CLEARY GOTTLIEB

ALERT MEMORANDUM

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Conflict Minerals: New D.C. Circuit Decision, but no Rule Changes – Yet

The SEC's conflict minerals rule was the subject of a new Court of Appeals decision this week, but for companies required to comply with the rule nothing has changed yet.

Industry groups led by the National Association of Manufacturers challenged the 2012 rule in federal court on a number of grounds. In 2013, a federal district court upheld the rule, and in April 2014, the D.C. Circuit Court of Appeals affirmed that decision in all respects but one: it held that the rule, and the underlying provision of the Dodd-Frank Act, violate the First Amendment to the U.S. Constitution to the extent they require a company to report to the SEC, and to state on its website, that any of its products have "not been found to be DRC conflict-free."

On August 18, 2015, the same panel reaffirmed its original judgment. It had agreed to reconsider the case because of an intervening *en banc* decision of the full D.C. Circuit Court of Appeals in another case, which raised a similar First Amendment challenge to Department of Agriculture requirements for labeling meat products. The *en banc* decision (available here) upheld the meat labeling rule, and in doing so it took a different view of the applicable standard of review for government compelled commercial speech than the panel had taken in the conflict minerals case. Upon rehearing, however, the panel reached the same conclusion as before about the conflict minerals rule, by the same 2-1 vote. Curiously, the two judges in the majority are both senior judges who did not participate in the *en banc* decision in the meat labeling case. The SEC is presumably now considering, together with the Department of Justice, whether to seek rehearing *en banc*, seek review in the Supreme Court or accept the ruling.

While the constitutional issue makes its way through the courts, the rule remains in effect. The SEC issued a partial stay in May 2014 (available here) that suspended the requirement to describe products using the challenged expression. The stay also suspended the related requirement to obtain an independent private sector audit unless a company voluntarily elects to describe any of its products as "DRC conflict free." These modifications to the rule applied to the conflict minerals reports filed in 2014 and 2015, and they still apply for now.

Without the partial stay adopted in response to the May 2014 decision, the transitional period contemplated by the rule would be ending, and the audit would be required for reports to be filed in 2016. Particularly in light of this, the SEC could reconsider the modified rule (and at some point will presumably amend the rule to reflect a final approach), although it may prefer to wait if it pursues the constitutional issue further in the courts. The SEC might also reconsider its approach in light of the findings of an August 2015 report issued by the Government Accountability Office (GAO) (available here) that most companies filing the conflict minerals disclosures (67%) were unable to determine the source of their conflict minerals and none could determine whether the minerals financed or benefited armed groups in the relevant countries.

This uncertainty presents a challenge for companies in preparing for reports to be filed in 2016: the rule as it now stands does not require the audit, but if a changed SEC approach reinstates the audit requirement, companies may face implementation challenges , as the audit is expected to take a significant amount of time. We recommend that companies carefully consider how long they will need to complete the audit, so that timely preparations can begin if the requirements change.

The opinion upholding the 2014 decision can be found here. (It includes the 2014 decision as an appendix.)

Please feel free to call any of your regular contacts at the Firm or any of our partners and counsel listed under Capital Markets or Corporate Governance located in the "Practices" section of our website if you have any questions.

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