

Practice Update

Federal Appellate Court Holds Portions of SEC Conflict Minerals Rule Violate First Amendment

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Last week, in the case of *National Association of Manufacturers v. Securities and Exchange Commission*, the D.C. Circuit Court of Appeals held that the SEC's conflict minerals rule adopted pursuant to the Dodd-Frank Wall Street Reform and Consumer Protection Act (Dodd-Frank) violates the First Amendment "to the extent the statute and rule requires regulated entities to report to the [SEC] and state on their website that any of their products have 'not been found to be DRC conflict free.'" The appellate court rejected the appellant's arguments that the SEC's rulemaking process had violated the Administrative Procedure Act and the SEC's cost-benefit analysis failed to satisfy standards under the Securities Exchange Act of 1934.

The SEC's conflict minerals rule implements Section 1502 of Dodd-Frank. The rule requires issuers that manufacture or contract to manufacture products for which "conflict minerals" (gold, tantalum, tin and tungsten) are necessary to functionality or production to conduct a country of origin inquiry to determine whether their conflict minerals originated in the Democratic Republic of the Congo or adjoining countries or are from recycled or scrap sources. If an issuer determines that its necessary conflict minerals originated (or has reason to believe that

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they may have originated) in the Democratic Republic of the Congo or an adjoining country and are not (or may not be) from recycled or scrap sources, the issuer must conduct due diligence on the source and chain of custody of its conflict minerals. Depending on the outcome of this due diligence investigation, the issuer may be required to disclose in a Form SD filed with the SEC and on its website information about the issuer's products that are found not to be DRC conflict free. "DRC conflict free" is defined under the rule to mean that a product does not contain conflict minerals necessary to functionality or production of that product that directly or indirectly finance or benefit armed groups in the Democratic Republic of the Congo or an adjoining country.

The *National Association of Manufacturers* court found that the conflict minerals rule violated the First Amendment because the requirement that issuers characterize their products as not "DRC conflict free" constituted impermissible compelled speech. The lower court had upheld the conflict minerals rule by applying a "rational basis" standard of review. The appellate court summarized prevailing case law as permitting the application of a rational basis standard only to disclosure of "purely factual and uncontroversial information" in cases involving consumer deception. Neither party had suggested that the conflict minerals rule was intended to address consumer deception. The court found, moreover, that the disclosure requirements under the conflict minerals rule went beyond purely factual, non-ideological information and compelled an issuer to "confess blood on its hands" by conveying moral responsibility for the Congo war, thereby interfering with the issuer's exercise of freedom of speech under the First Amendment. The court found that the rule could not be upheld on the basis of an intermediate standard of review, which would have required a showing that the rule was narrowly tailored and that a reasonably tailored, less restrictive means of accomplishing the rule's purpose would have failed, because the SEC

had provided no evidence to support such a conclusion. The case was remanded to the district court for further proceedings.

The immediate impact of the appellate court's ruling cannot be determined and is dependent on the SEC's responsive measures, which have not yet been made clear. The SEC could, among other things, seek judicial review of the decision, request a rehearing *en banc*, engage in further rulemaking to bring the conflict minerals rule into harmony with the decision or issue interpretive guidance. Given these uncertainties, companies that are subject to the conflict minerals rule should continue to take steps to timely comply with the rule's many surviving provisions and meet existing filing deadlines.

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