

## D.C. District Court Rejects Challenge to SEC Conflict Minerals Rule

On July 23, 2013, Judge Robert Wilkins of the U.S. District Court for the District of Columbia upheld the SEC's conflict minerals disclosure rule implementing a provision of the Dodd-Frank Wall Street Reform and Consumer Protection Act (Dodd-Frank Act), rejecting a challenge by the National Association of Manufacturers, the Business Roundtable, and the U.S. Chamber of Commerce, which claimed that the rule violated the Administrative Procedure Act (APA) and the First Amendment.<sup>1</sup>

The decision was a victory for the SEC, which has seen several of its recent regulations overturned by the courts, most recently on July 2 when another D.C. federal judge invalidated its rules implementing the Dodd-Frank Act's resource extraction payments reporting provision.<sup>2</sup> Arnold & Porter had submitted an amicus brief on behalf of several prominent experts on the Democratic Republic of the Congo (DRC) in support of the Plaintiffs arguing that the SEC had ignored evidence that the rule would likely worsen economic conditions in the DRC.<sup>3</sup>

Although an appeal to the U.S. Court of Appeals for the D.C. Circuit is likely, as a practical matter companies will not be able to delay compliance efforts pending the outcome of the litigation. The SEC's conflict minerals rule remains in effect, and companies must complete the required due diligence on the source and chain of custody of conflict minerals in their products and file the required disclosures with the SEC by May 31, 2014.

### I. Background

As described in a prior Arnold & Porter Advisory,<sup>4</sup> the SEC finalized a rule implementing Section 1502 of the Dodd-Frank Act in August 2012. Section 1502 was intended to reduce the flow of funds from the extraction and sale of four minerals that have been used to finance armed conflict in the DRC and surrounding countries by increasing accountability

<sup>1</sup> *Nat'l Assoc. of Manufacturers v. SEC*, No. 1:13-cv-00635-RLW, slip op. at 2 (D.D.C. July 23, 2013).

<sup>2</sup> For more information about the July 2 ruling, see Federal Court Vacates SEC Extraction Payment Disclosure Rule, available at <http://www.arnoldporter.com/resources/documents/ADV713FederalCourtVacatesSECsExtractionPaymentDisclosureRule.pdf> (July 2013).

<sup>3</sup> Brief of *Amicus Curiae* Experts on the Democratic Republic of the Congo in Support of Petitioners, *Nat'l Assoc. of Manufacturers v. SEC*, No. 12-1422 (D.C. Cir. Jan. 23, 2013), available at <http://goo.gl/mXkbgw>.

<sup>4</sup> See SEC Issues Final Rule to Implement Dodd-Frank Reporting Requirement Relating to Conflict Minerals, available at [http://www.arnoldporter.com/public\\_document.cfm?id=18976&key=2G0](http://www.arnoldporter.com/public_document.cfm?id=18976&key=2G0) (Aug. 2012). Further information may also be found in another prior Arnold & Porter Advisory. See SEC's Forthcoming Conflict Mineral Rules Form Part of Emerging Regulatory Landscape, available at [http://www.arnoldporter.com/public\\_document.cfm?id=18017&key=19H1](http://www.arnoldporter.com/public_document.cfm?id=18017&key=19H1) (Oct. 2011).

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for parties involved in the supply chains for those minerals. The SEC’s rule will require an estimated 6,000 companies that file annual reports with the SEC to review their supply chains and publicly disclose their use of tantalum, tin, tungsten, and gold, if any of those minerals are “necessary to the functionality or production of a product” that they manufacture or contract to manufacture.

While many industries have been affected, manufacturers of electronics, such as mobile phones, digital cameras, and computers, and companies in the automotive, construction, medical equipment, and aerospace sectors in particular utilize large quantities of the four minerals. When issuing the final rule, the SEC estimated that the financial burden would be approximately US\$3-4 billion at the outset for companies to develop their compliance programs, and between US\$207 and US\$609 million annually for ongoing compliance.

