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Recommendations for Companies Pending Appellate Review of the SEC Conflict Minerals Rules

By now, public companies and many of their suppliers are familiar with the Securities and Exchange Commission (Commission) conflict minerals reporting rules. Adopted by a 3-2 vote of the Commission in August 2012, the rules are intended to fulfill the mandate under Section 1502 of the Dodd-Frank Act to create a regime for reporting on public companies' manufactured products containing tin, tantalum, tungsten and gold that originated in the Democratic Republic of Congo (DRC) and adjoining countries. Public companies' first reports to the Commission are due no later than Monday, June 2, 2014.[1] We discuss below the status of the recent appellate challenge to the rules and what public companies should be doing in light of the challenge.

The conflict mineral rules have generated significant controversy since their inception. While there seems to be broad agreement as to the laudability of ending armed violence in the DRC, the debate continues as to whether the Commission's rules, as adopted, will be effective in achieving this goal and, more fundamentally, whether the Commission is the right government agency for advancing foreign policy objectives of this type. Arguing that the Commission overstepped its bounds in adopting the final version of the conflict minerals rules, a group of trade associations brought suit to challenge the rules shortly after their adoption. On July 23, 2013, the US District Court for the District of Columbia rejected the plaintiffs' challenge of the conflict minerals rules and granted the Commission summary judgment.

On appeal to the US Court of Appeals for the District of Columbia Circuit, the appellant trade associations argued that the final rules misinterpret and misapply Section 1502 in four general ways: (1) by refusing to create a *de minimis* exception for trace quantities of conflict minerals; (2) by expanding the scope of the rules to include conflict minerals that "may have originated" in the DRC when Section 1502 speaks only to minerals that "did originate" in that region; (3) by expanding the rules' scope to non-manufacturers; and (4) by providing for a transition period that unfairly distinguishes between larger and smaller companies. The appellants also asserted that both Section 1502 and the Commission's rules compel speech in violation of the First Amendment. As might be expected, the Commission and several amici briefs reject these arguments and mount a strong defense of the Commission's actions.

A three-judge panel of the DC Circuit heard oral arguments in the case on January 7, 2014. Media outlets reported that, during oral argument, two of the judges seemed very skeptical of the rules as adopted. There is no timetable for when the court may issue a decision, though we are cautiously optimistic that the court will rule before the June 2 reporting deadline. While the court has a range of options available in crafting a remedy, the most likely outcomes include upholding the rules in their entirety, vacating the rules

[1] Reports are due May 31, which falls on a Saturday; thus for 2014 the deadline is deferred to the next Monday, June 2. Our detailed summary of the conflict minerals rules can be found at http://www.hunton.com/files/Publication/46af05f9-c565-45e9-b02e-e5a78c680801/Presentation/PublicationAttachment/e16bef80-9230-48c2-a1f5-e95d90b8b235/Conflict_Minerals_Nuts_and_Bolts.pdf.

in their entirety or some middle ground whereby the rules are remanded back to the Commission for further action.[2] It is also possible that the court will take up the First Amendment challenge to the statute itself and strike down Section 1502 of the Dodd-Frank Act, though in other recent challenges to Commission rules the DC Circuit has largely avoided having to address similar First Amendment arguments by basing its ruling on other grounds. Whatever the decision, the losing party could seek a rehearing *en banc* before a larger panel of the DC Circuit, or could seek review by the US Supreme Court.

Given the cost and complexity in complying with the rules that has now become apparent to many companies affected by the rules, some may be tempted to scale back or suspend compliance efforts in the hope that a ruling from the DC Circuit may postpone the June 2 deadline. We caution against this approach. As it currently stands, the Commission's rules have been upheld by the district court, and they have not been stayed. Thus, they remain valid law. There is simply no way to predict when the DC Circuit will rule, and while we believe it is more likely than not a ruling will come before June 2, it is also possible the court will not rule until much later. Notwithstanding the judges' reported skepticism at oral argument, it is still possible that the court will uphold the rules in their entirety. Further, a ruling vacating or remanding the rules may not be the final word insofar as further lines of appeal remain available. Accordingly, there is a strong possibility that public companies will still be required to file reports on June 2.

Even if the rules are vacated, so long as Section 1502 is not struck down on constitutional grounds, the Commission will at some point be required to reissue new rules. Any new rules would still be subject to the Dodd-Frank parameters, which would continue to require some analysis of the supply chain and some inquiry into the sourcing of conflict minerals. Irrespective of the outcome of the litigation, a growing number of consumers and other stakeholders (such as NGOs, socially responsible investors and state pension funds) have begun to demand responsible sourcing of materials in products they purchase and companies in which they invest, which creates an additional consideration for affected companies. In addition, many large companies are committed to conflict-free supply chains, which will continue to pressure suppliers across various industries to comply with such initiatives regardless of the status of the Commission's rules. Finally, other conflict minerals legislation, such as that adopted in California and Maryland and that under consideration in the European Union, Canada and other US states, may impact certain public companies. Under each of these scenarios, there are also benefits in maintaining an infrastructure for providing future conflict mineral reporting.

In sum, at this time companies should stay the course and continue preparing for the June 2 deadline. We continue to monitor the litigation and expect to provide an update at such time as the DC Circuit makes a ruling.

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[2] If the court strikes down the Commission's rules, the decision to remand or vacate will depend on the Court's perceived seriousness of any deficiency found in the rule and the potentially disruptive consequences of remand. *See Chamber of Commerce of U.S. v. S.E.C.*, 443 F.3d 890, 908 (D.C.Cir. 2006).