AUTOMOTIVE

UPDATE: LEGAL CHALLENGE TO THE SEC'S CONFLICT MINERALS REPORTING REGULATIONS

by Richard A. Wilhelm

In the 2010 Dodd Frank Act, the United States Congress required, inter alia, the SEC to promulgate a rule requiring certain manufacturers to trace the sources of tin, tantalum, tungsten and gold that are contained in products they manufacture or contract to manufacture to allow them to report yearly to the SEC whether the products are "not DRC [Democratic Republic of the Congo] Conflict Free." DRC Conflict Free was defined by Congress as meaning the products do not contain minerals that finance or benefit violent armed groups in the DRC or adjoining countries. Congress required the SEC action because "it [was] the sense of Congress" that the exploitation of conflict minerals from that region was financing armed groups that engaged in "extreme levels of violence" creating "an emergency humanitarian situation." The rule was promulgated in 2012.

Since the SEC promulgated the rule implementing the provisions of Dodd Frank, the automotive industry has undertaken a very intensive coordinated effort, largely under the auspices of the Automotive Industry Action Group, to create and implement a system that would enable those industry members required to file reports to fulfill their reporting obligations under the rule. The first round of annual conflict minerals reports are required to be filed by May 31, 2014.

While the automotive industry was making efforts to comply with the conflict minerals rule, the National Association of Manufacturers ("NAM"), along with the U.S. Chamber of Commerce, commenced a legal challenge to the rule.

The crux of NAM's challenge was that the SEC failed to properly quantify the benefits and costs associated with the regulations and thereby acted arbitrarily and capriciously in promulgating them. NAM claimed the reporting requirements would not aid the DRC and could cripple the region economically. It claimed that the SEC improperly failed to agree to certain revisions that would have lessened the burdens and costs on business, like carving out a *de minimus* exemption for manufacturers whose products used only trace amounts of conflict minerals and predicating a burdensome due diligence requirement on whether a manufacturer had "reason to believe" that their products contained conflict minerals that may have originated in the DRC as opposed to whether the products "did originate" there. NAM also challenged the requirement that companies that contract for the manufacture of products that contain conflict minerals are required to report. NAM asked the court to strike the entire regulation and send the SEC back to square one.

NAM also made a less significant challenge to the portion of the rule that mandated that certain issuers who file conflict minerals reports and who have been unable to determine whether their products are DRC Conflict Free, describe those products in their reports (which also have to be posted to the companies' web sites) as "not 'DRC Conflict Free'" or having "not been found to be 'DRC Conflict Free.'" NAM contended that this requirement violated the First Amendment because the government was unconstitutionally compelling reporting companies to make a statement that implied moral responsibility for financing armed groups in the Congo. The SEC contended it was simply compelling a factual and non-ideological statement.

Last year, a federal district court rejected all of NAM's arguments and upheld the statute and the rule in their entirety. NAM appealed. On April 14, 2014 the Court of Appeals for the DC Circuit mostly upheld the lower court's ruling and refused to strike the entire rule as NAM had requested. It did, however, agree with NAM that the rule violated the First Amendment, but only "to the extent the statute and rule required regulated entities to report to the [SEC] and to state on their web site that any of their products have "not been found to be 'DRC Conflict Free'." It then went on to state that if the requirement to use that particular phrase stemmed from the rule and not the statute, the statute would be unaffected by its ruling. One judge on the panel flatly stated that the requirement did not stem from the statute.

The bottom line is that, barring the Supreme Court agreeing to address the issue, the conflict minerals reporting requirements are here to stay. The only part of the rule that is up in the air as a result of the Court's opinion is what the SEC will do to address the issue of the inability to require regulated companies to use the now taboo verbiage. NAM suggested that each filer could use their own language to describe their products in their conflict minerals reports and that the SEC could glean the status of the products from those reports. The SEC would then be free to publish its own list of the conflict status of all filers' products. How the SEC will address this issue, if it can before the May 31 filing deadline, is not yet known.

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