THOMPSON HINE

International Trade & Customs Update

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Appellate Court Finds SEC Conflict Minerals Rule Violates First Amendment

On April 14, 2014, a three-judge panel of the U.S. Court of Appeals for the District of Columbia Circuit (DC Circuit) issued its much-anticipated decision on a challenge brought by several business groups to section 1502 of the Dodd-Frank Wall Street Reform and Consumer Protection Act (Dodd-Frank) and the Securities and Exchange Commission's final rule on conflict minerals, promulgated thereunder ("Conflict Minerals Rule"). The court held that requiring companies to disclose that any of their products have "not been found to be 'DRC conflict free'" amounts to "compelled" speech in violation of the First Amendment.

This decision is likely to put pressure on the SEC to extend the June 2, 2014 reporting deadline while it evaluates its options. But until the SEC issues formal guidance, affected companies would be prudent to assume that the deadline remains in effect.

Background

Section 1502 of Dodd-Frank requires companies to determine whether the products they manufacture contain conflict minerals and, if so, to disclose that information to the SEC and the public. The Conflict Minerals Rule, issued in August 2012, requires most publicly traded companies to report annually to the SEC their use of "conflict minerals" (e.g., gold, tin, tungsten, tantalum). Companies reporting use of these minerals must also state whether the minerals originate in the Democratic Republic of Congo (DRC) or adjoining countries, and, if so, whether the minerals have been sourced from "conflict" sources (armed paramilitary groups within those countries). The first review period under the Rule is calendar year 2013, the results of which must be reported to the SEC by June 2, 2014. The reports must also be posted on the companies' websites.

Shortly after the final rule was issued, several business groups filed suit in the U.S. District Court, District of Columbia, to overturn it, raising claims under the Administrative Procedure Act (APA), the Securities Exchange Act of 1934 (Exchange Act) and the First Amendment. As we reported previously, the business groups' challenge was dismissed in its entirety by the district court in July 2013. The groups appealed to the DC Circuit, and on January 7, 2014, oral arguments were heard by a three-judge panel of that court.

Appellate Panel Decision

The April 14 decision upheld the district court's dismissal of the business groups' challenges, with the exception of the First Amendment claim. In a 2-1 decision, the DC Circuit concluded that the Conflict Minerals Rule – and depending on whether the statute mandates the offending language, section 1502 of Dodd-Frank as well – violates the First Amendment because the reporting and public disclosure requirements impermissibly compel speech. Applying an "intermediate scrutiny" standard, the court held that the government had failed to show that the speech "compelled" by the Rule – that is, disclosing that a product is not "DRC conflict free" – materially advanced a substantial government interest that could not be met by more narrowly tailored restrictions. The court remanded the case to the district court for further proceedings.

The DC Circuit declined to address whether section 1502 requires use of the phrase "not DRC conflict free" or whether those words were a discretionary choice by the SEC. In the latter case, the Rule could be remedied by a second round of notice-and-comment rulemaking without amending the statute. Any such fix, however, would need to take into account the court's view that a required disclosure statement that could be construed as conveying "moral responsibility" for the violence in the Congo would be problematic.

Next Steps

To date, the SEC has not issued a statement about the court's decision. As noted in the dissent, the DC Circuit is scheduled to hear *en banc* (the entire court) the issue of the appropriate standard of review for a First Amendment compelled speech case in another case on May 19, 2014. That decision has the potential to impact the standard that would apply in this case. Therefore, the SEC may seek rehearing *en banc* on this case. Although it is likely that the SEC will postpone compliance with the reporting obligations, it is plausible that it might suspend only the obligation to file the conflict mineral report, as that is where the offending language resides. Accordingly, companies should continue drafting their submissions, pending definitive guidance from the SEC.

FOR MORE INFORMATION

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