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ADVISORY | Securities

July 24, 2013

D.C. DISTRICT COURT UPHOLDS SEC'S CONFLICT MINERALS RULE

On July 23, 2013, the U.S. District Court for the District of Columbia rejected a challenge brought by the National Association of Manufacturers and other plaintiffs to the SEC's conflict minerals reporting rule.[1] The court's decision represents a victory for the SEC, and it means that public companies must continue their efforts to comply with the rule. The decision is also noteworthy because it contrasts sharply with the recent decision by the same court vacating the SEC's resource extraction payment rule.[2]

BACKGROUND

The SEC adopted the conflict mineral rules under Section 1502 of the Dodd-Frank Wall Street Reform and Consumer Protection Act ("Dodd-Frank Act") in August 2012.[3] The rules require public companies annually to disclose information about their use of specific minerals (generally, tantalum, tin, tungsten, and gold) originating and financing armed groups in the Democratic Republic of the Congo ("DRC") or an adjoining country. The rules affect thousands of public companies because conflict minerals are used to manufacture a wide array of products, such as smartphones, cameras, computers, microchips, automobiles, tools and heavy machinery. The first reports under the rule, which will cover the year ending December 31, 2013, are due by May 31, 2014.

THE COURT'S RULING

Plaintiffs challenged the conflict minerals rule on the basis that the rulemaking was arbitrary and capricious under the Administrative Procedure Act ("APA"). In addition, they contended that both the SEC's rule, as well as Section 1502 of the Dodd-Frank Act, compelled burdensome and stigmatizing speech in violation of the First Amendment. The Court rejected both arguments.

With respect to the APA claims, the Court rejected plaintiffs' contention that the SEC was obliged to consider, as part of its analysis, whether the rule would achieve the social and humanitarian benefits intended by Congress. The Court construed the SEC's statutory obligation to conduct analysis under Sections 3(f) and 23(a)(2) of the Securities Exchange Act of 1934 narrowly, stating that the SEC need only consider the impact of its rule on the specific economic-related factors identified in such sections - i.e., efficiency, competition, and capital formation, and that there is no requirement that

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[1] *National Association of Manufacturers, Chamber of Commerce of the United States of America, and Business Roundtable v. Securities and Exchange Commission*, No. 13-cv-635 (D.D.C. Jul. 23, 2013).

[2] *American Petroleum Institute, et al. v. Securities and Exchange Commission and Oxfam America, Inc.*, No. 12-1668 (D.D.C. Jul. 2, 2013). For additional information on that decision, see Covington Advisory: D.C. District Court Vacates SEC's Resource Extraction Payment Rule.

[3] *See* Conflict Minerals, Rel. No. 34-67716 (Aug. 22, 2012) ("Adopting Release"). The Adopting Release is available on the SEC's website. For additional information regarding the Adopting Release and interpretive questions regarding the conflicts minerals rulemaking, respectively, see Covington Advisory: SEC Adopts Conflict Minerals Rules and Covington Advisory: Conflict Minerals Rules – Frequently Asked Questions.

the SEC conduct "some sort of broader, wide-ranging benefit analysis."[4] Notably, the Court agreed with the SEC that the agency's role was "not to 'second guess' Congress's judgment as to the benefits of disclosure, but to, instead, promulgate a rule that would promote the benefits Congress identified and that would hew closely to that congressional command."

The Court also rejected plaintiffs' other arguments under the APA, determining that the SEC's estimate of the costs of compliance with the rule was adequate, and that several specific aspects of the rule adopted by the SEC were not arbitrary or capricious within the applicable judicial review standards.[5]

With respect to the plaintiffs' First Amendment claims, the Court adopted the "intermediate scrutiny" standard of review articulated by the Supreme Court in the *Central Hudson* case, which the Court concluded applied given the commercial nature of the required disclosures.[6] This standard provides that the required disclosures must "directly and materially advance" a "substantial" government interest. Applying this standard to the disclosures called for by the SEC's rule and Section 1502 of the Dodd-Frank Act, including, specifically, the disclosures required to be posted on each affected company's public website, the Court concluded that the conflict minerals disclosure scheme meets the *Central Hudson* intermediate scrutiny standard by "'directly and materially advanc[ing]' Congress's interest in promoting peace and security in and around the DRC." In reaching this determination, the Court noted that judicial review should be more deferential in areas of national security and foreign policy.

CONCLUSION

Many observers expect the plaintiffs to appeal the Court's decision to the Court of Appeals for the D.C. Circuit, which has vacated several SEC rules in the past several years. But for now, the Court's decision means that public companies subject to the rule must proceed with their compliance activities as planned, as the first conflict minerals reports and Form SD filings are now less than a year away.

If you have any questions concerning the material discussed in this client advisory, please contact the following members of our securities practice group:

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[4] The Court determined that the SEC did conduct an adequate analysis of the enumerated economic-related factors.

[5] The challenged aspects of the rule were (i) the absence of a *de minimis* exception, (ii) the scope of the reasonable country of origin inquiry, (iii) the inclusion of companies that "contract to manufacture" products containing conflict minerals, and (iv) different phase-in periods for smaller reporting companies and other companies.

[6] *Cent. Hudson Gas & Elec. Corp. vs. Pub. Serv. Comm'n*, 447 U.S. 557 (1980).