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Client Alert

May 2014

SEC Staff Issues Statement on Conflict Minerals Ruling; Report Not Stayed

On April 14, 2014, the US Court of Appeals for the District of Columbia Circuit issued a long-awaited opinion and found that certain requirements of the Securities and Exchange Commission's disclosure rules concerning conflict minerals are unconstitutional.[1] Although the court rejected most of the appellant trade groups' challenges to the rules, it did find that the requirement that issuers report that any of their products are not "DRC conflict free" violates the First Amendment. Thus, the court remanded the rules to the district court for further action. On April 29, the director of the SEC's Division of Corporation Finance (the Division) issued a statement on the ruling and provided guidance to public companies regarding their compliance obligations as the June 2 deadline for filing Form SD approaches, including confirming that the Division expects issuers to make their Form SD filings on or before June 2.

As part of its ruling, the DC Circuit concluded that the requirement in the rules and Section 13(p) of the Securities Exchange Act of 1934 (from which the rules are derived) to describe products as not "DRC conflict free" in SEC disclosures and on companies' websites unconstitutionally compels speech. Thus, the DC Circuit held that the rules and Section 13(p) violate the First Amendment to the extent they require issuers to report to the SEC and state on their websites that any of their products have "not been found to be 'DRC conflict free.'" The opinion hedges in a footnote as to whether the First Amendment ruling applies only to the rules themselves or Section 13(p) itself, but opens the door for the SEC to rewrite the rules in a way that will preserve the overall validity of the statute.

The DC Circuit opinion did not provide the level of clarity that many companies facing the June 2 reporting deadline had hoped for. Notwithstanding the court's ruling on the First Amendment issue, the court upheld the remaining portions of the SEC conflict minerals rules (including, for example, the lack of a *de minimis* exception) and found no defect in the administrative process by which they were adopted. The court's opinion also raises the possibility that the parties could seek to join in another pending DC Circuit case with First Amendment implications, and a ruling in that case could have the ultimate effect of stepping back from the conflict minerals decision. Finally, the DC Circuit withheld the issuance of its mandate until seven days after disposition of any timely petition for rehearing or petition for rehearing en banc. As a result, the earliest date on which the mandate could issue is June 5, 2014 — three days after the Form SD is due.

Perhaps seeking to clarify public company reporting obligations in light of the DC Circuit opinion, the Division's director issued a public statement (the Statement) on April 29. According to the Statement, a reporting company's Form SD, and any related Conflict Minerals Report, should comply with and address those portions of the conflict minerals rules the DC Circuit upheld. Thus, the Statement provides that companies that do not need to file a Conflict Minerals Report should disclose their reasonable country of origin inquiry and briefly describe the inquiry they undertook. For those companies that are required to

[1] The court's opinion is available at http://www.cadc.uscourts.gov/internet/opinions.nsf/D3B5DAF947A03F2785257CBA0053AEF8/$file/13-5252-1488184.pdf

file a Conflict Minerals Report, the report should include a description of the due diligence that the company undertook. Moreover, the Statement instructs that if a reporting company has products that fall within the scope of Items 1.01(c)(2) or 1.01(c)(2)(i) of Form SD, it would not have to identify the products as "DRC conflict undeterminable" or "not found to be 'DRC conflict free,'" but instead 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.

Importantly, the Statement provides that 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." Nevertheless, if a company voluntarily elects to describe any of its products as "DRC conflict free" in its Conflict Minerals Report, the Statement provides that the company would be permitted to do so as long as it had obtained an independent private sector audit (IPSA) as required by the rules. At this time, an IPSA will not be required unless a company voluntarily elects to describe a product as "DRC conflict free" in its Conflict Minerals Report.

The Statement is the latest chapter in a saga that is far from complete. From an administrative law perspective, it is unclear whether a member of the SEC staff, as opposed to the five commissioners, has the authority to blue-pencil a formal rule in this fashion, even in the face of the DC Circuit ruling. The appellant trade groups on April 29 filed a motion with the SEC for a stay of the conflict minerals rules, or at least a stay of the June 2 deadline, and if denied, they have indicated that they may file for a stay with the DC Circuit. The appellants may also seek an expedited order for the DC Circuit to issue its mandate, or they may raise a separate challenge regarding the Statement. The SEC or the appellant trade groups could seek an appeal or rehearing. The SEC commissioners could vote to issue more formal guidance. Two commissioners have gone on record supporting an immediate stay of the rules pending final resolution of the case. Further judicial rulings may be forthcoming. Accordingly, the Statement is not likely to be the final word. But for now, observing the Statement's guidance appears to be a prudent course of action for public companies seeking to make sense of these ongoing developments.

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