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SEC Will Not Enforce Part of the Conflict Minerals Disclosure Rule

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On Friday, April 7, 2017, the acting Chief of the Securities and Exchange Commission (the "Commission") Michael Piwowar released a statement that the Commission will not recommend enforcement of certain parts of its Conflict Minerals disclosure rule (Securities Exchange Act Section 13(p)(1) and Rule 13p-1 promulgated thereunder) (the "Rule"). The Rule, which became effective on November 13, 2012, is subject to ongoing litigation, the initial results of which struck down certain provisions as being unconstitutional. According to Piwowar's statement, the Commission will not recommend enforcement proceedings against reporting companies that only file disclosure under the provisions of paragraphs (a) and (b) of Item 1.01 of Form SD and do not provide the disclosure required by paragraph (c) of Item 1.01 of Form SD.

Items (a) and (b) require reporting companies to inquire into the country of origin of any columbite-tantalite, cassiterite, gold, wolframite, or their derivatives tantalum, tin or tungsten ("Designated Minerals") necessary to their products and to determine whether any such minerals originated in the Democratic Republic of Congo or surrounding regions (the "Covered Countries"), or are otherwise from recycled scrap sources. They then must describe their process and the results of their inquiry.

Item (c) requires more detailed disclosure with regard to any identified Designated Minerals that may have originated in the Covered Countries and are not from recycled or scrap sources. Reporting companies will continue to be obligated to perform a reasonable country of origin inquiry and disclose the results of that inquiry.

The acting Chief's statement can be found ***here***. The Staff of the Commission's Division of Corporation Finance issued a corresponding statement that is available ***here***.

The Conflicts Minerals Rule

Promulgated under Section 1502 of the Dodd-Frank Act, the Rule requires companies that file reports with the SEC to determine whether any Designated Minerals are necessary to the functionality or production of their final products and disclose any such minerals on Form SD. Companies must engage in a country of origin inquiry that is conducted in good faith and reasonably designed to determine whether any of its Designated Minerals were mined by armed groups in the Covered Countries or are from scrap or recycled sources.

If the results of the inquiry give the issuer reason to believe any Designated Minerals in its supply chain may have originated from one of the Covered Countries, the Rule requires further due diligence on the source and chain of custody of such minerals. If, after performing the diligence inquiry, the issuer still has reason to believe its products contain conflict minerals, it must file a Conflict Minerals Report as an exhibit to Form SD.

The Rule as adopted also required companies to disclose whether they were "DRC conflict free" or "not found to be DRC conflict free." Such disclosure requirement has been held unconstitutional as described below.

Litigation and the SEC's Reporting Guidance

After the Rule was adopted, the National Association of Manufacturers ("NAM") and other industry groups successfully sued the Commission claiming that the Rule violates issuers' rights to free speech. Specifically, NAM argued that the Rule's requirement that an issuer disclose whether its products are not DRC conflict free amounts to unconstitutional government-compelled speech.

The United States Court of Appeals for the District of Columbia Circuit agreed, reasoning that the manner of disclosure prescribed by the Rule amounts to requiring "an issuer to tell consumers that its products are ethically tainted, even if they only indirectly finance armed groups." According to the Court's opinion, an issuer could disagree with such an assessment of its moral responsibility, and it may convey that opposing message through silence. Therefore, the Court determined that "[b]y compelling an issuer to confess blood on its hands, the statute interferes with that exercise of the freedom of speech under the First Amendment." Accordingly, it struck down the portion of the Rule that required reporting companies to disclose a finding of "Not Found To Be DRC Conflict Free" on their websites and in their filings. However, the Court left the remaining provisions of the Rule in place, and remanded the case to the District Court. That decision was reaffirmed in 2015, and on April 3, 2017, the District Court for the District of Columbia entered final judgment on the case and remanded to the SEC.

Following the Court of Appeals' original decision in 2014, the SEC issued guidance allowing issuers to exclude the "DRC Conflict Free" labels.

Implications of the SEC's Recent Statements

According to Mr. Piwowar's statements, the purpose of the due diligence required in Item 1.01(c) is to determine whether and how to make the disclosure that the courts found to be unconstitutional. Considering the disclosure is unconstitutional, Mr. Piwowar noted that there is no reason to enforce the associated diligence investigation. Nonetheless, the disclosure is required by the Dodd-Frank Act, thereby necessitating SEC rulemaking to address the manner of providing such disclosure. As a result, the SEC must ultimately promulgate additional rulemaking outlining a disclosure obligation regarding conflict minerals. Bracewell will provide additional information regarding such regulations when they are proposed.