

Update on Current Status of Conflict Mineral Rules and Compliance Advice

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The SEC's official position last Friday, which we discussed [here](#), reinforced the Staff's earlier [guidance](#), and boiled down to a requirement to comply with the [conflict minerals rules](#) by June 2, 2014, other than any obligation to label products as "DRC conflict undeterminable" or "not found to be DRC conflict free." Yesterday, the rules' challengers asked the D.C. Circuit to stay the rule in its entirety, arguing that the SEC is trying to "enforce a tremendously costly rule that no longer achieves the statute's goals and that will likely be vacated." The challengers asked the court for a ruling by Memorial Day – one week before filings are due. Joe Hall, a partner in our Capital Markets Group, guides us through the recent events and discusses some of the challenges faced by companies with less than a month before the filing deadline.

The appeals court decision on April 14 found that the conflict minerals rules violate law, so why doesn't that overturn the rules?

It turns on a question of appellate procedure. The D.C. Circuit's decision on April 14 was certainly the key moment in the appeal so far, but on the same day the court also withheld its "mandate" – the order formalizing the decision – until seven days after the disposition of any petition for rehearing that the parties might file. That seven-day period is expected to expire no earlier than June 5 – three days after the first conflict minerals filings are due. The court could have ordered a stay of the rule in the meanwhile (the concurring judge suggested that it do just that), but for reasons not entirely explained in the opinion, the majority opted not to do so.

Why did the SEC issue an official limited stay when the Staff had already made the same statements in prior guidance? Was this necessary as a response to the plaintiff's earlier motion for a stay filed with the SEC? Is the SEC's limited stay in any way affected by the fact that two commissioners took an opposing view and believed that the rules should not go forward?

It's hard to know exactly why the SEC moved in the two-step manner it did, and there may be nothing more to it than the gears of internal agency procedure. Once Chair White announced at last Tuesday's hearing before the House Financial Services Committee that the agency was planning to issue guidance, that probably ratcheted up the pressure to get something out quickly to clear up any confusion over the agency's expectations – particularly in light of the statement issued the Monday before by the two commissioners who believe the entire rule should be stayed. But what the agency ended up issuing on the day of Chair White's testimony – a statement from the Director of the Division of Corporation Finance – was, as technical matter, not a binding SEC order. So while the Director's statement was quite helpful in explaining to companies what they would need to do, the SEC still ran the risk that the challengers could seek a court-ordered stay on the powerful grounds that the Director's statement did not legally excuse affected companies from having to file a conflict minerals report containing the "scarlet letter" phrasing that so concerned the appellate court. Friday's official SEC order granting a limited stay – which we can surmise was issued on a 3-to-2 vote – effectively defused that argument, which is probably why yesterday's emergency petition by the challengers is seeking a stay on the basis that the rules are now simply too costly to comply with given that (in the challengers' view) they no longer achieve their purpose. Of course, most companies subject to the rules have already spent the bulk of what they plan to spend for compliance this year.

What are the changes to the requirements that companies need to comply with from the original rules? In a practical sense, does that actually translate into less work for companies?

For most companies required to file a conflict minerals report for 2013, I suspect the bulk of the work – supply-chain diligence – was well underway if not completed by the time the appellate court issued its decision. But companies who hadn't wrapped up field work did not really catch a break. The limited stay only excuses companies from having to list their products as "DRC conflict undeterminable" or "not found to be DRC conflict free" – but for those same products, companies still have to disclose the facilities used to produce the conflict minerals, the country of origin of the minerals and their efforts to determine the mine or location of origin. The SEC's limited stay only affects the wording of the conflict minerals report – albeit in a way that the appellate court found to be constitutionally significant.

What are the consequences of delayed filings? Would that affect, for example, Form S-3 eligibility or WKSI status? Do we expect the SEC to review or comment on the filings?

Many companies are not subject to the rule in the first place because they don't manufacture or contract to manufacture products with necessary conflict minerals. But a company that is subject to the rules would run an enforcement risk if it failed to comply. The SEC staff has, however, confirmed that a late filing will not automatically result in a loss of S-3/F-3 eligibility or WKSI status.

I would certainly expect the staff to review the Form SD filings once they are in. Whether they choose to comment on individual filings, or instead issue general guidance pointing out things that companies should and should not do in future filings, remains to be seen.

In terms of implementation, what are the biggest issues companies are still facing at this point? Are companies dealing with any particular disclosure matters as they prepare the filings?

By now I think companies have worked through the basic question of whether their "products" contain "necessary" conflict minerals – although this consumed lots of time in the first few months after the rules were released. I think companies caught by the rules are largely done with their "reasonable country of origin inquiry" and, if required, their due diligence, but some are continuing to wrestle with how much detail to put in their filings – and for many companies this is as much a public relations and corporate social responsibility question as it is a legal question.

What are the SEC's options at this point on the parts of the rules that the appeals court struck down?

Presumably the SEC could seek a rehearing at the D.C. Circuit, or even appeal the circuit court's decision to the Supreme Court. But I think what's more likely is for the SEC to engage in some corrective rulemaking – that is, draft a revision to the rules that addresses the D.C. Circuit's concerns, put it out for public comment for 30 days or so, and then adopt revised rules in time for the 2014 reporting period.

The plaintiffs are arguing in yesterday's emergency motion that the premise of the rules relies on the prohibited language and without it, the rules become meaningless. What happens if the stay is granted? Can the plaintiffs continue to challenge the rules even if the stay is denied?

If the court grants yesterday's emergency petition before the June 2 filing deadline, then companies won't be required to file their reports this year. But since time is rapidly running out and we may not hear from the court until Memorial Day, it would probably be a bit of a gamble to stop working on your Form SD at this point. If the court doesn't act before June 2, or it denies the emergency petition, then based on what we know currently, the June 2 deadline stands for the 2013 reporting period. For 2014 and beyond, if the SEC adopts revised rules, the challengers could certainly try to block the rules in court again. And who knows? By then the balance of power in Congress may have shifted, and the challengers may be in a position to fight the rules legislatively as well as judicially.

If you have any questions regarding the matters covered in this publication, please reach out to any of the lawyers listed below or your usual Davis Polk contact.

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