In October 2012, Plaintiffs petitioned the U.S. Court of Appeals for the D.C. Circuit for review of the SEC rule. The case was fully briefed and set to be argued in May 2013, but the Plaintiffs sought transfer to the district court after the D.C. Circuit ruled in a similar case that challenges to the Dodd-Frank Act must originate in the district court. Judge Wilkins considered the parties’ appellate briefs as cross-motions for summary judgment, and heard oral argument on July 1.

## II. The District Court’s Ruling

Judge Wilkins rejected each of the Plaintiffs’ attacks on the SEC rule under the APA and First Amendment. He held:

- **The SEC adequately discharged its statutory obligation to consider whether its final rule would “promote efficiency, competition, and capital formation.”** Judge Wilkins held that the SEC did not need to undertake a broad cost-benefit analysis to justify this rule, reasoning that the “benefits” at issue “relate to *humanitarian* objectives that Congress concluded would be achieved by the rulemaking, rather than some sort of *economic* objectives underlying the Commission’s rule.”<sup>5</sup>
- **The SEC’s estimates of the rule’s costs were not arbitrary and capricious.** Judge Wilkins found that

the SEC sufficiently considered cost data from various sources to make its US\$3-4 billion cost estimate reasonable.

- **The SEC’s decision not to include a *de minimis* threshold was reasonable.** Judge Wilkins held that because Section 1502 was silent on whether the SEC’s rule could contain an exception for *de minimis* uses of conflict minerals, he was required to defer to the agency’s interpretation. He found that while the SEC’s analysis “arguably could have been more thorough,” he could not “say that the Commission’s determination was unreasonable.”<sup>6</sup>
- **The SEC acted reasonably in requiring issuers to conduct due diligence on their mineral purchases whenever there is reason to believe that the conflict minerals “may have originated” – rather than “did originate” – in the DRC region.** In Judge Wilkins’s view, there was no situation where a company “*would* have reason to believe that its minerals ‘may have originated’ in the [DRC region], but *would not* have reason to believe that its minerals ‘did originate’” in that region.<sup>7</sup>
- **The SEC’s inclusion of issuers that “contract to manufacture” products within the purview of its rule was permissible.** Judge Wilkins held that both Section 1502 and its legislative history were ambiguous with respect to whether Congress intended to require the new disclosures of companies that “contract to manufacture” products with conflict minerals. According to the judge, some of this ambiguity is “inherent in the term ‘manufacture’ itself.”<sup>8</sup> Thus, Judge Wilkins held that the SEC’s interpretation was not contrary to the statute, and he further held that it was not arbitrary.<sup>9</sup>
- **The SEC’s adoption of different phase-in periods depending on company size was reasonable.** Judge Wilkins dismissed the impact of the SEC’s decision to allow small companies to report that they could not

<sup>5</sup> *NAM* slip op. at 19 (emphasis in original).

<sup>6</sup> *Id.* at 34.

<sup>7</sup> *Id.* at 41-42 (emphasis in original).

<sup>8</sup> *Id.* at 44.

<sup>9</sup> *Id.* at 46.

determine whether their mineral purchases financed conflict in the DRC region for the first four years after the rule goes into effect, as opposed to only two years for larger companies. He noted, “All covered issuers, large and small, must still undertake a reasonable country of origin inquiry and, if necessary, the ensuing due diligence efforts” even while the phase-in periods are in effect.<sup>10</sup>

- **Finally, neither Section 1502 nor the SEC rule violate the First Amendment’s protection against compelled speech.** Judge Wilkins agreed with the Plaintiffs that the requirement that companies post their conflict mineral disclosures on their own websites compels their speech. But he reasoned that only intermediate scrutiny applied to the commercial speech at issue, and ruled that the statute and rule survived such scrutiny.

### III. Conclusion

Judge Wilkins rejected Plaintiffs’ challenges under the APA and First Amendment. An appeal seems likely, but the Plaintiffs have not announced a final decision to pursue an appeal. Companies that had adopted a wait-and-see approach in anticipation of Judge Wilkins ruling in the Plaintiffs’ favor should now push forward with developing their compliance programs. Even if the Plaintiffs file an appeal by August 22, proceedings could well go into 2014, leaving little time for companies to undertake the burdensome supply chain inquiries and make the necessary determinations prior to the SEC’s May 31, 2014, reporting deadline.

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<sup>10</sup> *Id.* at 47.

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