

Phone: 312 923-2820 Email: jburgdoerfer@jenner.com Download V-Card

Practice Groups: Corporate; Japan Practice; Mergers & Acquisitions; Private Equity/Investment Funds; Securities



**William L. Tolbert, Jr.,** Partner, Jenner & Block LLP

Phone: 202 639-6038 Email: wtolbert@jenner.com Download V-Card

Practice Group: Corporate; Mergers & Acquisitions; Securities



**Elaine Wolff,** Partner, Jenner & Block LLP

Phone: 202 637-6389 Email: ewolff@jenner.com Download V-Card

Practice Group: Corporate; Corporate Finance; Real Estate Securities, Securities



**Matthew C. Carter,** Associate, Jenner & Block LLP

Phone: 212 407-1781 Email: mcarter@jenner.com Download V-Card

Practice Group: Corporate; Corporate Finance; Mergers & Acquisitions; Private Equity/Investment Funds; Securities