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SEC Signals Some Relief on Conflict Minerals Rule

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Capital Markets and Securities

On April 7, 2017, the SEC's Division of Corporation Finance (the "Division") issued a statement indicating that it will not recommend enforcement action to the SEC if companies subject to the SEC's conflict minerals reporting rule only file disclosure under the provisions of paragraphs (a) and (b) of Item 1.01 of Form SD, and not under paragraph (c) of Item 1.01. As discussed below, the statement means that a company will not face the risk of an enforcement action if it fails to conduct the supply chain due diligence called for by paragraph (c) of Item 1.01 and does not file a Conflict Minerals Report, even when it would otherwise be required to take such steps. The Division's statement is available here.[1]

Procedural Background

The Division's statement was issued in response to the entry of final judgment on April 3, 2017 in the long-running legal challenge to the SEC's conflict minerals reporting rule.[2] The rule was challenged in 2013 by the National Association of Manufacturers and other parties on the basis that the rulemaking was arbitrary and capricious under the Administrative Procedure Act ("APA") and that the rule compelled burdensome and stigmatizing speech in violation of the First Amendment. The courts rejected the APA claims, but in 2014 and 2015 the U.S. Court of Appeals for the District of Columbia Circuit held that the rule violates the First Amendment rights of public companies by compelling them to make public disclosures regarding the "conflict-free" status of their products.[3] In April 2014, in light of the Court of Appeals' ruling, the Division provided guidance to public companies that they would not be expected to identify products as "not found to be 'DRC conflict free'" or "DRC conflict undeterminable" in their Conflict Minerals Reports, but would be expected to include a description of their due diligence process and to provide other specified disclosures called for by paragraph (c) of Item 1.01 of Form SD. Conflict Minerals Reports filed by public companies in 2014, 2015, and 2016 were prepared in accordance with the Division's 2014 guidance.

[1] On the same day, Acting SEC Chairman Michael Piwowar also issued his own statement, in which, among other things, he said that, in light of the uncertainties noted below, "until these issues are resolved, it is difficult to conceive of a circumstance that would counsel in favor of enforcing Item 1.01(c) of Form SD."

[2] *National Association of Manufacturers, et. al. v. Securities and Exchange Commission, et. al.* No. 13-CF-000635 (D.D.C. Apr. 3, 2017).

[3] *See National Association of Manufacturers, et. al. v. Securities and Exchange Commission, et. al.* 800 F. 3d 518 (D.C. Cir. 2015).

On April 3, 2017, the District Court for the District of Columbia entered final judgment and remanded the case to the SEC for further action in light of the Court of Appeals' rulings. The Division cited the uncertainty regarding how the SEC will resolve what the Division calls the "significant issues" raised by the remand of the case in explaining its determination to issue its most recent statement.

The Division's Statement

As noted above, the Division's statement indicates that it will not recommend enforcement action to the SEC if companies only file disclosure under the provisions of paragraphs (a) and (b) of Item 1.01 of Form SD, and not under paragraph (c) of Item 1.01 of Form SD. This will be the case even for companies that are otherwise subject to paragraph (c) of Item 1.01.

Paragraph (c) of Item 1.01 of Form SD imposes significant obligations that, arguably, comprise the heart of the conflict minerals reporting rule. Under paragraph (c), a company that determines that conflict minerals in its products originated in the Democratic Republic of the Congo ("DRC") or an adjoining country, or that has reason to believe such minerals may have originated in such countries, must exercise due diligence on the source and chain of custody of such conflict minerals and must file a Conflict Minerals Report as an exhibit to its Form SD (unless the company concludes, as a result of its due diligence, that conflict minerals did not originate in the DRC or an adjoining country or that they came from recycled or scrap sources). Thus, the Division's statement means that companies will not face the risk of enforcement if they do not conduct the due diligence called for by paragraph (c) on the source and chain of custody of their conflict minerals, and do not file a Conflict Minerals Report, even when otherwise required to take such steps.

There are some caveats. First, the Division's statement reminds companies that they are still expected to file disclosure under paragraphs (a) and (b) of Item 1.01 of Form SD, which require a description (in Form SD) of the company's "reasonable country of origin inquiry." Second, the Division's statement does not, in and of itself, rescind paragraph (c) or suspend the obligations under such paragraph to conduct due diligence or file a Conflict Minerals Report. Finally, notwithstanding the Division's updated guidance, some companies will undoubtedly wish to consider public relations and consumer expectations when deciding whether to report on the results of their conflict minerals due diligence this year.

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