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Conflict Minerals Disclosure Requirement Confirmed Unconstitutional

On August 18, 2015, the U.S. Court of Appeals for the District of Columbia Circuit, in a 2-1 decision (opinion available here), confirmed its earlier decision in April 2014 by ruling that the U.S. Securities and Exchange Commission (SEC) cannot require public companies to disclose whether their products may contain "conflict minerals" that "have not been found to be 'DRC conflict free,'" because to do so violates their free speech rights. Absent any further action by the SEC or its staff, this court action will postpone the need for companies to obtain an independent audit of any conflict minerals disclosures for 2015, unless they voluntarily claim DRC conflict-free status.

Background. Among the miscellaneous provisions of the Dodd-Frank Act, which became law in 2010, was the controversial directive that the SEC adopt rules requiring certain public companies to disclose their use of specified conflict minerals thought to be potential sources of financing for armed conflict in the Democratic Republic of the Congo and adjoining countries, if those minerals are "necessary to the functionality or production of a product" manufactured by those companies. Although the SEC was able to propose such rules later that same year, moving from that proposal to the rules that were ultimately adopted nearly two years later was a "challenging project," in the words of the SEC's then-chairman, Mary L. Schapiro. (See our previous client alert here.)

As adopted by the SEC, the conflict minerals rules require certain public companies to conduct due diligence on the source and chain of custody of its conflict minerals, as well as file with the SEC a more detailed Conflict Minerals Report, potentially including disclosure to the effect that the company's conflict minerals have not been found to be DRC conflict free.

Prior Appellate Ruling and SEC Response. Once adopted, the conflict minerals rules were quickly challenged, leading to the court's April 2014 ruling that the conflict minerals disclosure requirement to label products as not DRC conflict free in SEC filings compels speech in violation of the First Amendment. (See our previous client alert here.) In response to that ruling partially invalidating its rule, the SEC's Division of Corporation Finance issued a statement with interim guidance that relieved companies of having to label their products as originally prescribed by the rules and, in some instances, having to obtain an independent private sector audit until the SEC or a court takes further action. (See our previous client alert here.) The SEC staff also clarified that notwithstanding the pending litigation with respect to the First Amendment labeling issue, companies still were required to disclose the source of so-called conflict minerals contained in their products. (See our previous client alert here.)

SEC Appeal and Rehearing. In November 2014, the court granted the SEC's request for a rehearing to reconsider the court's April 2014 decision in light of subsequent case law developments regarding compelled speech, including the court's July 2014 *en banc* decision upholding the U.S. Department of Agriculture's meat country-of-origin labeling requirements. In its rehearing decision on August 18, 2015, the divided panel confirmed its earlier ruling that the conflict minerals rule violates the First Amendment to the extent that it requires public companies to state that any of their products have not been found to be DRC conflict free.

Implications. Until the SEC or its staff takes further action or issues new guidance in response to this rehearing decision, the staff's prior April 2014 statement continues to apply. Although companies still are required to disclose certain information concerning the source of their conflict minerals, they will not be required to report a conclusion that their conflict minerals have not been found to be DRC conflict free. While a company may voluntarily elect to describe its products as DRC conflict free in its Conflict Minerals Report, making that disclosure will require the company to obtain an independent private sector audit of the process underlying such determination. Other than for such voluntary disclosures, under the staff's prior guidance, such audits are not required for companies filing Conflict Minerals Reports.

We will continue to monitor developments regarding conflict minerals disclosure requirements in the courts and at the SEC.